

Local Control of the Bureaucracy: Federal Appeals Courts, Ideology, and the Internal Revenue Service

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ABSTRACT

Recent studies show that the IRS is subject to some political control in shifting its policy between competing ideological or partisan concerns. We extend these studies to examine regional court influence over IRS audit policy within the separation of powers (“SOP”) framework. Examining cross-sectional time series data from 1960 until 1988, we found that the IRS shifts the number of audits it conducts of businesses versus individuals in response to the prevailing median ideology of the federal courts of appeals, and in response to the prevailing ideological framework of the President and Congress. As the median federal court of appeals judge in a circuit becomes more liberal, the IRS conducts more audits of businesses located in that region. As the median federal court of appeals judge in a circuit becomes more conservative, the IRS conducts more audits of individuals living in that region. Courts, therefore, provide an additional measure of control over bureaucratic behavior. The different ideologies of the various courts of appeals provide an explanation for regional variation in IRS policy.

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I. REGIONAL COURT INFLUENCE OVER BUREAUCRATIC
POLICYMAKING: COURTS, IDEOLOGICAL PREFERENCES, AND THE
INTERNAL REVENUE SERVICE

Many scholars have empirically demonstrated institutional constraints on bureaucratic behavior.¹ These studies show that this “headless fourth branch of government”² is in fact subject to democratic control.³ Most studies examine national control of bureaucracy, and posit that agency officials carry out the policy choices of the President, Congress, or, to some extent, the Supreme Court.⁴ Recently, several studies extended this national perspective, focusing on regional judicial control of bureaucratic behavior.⁵ Using various measures of partisanship or ideology, these studies indicated that national agency policy changed as the federal district courts’ or federal courts of appeals’ partisanship or ideologies changed.⁶

However, current research leaves key questions unanswered. Although studies show that agencies are subject to political control by the branches of government,⁷ how agencies respond to competing legislative and executive control has yet to be determined. An agency, subordinate to the other branches of government, cannot achieve all of the policy goals of the President. Instead, the agency

1. See, e.g., MORRIS P. FIORINA, *CONGRESS: KEYSTONE OF THE WASHINGTON ESTABLISHMENT* (2d ed. 1989).

2. Robert E. Cushman, *The Problem of Independent Regulatory Commission*, CD. C. GPO (1937).

3. See *infra* notes 4 and 5.

4. See, e.g., B. DAN WOOD & RICHARD WATERMAN, *BUREAUCRATIC DYNAMICS: THE ROLE OF BUREAUCRACY IN A DEMOCRACY* (1994); Randall Calvert et al., *A Theory of Political Control and Agency Discretion*, 33 AM. J. POL. SCI. 588 (1989); Terry M. Moe, *Control and Feedback in Economic Regulation: The Case of the NLRB*, 79 AM. POL. SCI. REV. 1094 (1985) [hereinafter *Control and Feedback*]; Terry M. Moe, *Regulatory Performance and Presidential Administration*, 26 AM. J. POL. SCI. 197 (1982) [hereinafter *Regulatory Performance*]; B. Dan Wood & Richard W. Waterman, *The Dynamics of Political-Bureaucratic Adaptation*, 37 AM. J. POL. SCI. 497 (1993) [hereinafter *Dynamics*].

5. See, e.g., Robert M. Howard, *Litigation, Courts, and Bureaucratic Policy: Equity, Efficiency and the Internal Revenue Service*, 30 AM. POL. RES. 583 (2002); Robert M. Howard & David C. Nixon, *Regional Influence Our Bureaucratic Policymaking: Courts, Ideological Preferences, and the Internal Revenue Service*, 55 POL. RES. Q. 907 (2002); Evan J. Ringquist & Craig F. Emmert, *Judicial Policymaking in Published and Unpublished Decisions: The Case of Environmental Civil Litigation*, 52 POL. RES. Q. 7 (1999).

6. See *supra* note 5.

7. See *supra* notes 1 and 4.

must strategically interact with the other institutions of national government and settle for the best possible policy outcome in our SOP framework. Additionally, one must ascertain how an agency responds to regional, as opposed to national, court control within this framework. Finally, one must determine if existing studies used appropriate ideological measures of the policy preferences of regional courts. This Article attempts to answer these questions by analyzing and testing the influence of variation in the ideology of federal courts of appeals on the audit behavior and policy of the Internal Revenue Service (“IRS”).

The IRS provides a unique opportunity to demonstrate the usefulness of a regional approach to bureaucratic research. Given the importance and pervasiveness of tax laws and tax policy, one would expect the IRS to implement policy based on the competing concerns of the three national branches of government. However, many citizens, scholars, journalists, and officials claim that the IRS does not carry out the policy wishes of the President and ignores congressional and court control.⁸ They point to the significant regional variation in IRS policy, arguing that there is little consistency in audits or audit policy.⁹

An examination of IRS audit data provides some reinforcement for the view that the IRS treats taxpayers inconsistently.¹⁰ The IRS has sixty-three district offices in four national regions, all of which exhibit significant variation in audit rates.¹¹ While some variation is to be expected, popular accounts seem to suggest that the variation is somehow evidence that either the national or regional government

8. See, e.g., DAVID BURNHAM, *A LAW UNTO ITSELF: POWER, POLITICS AND THE IRS* (1989); SUSAN B. LONG, *THE INTERNAL REVENUE SERVICE: MEASURING TAX OFFENSES AND ENFORCEMENT RESPONSE* (1980); Elizabeth MacDonald, *How the IRS Targets You*, MONEY, Aug. 1994, at 132-39.

