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SOME SUGGESTED TOPICS IN THE FIELD OF TAX ADMINISTRATION

STANLEY S. SURREY†

In recent years the approach to federal income tax administration has largely been in terms of generalities and platitudes. All difficulties are usually said to be traceable to a lack of adequate personnel in the Bureau of Internal Revenue and to a soak-the-taxpayer policy characterized by a devotion to dollars rather than to principles of tax law. The sure cure is claimed to lie in the development of an independent, intelligent, fearless personnel willing to make the right decision regardless of revenue loss and regardless of possible criticism from officers standing higher in the Bureau hierarchy. We are also reminded that somewhere there exists the simplified, stable, unchanging revenue act which will solve all our troubles, though any experienced tax technician would sadly admit that this objective cannot be attained. Of late there has developed a tendency to mitigate somewhat the blame fastened upon the Bureau through recognition of the fact that at times the taxpayer may be at fault. As a consequence the nurturing of a willing attitude among taxpayers has been proclaimed as a wise policy of tax administration. No one can deny that it is the part of tax wisdom to strive constantly to improve the quality and attitude of Bureau personnel and to impress upon taxpayers the extent and seriousness of their obligation of self-assessment. But it takes more than men of good will to administer successfully a revenue system which produces seven million income tax returns annually. Even a highly efficient, smoothly working tax machine would be subjected to a severe strain by this constant volume of tax returns. There are many who think that the present machine is so far from adequate that it will break down unless long-overdue re-

† B.S., College of the City of New York, 1929; LL.B., Columbia University, 1932. Assistant Legislative Counsel, United States Treasury Department. Although the author is employed by the United States Treasury Department, the views set forth herein are entirely his own and in no way indicate the views of the Treasury Department.

pairs are made. The growing discrepancy between the volume of returns and the machinery for their administration cannot be met by thinking only in terms of a highly-skilled personnel, and other long-range, nearly evolutionary changes. The realities of the situation demand more immediate pragmatic action in an endeavor to make the current administration of income, estate, and gift taxes serve more effectively both the taxpayers and the Government. In this article an attempt will be made to sketch some of the fields in which the students of tax administration may play.

I. PROBLEMS OF ADMINISTRATIVE PROCEDURE— NEW DECENTRALIZATION PROGRAM

In the December, 1938 issue of the *Columbia Law Review*,¹ Professor Traynor of the University of California School of Jurisprudence critically surveyed the then existing administrative procedure and found results which he believed were indicative of serious defects. He noted that at the close of the fiscal year 1937-1938 there were 8,553 cases involving \$513,985,520 pending before the Board of Tax Appeals, and the courts that review its decisions.² He then pointed out that 70 per cent of the dockets of the Board of Tax Appeals were settled by agreement of the parties without action by the Board.³ The majority of the cases so settled had taken from four to five years for their termination.⁴ The remaining 30 per cent of the dockets were on the average decided by the Board six years after the tax year involved.⁵ It was apparent that the dockets in which a Board decision was essential to a solution were hopelessly caught in a jam of cases which did not require judicial action but which had been permitted to cross over into the judicial stage through the failure of the prior administrative machinery to function prop-

1. Traynor, *Administrative and Judicial Procedure for Federal Income, Estate, and Gift Taxes—A Criticism and a Proposal* (1938) 38 *Col. L. Rev.* 1393. See also Surrey, *The Traynor Plan—What It Is* (1939) 17 *Taxes* 393.

2. Traynor, *supra* note 1, at 1393. At the close of the fiscal year 1938-1939 there were 7,864 cases pending, involving \$456,974,846.

3. In the fiscal year 1937-1938, out of 5,799 dockets closed in the Board of Tax Appeals, 4,273 or 73.6 per cent were closed by agreement. Traynor, *supra* note 1, at 1394, and n. 3. In the fiscal year 1938-1939, out of 5,885 dockets closed, 4,158 or 70.6 per cent were closed by agreement.