9. MacDonald, *supra* note 8, at 134-35.

10. See John T. Scholz & B. Dan Wood, *Efficiency, Equity, and Politics: Democratic Control Over the Tax Collector*, 43 AM. J. POL. SCI. 1166, 1176-79 (1999) [hereinafter *Efficiency, Equity, and Politics*].

11. See MacDonald, *supra* note 8, at 134. A citizen of Nevada, which has a statewide audit rate of 1.76%, is seven times more likely to be audited as a citizen of Wisconsin, which has a statewide audit rate of 0.24%. A citizen of the Middle Atlantic region has a 20% greater probability of getting audited than a citizen of the Midwest. *Id.*; Transactional Records Access Clearinghouse, available at <http://trac.syr.edu/data/irs/help/irsdistlist.html>.

lacks political control over the IRS.¹²

We argue that the IRS operates in a manner similar to other agencies and that identifiable political pressures on the agency induce variations in audits rates. One explanation for these variations is the differing ideologies and policy preferences of the various federal courts of appeals. Federal courts often interact with the IRS in a regionally specific manner, mainly at the appellate level.¹³ The appellate court level is an important and appropriate forum to examine federal court influence over IRS policy. This Article investigates the state-level variation in audit rates of businesses versus individual taxpayers from 1960 to 1988.¹⁴ Specifically, we examine whether variation in policy preferences of federal courts of appeals generates variation in audit policies.

II. BUREAUCRATIC CONTROL AND THE INTERNAL REVENUE SERVICE

The bureaucratic literature emphasizes the rational, internal, goal-seeking nature of bureaucracy.¹⁵ Agencies allegedly develop goals independent of elected officials' goals. Broad political goals such as service, fairness, justice, and equity often lose out to the parochial goals that agencies develop. Agencies with enforcement responsibility often have incentive to focus on legally sound, but politically trivial, goals in order to augment their perceived successes.¹⁶

12. See MacDonald, *supra* note 8.

13. I.R.C. § 7482 (2002); See also MARSHALL W. TAYLOR ET AL., *TAX COURT PRACTICE* (1990). In 1997, federal appellate courts handled 248 civil tax appeals from plaintiffs. Annual Report of the Director of the Administrative Office of the U.S. Courts (GPO 1997). In contrast, the Supreme Court handled only 166 federal tax cases between 1946 and 2001. LEE EPSTEIN ET AL., *THE SUPREME COURT COMPENDIUM* 678 (3d ed. 2003).

14. We chose state variation over regional variation because state-level data has been much more stable over this period of time. See John T. Scholz & B. Dan Wood, *Controlling the IRS: Principles, Practices, and Public Administration*, 42 AM. J. POL. SCI. 141, 148 (1998) [hereinafter *Controlling the IRS*].

15. See, e.g., FIORINA, *supra* note 1; WILLIAM T. GORMLEY, JR., *TAMING THE BUREAUCRACY: MUSCLES, PRAYERS, AND OTHER STRATEGIES* (1989); WILLIAM A. NISKANEN, JR., *BUREAUCRACY AND REPRESENTATIVE GOVERNMENT* (1971); AARON WILDAVSKY, *THE NEW POLITICS OF THE BUDGETARY PROCESS* (2d ed. 1992); JAMES Q. WILSON, *BUREAUCRACY: WHAT GOVERNMENT AGENCIES DO AND WHY THEY DO IT* (1989).

16. See, e.g., Robert A. Katzmann, *Federal Trade Commission*, in *THE POLITICS OF REGULATION* (James Q. Wilson, ed., 1980). For example, for police and prosecutors, compiling

Many argue that the IRS follows this pattern and often exceeds other agencies in disdain for broad political and social goals.¹⁷ Martin Shapiro observed that the IRS's goal of maximum tax yield could subvert a broad tax policy aim of equity and fairness.¹⁸ Susan Long¹⁹ and others²⁰ contend that the IRS has goals, such as maximizing revenue, that are independent of justice and fairness. Elizabeth MacDonald asserts that the IRS rewards with larger budgets those regions and districts that collect the most in revenue.²¹ Congressional hearings in the mid-1990s, corroborate many of these assertions; witnesses testified that IRS agents engaged in arbitrary and capricious behavior during both audit and post-audit activity.²²

However, despite assertions of an agency "out of control," recent events and studies show the IRS is politically responsive.²³ Well-publicized congressional hearings on IRS abuse of taxpayers have led to IRS internal audits, firings in district offices, and promises of reform by both the Secretary of the Treasury and the Director of the IRS.²⁴ In response to allegations of IRS abuse, Congress passed the "Taxpayer Bill of Rights."²⁵ Included in the law is a change in the burden of proof for audit disputes so the burden rests with the IRS rather than with the taxpayer.²⁶

arrest and conviction records becomes more important than efficiency, fairness, or the administration of justice, because arrests and convictions lead to greater prestige and larger budgets.

17. See, e.g., BURNHAM, *supra* note 8, at 226-54; HOLMES F. CROUCH, GOING INTO TAX COURT: TRY HARD; BE ALERT, IT'S A STACKED DECK (1993); LONG, *supra* note 8, at 131-48; MARTIN A. SHAPIRO, WHO GUARDS THE GUARDIANS: JUDICIAL CONTROL OF ADMINISTRATIVE ACTS (1988); PAUL N. STRASSELS, ALL YOU NEED TO KNOW ABOUT THE IRS: A TAXPAYERS GUIDE (1979).

18. SHAPIRO, *supra* note 17, at 107-27.

19. LONG, *supra* note 8, at 131-48.

20. See BURNHAM, *supra* note 8, at 226-54.

21. MacDonald, *supra* note 8, at 136.

22. See *Hearings on H.R. 2337 Before the House Comm. on Ways and Means*, 104th Cong. 506 (1996).

23. See *Controlling the IRS*, *supra* note 14; *Efficiency, Equity, and Politics*, *supra* note 10.

24. David E. Rosenbaum, *Internal Audit Confirms Abusive I.R.S. Practices*, N.Y. TIMES, Jan. 14, 1998, at A15.

25. Taxpayer Bill of Rights, Pub. L. No. 104-168, 110 Stat. 1452 (1996).

26. *Id.* See also Paul Wiseman, *House Set to Vote Today on Overhaul of Tax Agency*, USA TODAY, Nov. 5, 1997, at A17; Richard W. Stevenson, *G.O.P. Chief Aims to Shift Burden in IRS Disputes*, N.Y. TIMES, Oct. 19, 1997, at A1.

In a recent study, John Scholz and Dan Wood show that the IRS changes its business to individual audit ratio in response to political change.²⁷ Using a multivariate analysis, the authors used several state and federal political control variables to examine the impact of partisanship change and change in political control on audit ratios.²⁸ The study indicated that changes in presidential administrations and congressional committee membership spurred changes in IRS audits.²⁹ In a later study, Scholz and Wood show that federal and state partisan composition also affects audit rates.³⁰ Additionally, Robert Howard, individually,³¹ and with David Nixon³² observed IRS responsiveness to regional courts, indicating that regional variations in audit policy are partially explained by ideological differences in these courts.³³

These studies support previous empirical examinations of bureaucratic control by the federal executive and legislative branches.³⁴ However, none of these studies examined how agencies carry out regionally specific policy when also subjected to pressure from the executive and legislative branches, or the relative degree to which regional courts affect agency policy. In addition, all studies of lower courts have relied on, at best, imperfect measures of judicial ideology. In the following sections, we address these concerns by offering a model of how agencies may respond to federal regional courts and the federal executive and legislative branches.

27. *Controlling the IRS*, *supra* note 14.

28. *Id.* at 148-54.

29. *Id.* at 155-57. President Reagan's election, for example, led to an increase in individual audits and a decrease in corporate audits. *Id.*

30. *Efficiency, Equity, and Politics*, *supra* note 10. The study indicated that Republicans initially sought efficiency over tax fairness or equity, and Democrats favored equity. *Id.*

31. Howard, *supra* note 5.

32. Howard & Nixon, *supra* note 5.

33. *Id.*

34. See Calvert et al., *supra* note 4; Matthew D. McCubbins & Thomas Schwartz, *Congressional Oversight Overlooked: Police Patrols Versus Fire Alarms*, 28 AM. J. POL. SCI. 165 (1984); *Regulatory Performance*, *supra* note 4; *Control and Feedback*, *supra* note 4; *Dynamics*, *supra* note 4.

III. SEPARATION OF POWERS AND BUREAUCRATIC POLICYMAKING

We premise our argument on an SOP model and examine the actions of regional directors and their ability to adjust the number of audits conducted in each district to most effectively carry out the President's preferred policy.³⁵

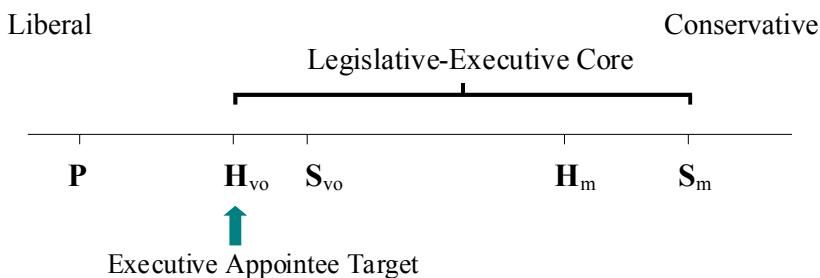
The SOP model formalizes the mechanics of the American legislative process, thus specifying the primary dynamics of bureaucratic control. The SOP model suggests that a "core," or, "uncovered set" of legislative and presidential preferences constrain certain agency policy choices, but that agencies are otherwise relatively free to propose and implement policies as they see fit.³⁶ Thus, in a single liberal-conservative dimension, agencies may propose any policy within a "legislative-executive core," and that policy will not be overturned through statutory means.³⁷ Thus much of the "control" over agencies operates implicitly—agencies choose policies in order to avoid legislative reversals, because an agency policy outside the legislative-executive core will be overturned by the statutory establishment of a policy located within the core.

35. Because regional directors are appointed by the IRS Commissioner and are under the direct supervision of the Deputy Commissioner, both of whom are appointees of the President subject to confirmation by the Senate, one can expect them to try to carry out the policy preferences of the President. See *infra* note 38 and accompanying text.

36. See Thomas H. Hammond & Gary J. Miller, *The Core of the Constitution*, 81 AM. POL. SCI. REV. 1155 (1987); Thomas H. Hammond & Jack H. Knott, *Who Controls the Bureaucracy? Presidential Power, Congressional Dominance, Legal Constraints, and Bureaucratic Autonomy in a Model of Multi-Institutional Policy-Making*, 12 J. LAW ECON. & ORG. 119 (1996).