4. Traynor, *supra* note 1, at 1394.

5. Traynor, *supra* note 1, at 1393. The figure in the text was based upon a survey of cases closed in 1934. A survey of the cases closed in 1939 would probably disclose that the six year period had been reduced to five.

erly. A Board which at best can dispose of a little over a thousand cases a year through decision, and which at the close of the fiscal year 1937-1938 had 7,414 dockets pending before it,⁶ was being subjected to an annual flood of 5,000 petitions,⁷ so that its ability to function at all depended on the settlement policy of the Bureau of Internal Revenue. Another evidence of a basic weakness was the number of petitions relating to small amounts of tax, less than \$5,000 being involved in 57.4 per cent of the petitions and less than \$2,000 in 25.9 per cent.⁸ Still another significant fact was that the Commissioner was forced to abandon about 70 per cent in amount of the deficiencies asserted in his ninety-day letters—the Technical Staff conceded 64.4 per cent in amount, the Appeals Division of the Chief Counsel's office conceded 68.6 per cent and there was a reduction in amount by Board decision of 74.2 per cent. Stated differently, in the Board of Tax Appeals dockets closed either by settlement or decision of the Board and the reviewing courts, the net amount recovered by the Government was 32.6 per cent of the amount in controversy.⁹

Here then was evidence of excessive deficiencies, inability of the administrative machinery to handle a large number of the cases until they had become judicial proceedings, and consequent delay in the termination of both these cases and the proceedings which were the proper objects of Board consideration. These conditions were regarded as the result of three interacting causes—the elaborate machinery for the administrative review of controversies, the inability of the Commissioner to obtain the necessary factual information, and, partly in consequence thereof, the

6. Traynor, *supra* note 1, at 1396. At the close of the fiscal year 1938-1939, there were 6,574 dockets pending.

7. In the fiscal year 1937-1938, there were 4,912 petitions filed and 5,799 dockets closed, of which 1,108 or 19.1 per cent were closed by decision of the Board. Traynor, *supra* note 1, at 1396. In the fiscal year 1938-1939, there were 4,854 petitions filed and 5,885 dockets closed of which 1,311 or 22.2 per cent were closed by decision.

8. Traynor, *supra* note 1, at 1398, n. 12. The figures in the text are for the end of the fiscal year 1937-1938. As respects the fiscal year 1938-1939, 56.1 per cent of the petitions involved less than \$5,000 and 38.4 per cent less than \$2,000.

9. Traynor, *supra* note 1, at 1399, n. 13. The figures in the text are annual averages for the fiscal years 1935-1936, 1936-1937, and 1937-1938. In the fiscal year 1938-1939, the Technical Staff conceded 59.5 per cent in amount, the Appeals Division conceded 75.1 per cent, and there was a reduction by Board decisions of 87.8 per cent. The net amount recovered was 33.6 per cent of the amount in controversy.

Commissioner's resort to vague and indefinite deficiency letters. Professor Traynor suggested that these difficulties be met by adoption of the following procedure: The importance of the preliminary conferences between the taxpayer and the Bureau representatives would be emphasized and every effort made to encourage an amicable settlement of a tax controversy in that stage. If a settlement were not arrived at, the taxpayer would be given an opportunity to file a protest, but in default of such filing the claimed deficiency would be immediately assessed. The protest would contain a complete factual statement of the taxpayer's case together with a list of relevant documents and of those persons having knowledge of the facts stated in the protest. A conference, conducted by the most capable tax technicians in the Bureau, would then be held on the protest. If this conference likewise failed to terminate the controversy, the Commissioner would issue a ninety-day letter or notice of deficiency, which would be accompanied by specific findings of fact. If the taxpayer then chose to take his case to the Board, he would be limited to the grounds, documents, and facts outlined in his protest. The Commissioner would correspondingly be limited to the issues and facts contained in his findings of fact and could not present a claim for an additional deficiency. In exceptional and justifiable cases the Board might relax these restrictions to permit the introduction of new facts or a different method of approach to the issues involved. The deficiency procedure and the refund procedure would be coordinated so as to eliminate the existing differences and to make it largely immaterial over which procedural route the case travelled. Finally, to reduce the loss in revenue resulting from the uncollectibility of about 11 per cent of the deficiencies determined by the Board, a bond or other security would have to be posted by the taxpayer before filing his petition unless such requirement was waived by the Board.

No attempt has been made to state Professor Traynor's proposals in full, for we are not here concerned with an intensive analysis of them. He offered these suggestions, not as definitive solutions, but in order to stimulate critical discussion of the serious problems presented by the existing procedure. Nearly all of the discussion which followed, however, was levelled at Professor Traynor's proposals and evaded the problems with which he was concerned, although their existence was generally con-