37. See Hammond & Knott, *supra* note 36, at 128-32. Referring to Figure 1, if the President, P, is relatively extreme, one boundary of the legislative-executive core is defined by the median House member, H_m, or the median senator, S_m, whichever is furthest from the President. *Id.* The other boundary of the core is defined by the crucial veto-override legislator in the House, H_{vo}, or Senate, S_{vo}, whichever is closer to the President. *Id.* For a liberal president, the 67th most liberal senator is the crucial veto override member in the Senate. The same logic applies in the House. *Id.*

Figure One



P – President

H_{vo} – 290th Most Liberal House Member (key veto override representative)

S_{vo} – 67th Most Liberal Senator (key veto override senator)

H_m – Median Representative

S_m – Median Senator

In the case of executive agency appointees, the ability of the President to unilaterally fire and replace the appointee normally means that the appointee must act as a faithful agent of the President and his policies.³⁸ Therefore, if the SOP model is accurate, agencies with executive appointees will establish policies within the boundary of the legislative-executive core closest to the President, and will shift its policies as the legislative-executive core shifts. We term this prediction the executive appointee target policy.³⁹ Based on this logic, each regional director will establish a particular policy at exactly the same point in the legislative-executive core. However, this idea of regional homogeneity fails, as there is significant regional variation in agency policies.⁴⁰

38. See Timothy P. Nokken & Brian R. Sala, *Confirmation Dynamics: A Model of President Appointments to Independent Agencies*, 12 J. THEORETICAL POL. 91, 95-97 (2000).

39. See, e.g., Charles R. Shipan, *Political Influence, Regulatory Regimes, and the FDA*, Paper Presented at the Annual Meeting of the Public Choice Society (1998) (on file with author) (confirming this dynamic for the Food and Drug Administration, based on time series analysis of the agency's monitoring activities).

40. See *supra* note 9 and accompanying text.

There are two plausible dynamics that might drive a regional agency director to vary his or her policy choices from the executive branch's established target policy. First, a regional director may not serve as faithful agent of the President. If his or her policy preference lies within the legislative-executive core and he or she can avoid getting fired, a regional director may choose a policy other than the executive appointee target policy, thus, farther from the President's preferred policy.⁴¹ Second, regional directors may be responsive to specific politicians who do not play a critical role in an SOP model. Appointed regional directors, for example, may be responsive to political pressures from their senatorial patrons, their local congressional representatives, or even state elected officials.⁴²

IV. REGIONAL COURT INFLUENCE AND BUREAUCRATIC POLICYMAKING

Thus far, no formal treatment of SOP dynamics has modeled the impact of regional courts on agency policymaking. Furthermore, no empirical examination of SOP dynamics has recognized the possibility of politically relevant regional variation in agency behavior, despite clear evidence of regional variation within many agencies.

Because the federal courts are regionally organized, they may induce regional variation in agency policy. Courts have been partially incorporated into one SOP model at the national level.⁴³ This Article pursues a variant of that model, which recognizes that interaction with the bureaucracy primarily occurs at the regional level, in the

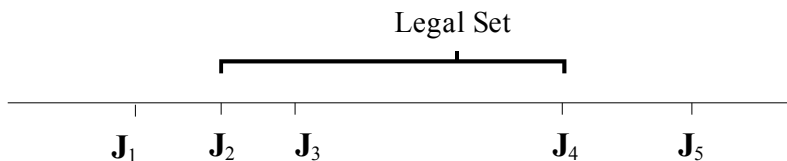
41. Principal-agent theory suggests that delegation of control is always imperfect. Terry M. Moe, *An Assessment of the Positive Theory of 'Congressional Dominance,'* 12 LEGIS. STUD. Q. 475 (1987). However, principal-agent dynamics addressing the President's removal power over executive personnel has not been integrated into current SOP models, and we make no attempt to do so in this Article. Rather we assume IRS regional directors are faithful agents of the President.

42. See, e.g., *Controlling the IRS*, *supra* note 14; *Efficiency, Equity, and Politics*, *supra* note 10; Howard, *supra* note 5. For example, because IRS policies on audits may directly impact a state's economy and its constituents, local politicians may put pressure on regional IRS directors to adopt audit policies favorable to their constituents. However, current SOP models of agency policy have not discussed this kind of responsiveness because all appointees in previous models have occupied national, rather than regional positions.

43. See Hammond & Knott, *supra* note 36, at 124-25.

courts of appeals typically hear cases in randomly assigned three-judge panels.⁴⁶ One may look at this random assignment like a combination problem.⁴⁷ For example, consider Figure Three's illustration of a hypothetical court of appeals with five judges, J_{1-5} , whose ideological preferences are arrayed on a liberal-conservative scale. The median judge on this court is J_3 .

Figure Three



As Table One indicates, there are ten distinct three-member panels possible. In this hypothetical circuit, both J_2 and J_4 are the median judges in three potential panels each. In four potential panels, the median judge is J_3 . Thus, the median judge on the court, J_3 , is more likely than any other judge to be the median judge on any given panel. Because the median judge on the court is most likely to be the median judge on any particular panel, variation in the ideology of the median court of appeals judge should be related to variation in regional agency policy.

46. Excluding the Federal Circuit, the Federal Courts of Appeals employ three-judge panels in over 99% of all administrative hearings. See Peter H. Schuck & E. Donald Elliott, *To the Chevron Station: An Empirical Study of Federal Administrative Law*, 1990 DUKE L.J. 984, 1018-20, Law Issue (1990).

47. For example, k judges serve on a court of appeals and 3 judges serve on a panel. Thus, there are $\left(\frac{k!}{(k-3)3!}\right)$ distinct panels.

Table One

Three-member permutations for a five-member appellate court			
Panel Members	J ₁ , J ₂ , J ₃	J ₁ , J ₃ , J ₄	J ₁ , J ₄ , J ₅
	J ₁ , J ₂ , J ₄	J ₁ , J ₃ , J ₅	J ₂ , J ₄ , J ₅
	J ₁ , J ₂ , J ₅	J ₂ , J ₃ , J ₅	J ₃ , J ₄ , J ₅
		J ₂ , J ₃ , J ₄	
Panel Median	J ₂	J ₃	J ₄

The bounds of acceptable court of appeals policy might be thought of as the interval between J₂ and J₄. In this hypothetical court of appeals, no three-member panel will vote to uphold a policy outside of that range. The IRS could infer that this indicates the permissible range for policy preferences in that court of appeals. However, if each possible panel has an equal probability of assignment (1/10, in this example), then a specific panel may choose to overturn an agency policy, even if the agency establishes the policy within the court's broad range of acceptable policy.⁴⁸ Thus, a rational IRS official should establish policies based on a calculation of the lottery among all possible panels. Specifically, the IRS should randomize its policy choices to meet the preferences of J₂, J₃, and J₄, with probabilities .3, .4, and .3, respectively, because the probabilities of having J₂, J₃, or J₄ as the median judge on a panel are .3, .4, and .3, respectively.⁴⁹

48. For example, if the IRS establishes a policy at J₂, but draws a panel composed of J₃, J₄, and J₅, the IRS policy is vulnerable to a judicial reversal.

49. However, one cannot observe randomizing behavior, one can only observe the specific policy choices the IRS establishes in each circuit.

V. HYPOTHESES, DATA, AND MEASURING IDEOLOGY

Congress micromanages the IRS to a greater extent than many other regulatory agencies.⁵⁰ Nevertheless, the agency possesses considerable discretion in its enforcement actions.⁵¹ No single discretionary action at the IRS generates more numerous or more intense constituent complaints than the audit. The agency uses a number of secret formulas⁵² to select taxpayers for audits, and adjustments to those formulas differentially affect different taxpayer income classes.⁵³ Moreover, the degree to which audits focus on businesses or individuals is politically relevant to competing concerns of equity and efficiency.

A. Hypotheses

Looking for regional court control over the audit ratio within an SOP framework, we derived the following hypotheses:

1. As the median ideology of a federal court of appeals moves in a liberal direction, the IRS director in the court's region will increase the number of business audits.
2. As the ideology of the executive—legislative core moves in a liberal direction, the IRS will increase the number of business audits.

B. Data

Relying on a dataset of IRS audits,⁵⁴ we designed a model suitable for testing the impact of federal courts of appeals's ideologies on IRS audit policy in an SOP framework that allows for regional variation. The dataset we constructed features an annual ratio of the total number of individual tax return audits over the total number of

50. See BURNHAM, *supra* note 8, at 238-40.

51. See LONG, *supra* note 8, at 131-48.

52. The best known is the Discriminate Income Function (DIF).

53. *Id.*

54. See *Efficiency, Equity, and Politics*, *supra* note 10, at 1175-79.

business tax return audits in each state from 1960 to 1988 (n=1350).⁵⁵ This ratio increased when the IRS shifted audit attention away from business taxpayers, toward individual taxpayers.⁵⁶ Following the approach used by Scholz and Wood,⁵⁷ and Howard and Nixon,⁵⁸ we examine state variation for this study.

We use two control variables to account for alternative, but potentially correlated explanations: (1) State per capita income; and (2) Local government ideology. The first is a measure of state wealth; one should expect greater individual audits in wealthier states and in states with lower employment rates.⁵⁹ The second is a measure of the proportion of Democratic representatives in the state legislature and Democratic control of the Governor's office,⁶⁰ and has been used in previous studies of IRS audit policy.⁶¹

Our key independent variables are measures of political ideology for courts, Congress, and the President. All of our ideology indicators are based on a version of NOMINATE scores, which indicate preferences along the traditional liberal-conservative dimension of American politics, and have been employed extensively in political science literature as measures of policy preferences. We focused on first-dimension "common space" W-NOMINATE scores derived by Keith Poole,⁶² because they are unusually useful in that the scores are comparable across institutions and time.⁶³ Our analysis goes further

55. Data on the IRS, including audit rates, are available by state, district office, and region. Data was not available for 1970 and 1971, thus we were not able to include data from those years in our analyses.

56. There was a slight change in the business and individual audit categories after 1980. However, the business and individual ratios should not be affected by this change.

57. See *Controlling the IRS*, *supra* note 14; *Efficiency, Equity, and Politics*, *supra* note 10.

58. Howard & Nixon, *supra* note 5.

59. See *Efficiency, Equity, and Politics*, *supra* note 10, at 1175; Howard & Nixon, *supra* note 5, at 913.

60. See William D. Berry et al., *Measuring Citizen and Government Ideology in the American States, 1960-93*, 42 AM. J. POL. SCI. 327, 332-34 (1998).

61. *Id.*

62. Keith T. Poole, *Recovering a Basic Space from a Set of Issue Scales*, 42 AM. J. POL. SCI. 954 (1998). These scores indicate economic conservatism of all presidents and members of Congress since 1938, ranging continuously from -1.0 (most liberal) to +1.0 (most conservative). The scores are static in that an individual is assumed to maintain the same ideology for the duration of his or her career. Keith T. Poole, *Changing Minds? Not in Congress!*, Gsia Working Paper #1997-22 (1998).

63. For example, it is legitimate to claim that a Representative serving in 1942 with a

by extending Poole's first dimension "common space" W-NOMINATE scores to the judges of the federal courts of appeals.

To allow a test for the influence of Congress and the President, we employed Poole's NOMINATE scores to construct a "core" variable. This variable indicates the ideal point in the common-space W-NOMINATE scale of the pivotal veto override member in the Congress.⁶⁴ To allow a test for the influence of the federal courts of appeals, we constructed indicators for the central tendency and scope of preferences in each federal court of appeals each year. We hypothesize that regional IRS directors respond to pressures from the federal court of appeals judicial authorities in their region, as well as to pressures from Congress and the President.