ceded.¹⁰ Many of the criticisms appear to result from misconceptions of his recommendations. Thus, it was pointed out that the great bulk of the income tax controversies are settled administratively prior to petition to the Board. Of these controversies, 198,531 cases or 98.2 per cent are settled before petition to the Board, the remaining 1.8 per cent representing settlements after petition to the Board.¹¹ It was contended that the rigid requirements of the formal protest would prevent settlement of these cases. But this criticism completely overlooks Professor Traynor's statement that the protest procedure would in practice apply not to the 98.2 per cent of the cases now settled prior to the petition to the Board, but only to about 5,000 cases—the 1.8 per cent disposed of administratively after petition to the Board (3,688 cases) plus the cases terminated by Board decision on the merits (about 1,175 cases).¹² It is the administrative procedure applicable to this latter group of cases, which today go to the Board and the courts, that is of vital importance and with which Professor Traynor was primarily concerned. The attempt to dismiss the problem by stating that less than 1/10th of 1 per cent of the controversies end up in the Board of Tax Appeals is a failure to observe that it is precisely this small fraction of cases which has placed \$513,985,520 in litigation and whose delayed solution for a six-year average period is the major problem.¹³

10. The articles discussing Professor Traynor's proposals are: Youngquist, *Proposed Radical Changes in the Federal Tax Machinery* (1939) 25 A. B. A. J. 291; Seidman, *Proposed Procedural Changes in Federal Tax Practice* (1939) 67 J. of Accountancy 221; Prettyman, *Comment on the Traynor Plan for Revision of Federal Tax Procedure* (1939) 27 Geo. L. J. 1038; Angell, *Procedural Reform in the Judicial Review of Controversies under the Internal Revenue Statutes: An Answer to a Proposal* (1939) 34 Ill. L. Rev. 151; also discussion on these proposals at the Eighth Tax Clinic of the A. B. A. Committee on Federal Taxation, reported in (1939) 17 Taxes 390, at 429 et. seq.

11. Traynor, *supra* note 1, at 1394. The figures in the text are the annual averages for the fiscal years 1935-1936, 1936-1937, and 1937-1938.

12. Traynor, *supra* note 1, at 1394, 1936, and 1414, n. 41. The figures in the text are the annual averages for the fiscal years 1935-1936, 1936-1937, and 1937-1938. At the most, the protest would only be used in those cases in which deficiency letters are now issued. There were 10,241 deficiency letters issued under the income tax in the fiscal year 1937-38, and 13,238 in 1938-1939.

13. Traynor, *supra* note 1, at 1393. The figure in the text is the total amount involved in the cases, 8,553 in number, pending before the Board and the courts that review its decisions at the end of the fiscal year 1937-1938. At the end of the fiscal year 1938-1939 the amount was \$456,974,846 for 7,864 cases.

Again, criticism was directed at the proposal that findings of fact be issued by the Commissioner on the ground that if the proposal were adopted the taxpayer would be placed entirely at the mercy of the Commissioner. This criticism ignored the fact that these findings were proposed as a limitation upon the Commissioner, with the objective of providing the taxpayer with a definitive statement of the case asserted against him. Moreover, it was nowhere suggested by Professor Traynor that the findings of fact be final if supported by evidence. While the burden of proof to upset the findings would rest upon the taxpayer, the findings would be tested by the weight of evidence and not, as is the case generally with respect to the findings of administrative tribunals, by whether there was evidence to support them. Other critics made much of the argument that the taxpayer would be forced to hire a lawyer or an expert accountant and would no longer be able to tilt unassisted against the Bureau. In actual practice, however, the taxpayer has been his own lawyer or accountant in only 4.2 per cent of the cases closed by the Technical Staff, 6.7 per cent of the cases settled by the Appeals Division, and 5.6 per cent of the cases decided by the Board,¹⁴—the cases which would be principally affected by the protest requirement.

It is difficult to understand the criticism of the suggestion that the taxpayer be bound in the Board by the record he made before the Commissioner, since that criticism is not extended to the present procedure which binds the taxpayer in the circuit court of appeals to the record made in the Board. Even as regards the requirement of a bond or other security, concededly a debatable point, the criticism neglected the fact that such a requirement would hardly affect more than 15 per cent of the taxpayers now filing petitions to the Board.¹⁵ Moreover, the Board by waiving the requirement could easily take care of the 40 to 70 odd million dollar deficiency asserted in the *Tex-Penn* case,¹⁶ the most frequently cited example, although hardly a typical case.

14. Traynor, *supra* note 1, at 1417, n. 45.

15. Traynor, *supra* note 1, at 1434-5.

16. *Commissioner of Internal Revenue v. Tex-Penn Oil Co.* (1937) 300 U. S. 481. The deficiency asserted by the Commissioner varied greatly at different times, once reaching some 70-odd millions of dollars. The Board of Tax Appeals found a deficiency of over \$9 million dollars, which the circuit court of appeals and the Supreme Court reduced to zero. *Tex-Penn Oil Co. v. Commissioner of Internal Revenue* (C. C. A. 3, 1936) 83 F. (2d) 518.