C. Measuring Judicial Ideology

Unlike the Supreme Court,⁶⁵ there is no generally accepted measure of lower court ideology that is strictly comparable across institutions and time.⁶⁶ Scholars often employ a judge's partisan affiliation as a surrogate for judicial attitudes.⁶⁷ However, focusing on partisanship of judges restricts possible ideology indicators to one of two values, which fails to account for the subtlety and diversity of attitudes on the bench. Some scholars occasionally ignore a judge's personal ideology by inferring his or her ideology from the

score of .20 is more conservative than a Senator serving in 1969 with a score of .19, and that a President serving in 1972 with a score of .43 is substantially more conservative than either the Representative or Senator.

64. See KEITH KREHBIEL, *PIVOTAL POLITICS* (1998).

65. Segal and Cover derived ideological scores for Justices through a content analysis of four newspapers—the *New York Times*, the *Chicago Tribune*, the *Washington Post* and the *Los Angeles Times*—at the time of the appointment of each new Justice. Jeffrey A. Segal & Albert D. Cover, *Ideological Values and the Votes of U.S. Supreme Court Justices*, 83 AM. POL. SCI. REV. 557, 560 (1989). The scores range from -1.0 to +1.0 as the ideology is calculated from the most conservative to the most liberal. *Id.* The coding starts with the appointment of Earl Warren and ranges from a -1.0 for Justice Scalia to a +1.0 for Justices Brennan and Marshall. *Id.* A complete listing can be found in the SUPREME COURT COMPENDIUM. EPSTEIN ET AL., *supra* note 13.

66. See, e.g., Tim Groseclose et al., *Comparing Interest Group Scores across Time and Chambers: Adjusted ADA Scores for the U.S. Congress*, 93 AM. POL. SCI. REV. 33 (1999).

67. The party of each judge that has served in one of the modern circuits is available in the Appellate Biographical Database. See Gary Zuk et al., *Appellate Biographical Database*, National Science Foundation SBR 93-11999 (1997).

appointing President, which also fails to capture the diversity of judicial attitudes.⁶⁸ A number of scholars suggest determining judicial ideology by combining existing measures of ideology.⁶⁹ However, these measures often lack significant variation, and it is impossible to compare these ideologies to the ideologies of legislators and presidents.

We use a predictive approach to data collected by Nixon,⁷⁰ and propose a measure of the personal ideology of each federal court of appeals judge that is strictly comparable to Poole's common-space W-NOMINATE scores.⁷¹ We extended Nixon's data by assembling data on all 63 federal judicial appointees who also served in

68. For example, Tate and Handberg proposed an ordinal measure of the ideology of the appointing president: -1 for ideologically conservative presidents, 0 for nonideological presidents, and 1 for ideologically liberal presidents. See C. Neal Tate & Roger Handberg, *Time Binding and Theory Building in Personal Attribute Models of Supreme Court Voting Behavior, 1916-88*, 35 AM. J. POL. SCI. 460, 466 (1991). This measure may be attributed to every judge on the circuits, but the data range is not much better with only three possible values of ideology. Segal, Timpone and Howard improved on the Tate and Handberg ranking of presidential ideology by surveying presidential scholars and establishing an interval scale for each president since Franklin Roosevelt. Jeffrey A. Segal et al., *Buyer Beware? Presidential Influence Through Supreme Court Appointments*, 53 POL. RES. Q. 557, 561 (2000). Segal, Timpone and Howard's economic liberalism scores for judges ranged from 17.6 (appointees of Reagan, the most conservative president) to 82.5 (appointees of Franklin Roosevelt, the most liberal president). *Id.* at 562. Using this approach, the data range for judges' ideology is at least theoretically better. However, no rankings are available for presidents or their appointees prior to Franklin Roosevelt, and all judges appointed by the same president receive the same score. *Id.* at 560-62. Giles et al., modified this approach by ascribing to each judge Poole's NOMINATE indicators for the judge's appointing president or sponsoring senator. Michael Giles et al., *Picking Federal Judges: A Note on Policy and Partisan Selection Agendas*, 54 POL. RES. Q. 623, 631 (2001). However, the approach does not distinguish between different judges appointed by the same president.

69. For example, Songer has constructed a more differentiated measure of judicial ideology based on a logit analysis of judicial voting in economic cases, with a North/South dummy and the Tate/Handberg measure of the appointing president's ideology as predictors. The scores range from 0 (conservative) to 1 (liberal) and can be computed for every appellate judge ever serving on the modern circuit bench. *Id.* at 212. Humphries and Songer also computed social liberalism scores. *Id.* In practice, judges are assigned only one of six possible scores, and it is impossible to make direct comparisons with congressional and executive ideology.

70. David C. Nixon, *Separation of Powers Constraints on Appointee Ideology*, J.L. ECON. & ORG (forthcoming). Nixon assembled a data on 95 executive appointees who also served in Congress. *Id.* He demonstrated that SOP considerations at the time of these executive appointees predicated their first-dimension common-space W-NOMINATE scores. *Id.*

71. See Poole, *supra* note 62.

Congress.⁷² The predictive model presented in Table Two, is the basis for our measure of judicial ideology. It is based on factors one can identify for any federal judge. The predicted scores from this model tend to range from -.5 (liberal) to +.5 (conservative), and are quite finely differentiated, based on the political circumstances surrounding the judge's appointment.

Table Two

OLS Model of Judicial Ideology. Dependent Variable: Poole's common space W-nominate scores. Sample: 63 federal judges who have served in one of the 75th -105th Congresses

<i>Independent Variables</i>	<i>coefficients</i>
Constant	-.0306
Judge's own Party (-1 democrat, 0 independent, +1 republican)	.2371
Appointing President's Party (-1 democrat, +1 republican)	.0448
Unified Government at time of Appointment (0 - no, 1 - yes)*	.0249
Wartime Appointment (0 - no, 1 - yes)	.0694
Southern Democrat (0 - no, 1 - yes)	.1285
Northeastern Republican (0 - no, 1 - yes)	-.0151
State Ideology ⁷³	.3999
R ²	.750

* In positive values for Republican presidents, negative values for Democratic presidents

72. Additional judges have served in Congress, but Poole's ideology measures are available only for presidents and members of Congress elected after 1938.

73. State ideology is based on unweighted scores computed by Wright et al. See Gerald C. Wright et al., *Measuring State Partisanship and Ideology with Survey Data*, 47 J. POL. 469 (1985).

Our measure of a judge's ideology, scaled in first-dimension "common-space" W-NOMINATE metric, is based on the linear equation implied by Table Two.⁷⁴ Once additional variables are included, the two primary determinants of judicial ideology (SOP constraints and senatorial courtesy) make no significant contribution to the model ($F_{2,54}=2.8$, n.s.). This occurs because the independent variables serve as surrogates for SOP constraints and senatorial courtesies.⁷⁵ These static scores provide substantial differentiation between judges. Because these scores are scaled in the same issue space and on the same metric as the first dimension of Poole's common-space W-NOMINATE scores, it is possible to make relative comparisons across time and institutional settings.⁷⁶

Admittedly, there is a potential problem with using these ideological economic liberalism scores. To date, the literature has not shown that ideological voting and voting in favor of or against the IRS, is concordant.⁷⁷ However, by using Songer's United States Court of Appeals Database⁷⁸ it is possible to examine the voting record of the individual courts of appeals judges who voted on civil cases involving the IRS during the period of our study. Although the IRS audits a greater number of individual taxpayers than businesses,⁷⁹ given the expense of both filing lawsuits and appealing to one of the federal courts of appeals, business organizations bring a far greater percentage of appeals challenging the IRS than do individuals. Thus, we expect the mean level of support for the IRS to be higher the more liberal the judge and lower the more conservative

74. Judge's ideology = $-.0306 + (.2371 * \text{judge's own party}) + (.0448 * \text{party of judge's appointing president}) + (.0249 * \text{unified government at time of judge's appointment}) + (.0649 * \text{war at time of judge's appointment}) + (.1285 * \text{judge is a southern democrat}) - (.0151 * \text{judge is a northeastern republican}) + (.3999 * \text{ideology of judge's home state})$.

75. The partisanship of the judge and the partisanship of the President are surrogates for SOP constraints. The state ideology, and whether a judge was supported by a southern democrat or a northeastern republican are surrogates for senatorial courtesy.

76. For example, a researcher could legitimately claim that if judge A, appointed in 1962, has an ideology of .3, and President B elected in 1972, has an ideology of .31, the judge is slightly less conservative than the President.

77. The very liberal Justice William O. Douglas is a well-known counter example. Douglas was an opponent of the IRS, usually voting against the government in tax cases.

78. Donald D. Songer, *The United States Courts of Appeals Database*, National Science Foundation SES #8912678.

79. In this dataset the ratio of individual to business audits was close to six to one.

the judge.

There is a relationship between this study's judicial ideology measure and judicial votes in favor of and against the IRS. Using the coding from the Songer database, we derived mean levels of support for the IRS for each court of appeals judge. We then compared these levels of support for the IRS to the Nixon measure of judicial ideology.⁸⁰ We calculated the Pearson correlation between Nixon's ideology score and the mean support for the IRS for each of the 219 judges for whom we could identify both of these factors. The correlation is .22 and significantly different from zero at the .001 level, which indicates a positive association between higher economic liberalism and support for the IRS. Conversely, the lower the economic liberalism score of a judge, the more likely it is that that judge will support a business over the IRS.

VI. AN SOP MODEL OF REGIONAL VARIATION IN AUDIT POLICY

We determined the judicial ideology score for each judge on each federal court of appeals and then identified the median ideology for each federal court of appeals each year. If national policymaking conditions are adequate to explain IRS policy choices, then variation among states will be unrelated to policy preference of the federal courts of appeals. On the other hand, if national policymaking conditions do not adequately explain IRS policy choices, it is plausible to suggest that the IRS deviates from their executive appointee target policy by adopting policies closer to the median federal courts of appeals judicial ideology, to avoid being overturned.

A. Methodology

The data used for this study is cross-sectional time-series data, or panel data. The structure of this data makes the use of Ordinary Least Squares (OLS) problematic since one cannot assume that all the errors will be uncomplicated or "spherical."⁸¹ There is the potential

80. See *supra* note 70.

81. See, e.g., Nathaniel Beck & Jonathan N. Katz, *What To Do (and Not To Do) with Time-Series Cross-Section Data*, 89 AM. POL. SCI. REV. 634-36 (1995); WILLIAM H. GREEN, *ECONOMETRIC ANALYSIS* (1997).

for auto/serial correlation and heteroscedasticity.

Because states are different sizes, using a ratio for the dependent variable reduces the risk of heteroscedasticity.⁸² Because audit rates have declined over time, the use of a ratio also reduces the risk of other methodological problems associated with longitudinal studies, such as non-stationarity. Inclusion of a lagged dependent variable controls for autocorrelation of the residuals.⁸³ Finally, we use cross-sectional time series data with corrections for standard errors.⁸⁴ The results are reported as regression coefficients.

Table Three

Descriptive Statistics		
<i>Variable</i>	<i>Mean</i>	<i>Standard Deviation</i>
Audit Ratio	5.92	3.32
Median Nixon Ideology Score	-.021	.099
Core Boundary	-.04	.23
Per Capita Income	13769	4023
Local Government	48.77	23.66

82. We searched for heteroscedasticity by graphing the estimated squared residuals, u_i^2 , against the estimated Y_i , and against several of the explanatory variables. We also performed White's general heteroscedasticity test on the reduced form and final equations. See GREENE, *supra* note 81, at 550. The chi squared values obtained were all below the critical chi square value at the .05 level of significance.

83. We also tested for autocorrelation. Because the Durbin-Watson test is not a valid test in the presence of a lagged dependent variable, we used a modification of the Bruesch-Godfrey test suggested by Greene. See GREENE, *supra* note 81, at 596. This test indicated no significant evidence of autocorrelation.

84. See Beck & Katz, *supra* note 81.

We tested our hypotheses using our panel design based on a regression equation,⁸⁵ taking into account all the predictors. The results, presented in Table Four, support our hypotheses. Given the scale of these measures, the directions of the coefficients are also as hypothesized. As a federal court of appeals becomes more liberal, the audit rate of individuals decreases. As the legislative-executive core boundary shifts in a more liberal direction, the audit rate of individuals will also decrease. The results also indicate that federal courts of appeals ideology is a greater determinant of the regional variation in IRS audits rates than is the legislative-executive core. When controlling for the court's ideology, the coefficient for the legislative-executive core is 1.63. Substantively, this means that a standard deviation shift of the legislative-executive core in a more liberal direction translates into a positive shift of .37 for the ratio of business to individual audits, which is a smaller effect than that of the federal courts of appeals.

As expected, the data indicates that IRS altered the audit ratio in response to the policy preferences of the median federal courts of appeals judge.⁸⁶ Because the predictors are measured in the identical metric, describing the effect of judicial ideology on IRS audits is strictly comparable to the coefficient describing the effect of the legislative-executive core. If the core shifts by .25 in a conservative direction, the ratio of individual to business audits shifts upward by .4. If the median federal court of appeals judge shifts in a conservative direction by .25, the ratio of individual to business audits shifts upward by 1.98.⁸⁷

85. $Y_t(\text{Audit Ratio}) = \alpha + \beta_1(\text{Court Median Ideology}) + \beta_2(\text{Core Boundary}) + \beta_3(\text{Local Government}) + \beta_4(\text{Per Capita Income}) + \beta_5(Y_{t-1})(\text{Lag Audit Ratio}) + \epsilon$.

86. As the median ideology moved in a liberal direction, a greater percentage of wealthy taxpayers were audited. As the median ideology moved in a conservative direction, the IRS audited more low-income tax returns.

87. This impact is almost five times larger than the affect of Congress and the President. In actuality, such a dramatic ideology shift on the appellate bench is uncommon, except over long periods of time.

The per capita income coefficient failed to achieve statistical significance. The local government ideology measure showed some influence, although the effect of a 2.0 standard deviation shift was extremely small (.004).

Table Four

Regional vs. National Influence: IRS Audit Ratio	
<i>Independent Variable</i>	<i>Coefficient (Standard Error)</i>
Court Ideology	7.90*** (2.39)
Core Boundary	1.63** (.64)
Local Government	.01* (.005)
Per Capita Income	.00004 (.00003)
Audit Ratio Lag	.15*** (.04)
Constant	5.39*** (.58)
R ²	.18
Chi ²	111.82***

N= 1350

* = p<.05 (two tailed)

** = p<.01 (two tailed)

*** = p<.001 (two tailed)

VII. DISCUSSION AND CONCLUSION

This study had two purposes. One was to examine the assertion of many scholars, journalists, and citizens that the IRS has wide discretion and lacks political control; this study sought to determine if the IRS operates within an SOP framework at lower levels of agency hierarchy. The other purpose was to analyze the interplay between federal courts of appeals ideology measures and IRS audit ratios.

To answer these questions, this study examined regional variation in audits between individuals and businesses. The very existence of regional variation in IRS audit behavior is considered evidence of the lack of political control over the agency. Additionally, because IRS decisions are technically complex there is an information asymmetry between IRS bureaucrats and the political powers seeking to oversee IRS decisions.

While others have shown that partisan political change has an impact on IRS audit behavior,⁸⁸ this Article expanded the scope of the inquiry to consider how oversight exercised by the federal courts of appeals operates within a national SOP framework. The results suggest that ideological changes in the national executive and legislative branches, together with ideological changes in regional federal courts of appeals can influence IRS audit behavior. These results indicate that regional variation in IRS policy may not be a consequence of an agency out of control or of an agency exploiting information asymmetries, but is the result of different regional political and judicial ideologies that regional IRS policy makers confront.

Clearly there is still significant unexplained variation. Undoubtedly the IRS, like all agencies, has its own set of “pathologies.” It appears, however, that the IRS responds to national, as well as regional, control, indicating, perhaps, that fears of unfettered bureaucracies undermining democratic governance are unfounded.

Through our measure of the ideology of federal courts of appeals judges, this study was able to discern the difference in influence

88. See, e.g., *Controlling the IRS*, *supra* note 14; *Efficiency, Equity, and Politics*, *supra* note 10; Howard & Nixon, *supra* note 5.

between federal courts of appeals and national political control. Our analysis demonstrates that ideological shifts in federal courts of appeals have an almost five times greater impact on IRS audit behavior than do shifts in national executive ideology. While these shifts in court ideology take place over a much longer period of time than national executive shifts, the analysis shows that the regional autonomy and variance that resulted from IRS scandals of the 1950s⁸⁹ did result in local IRS officials paying greater attention to local conditions than they did to national conditions.

89. See *Controlling the IRS*, *supra* note 14, at n.2.