Nevertheless, the suggestions of Professor Traynor are provocative of many questions. As he himself observes, the protest requirement might in some cases produce troublesome difficulties. The limitations on Board review would require a highly intelligent handling of the cases to insure their successful operation. For these reasons, it is timely to consider a recent but fundamental development in the administration of income, estate, and gift taxes which has within it the potentialities of a successful solution to many of the present problems. This is the decentralization of the Technical Staff and the Appeals Division commenced in 1938 and concluded in 1939. As the new procedure resulting from this decentralization is highly important, a description of it seems desirable.¹⁷

The Internal Revenue Agents in Charge will continue as before to be responsible for the cases in their preliminary stages. If investigation discloses that a deficiency should be asserted, the Internal Revenue Agent in Charge will send the taxpayer a preliminary thirty-day letter advising him of the proposed adjustment in tax liability and of the opportunity to file a protest within thirty days from the date of the letter.^{17a} The taxpayer will also be advised of his opportunity to obtain a hearing, if he so desires, in the Office of the Internal Revenue Agent in Charge. If a protest is filed and a conference held which produces an agreement, or if the taxpayer agrees to the adjustment without filing any protest, the Internal Revenue Agent in Charge has authority to conclude the case. While the agreement is subject to review in Washington, in only a small number of cases is the disposition of the case altered. If an agreement is not reached, the taxpayer is notified of the deficiency that is proposed and of his opportunity to obtain a hearing before the appropriate field division of the Technical Staff. If the taxpayer does not avail himself of such opportunity, or did not in the first instance file a protest after receiving the preliminary thirty-day letter, the Internal Revenue Agent in Charge is authorized to send the tax-

17. See generally, Commissioner's Mimeograph, Coll. No. 4792, revised January 4, 1939; Commissioner's Mimeograph, Coll. No. 4960, September 14, 1939; Commissioner's Mimeograph, R. A. No. 899, revised January 26, 1939; Annual Report of the Commissioner of Internal Revenue (1939) 39-44.

17a. The protest referred to in the text need not contain the detailed statement of the taxpayer's case that would be required under Professor Traynor's plan.

payer a final ninety-day statutory notice of deficiency in the name of the Commissioner. A period of 120 days from the date of the preliminary thirty-day letter is on the average allowed for the consideration of the proceeding in the office of the Internal Revenue Agent in Charge. There may, of course, be a number of conferences and protests in this stage of the proceeding.

If the taxpayer, after consideration of his protest by the Internal Revenue Agent in Charge, desires a hearing before the Technical Staff, he will be afforded one in the appropriate field office of the Staff. There are ten field divisions of the Staff, each of which has a defined territorial jurisdiction. There are several local offices in each division. The personnel of each Staff Division consists of a Head and an Assistant Head, designated by the Commissioner, a Division Counsel and an Assistant Division Counsel, designated by the Chief Counsel, and a number of technical advisors, attorneys, auditors and clerks. As indicated above, each Staff Division will consider cases referred to it, at the request of the taxpayer, by the Internal Revenue Agents in Charge situated within the territorial jurisdiction of the Division. The Staff Division will not consider, before the issuance of the statutory notice of deficiency, any case in which no protest has been filed with the Internal Revenue Agent in Charge, or in which the taxpayer does not desire Staff consideration. The Internal Revenue Agent in Charge may be represented at such a hearing if he desires. If the taxpayer and the Technical Staff agree on the disposition of the case, the Head of the Division can conclude the case without the settlement being subject to change in Washington. If an agreement is not reached, a memorandum will be prepared in the Staff Division setting forth the exact grounds upon which the proposed deficiency is asserted, and, after its consideration by the Division Counsel, will be transmitted to the Internal Revenue Agent in Charge. He will then issue in the name of the Commissioner a statutory notice of deficiency based upon such memorandum. The taxpayer after receipt of such ninety-day letter may obtain a hearing before the Staff Division in the ninety-day period only in very unusual circumstances, such as a shift in legal interpretation or a change in the Regulations.

After the filing of a petition to the Board of Tax Appeals by

a taxpayer, the Staff Division will generally afford the taxpayer a hearing on his case in an effort to settle it administratively if the taxpayer requests such hearing. This hearing, however, will for the most part be conducted by the same persons who considered the case prior to the issuance of the ninety-day letter; while new conferees may be added, the former conferees will also attend the conference. The Division Counsel will handle before the Board of Tax Appeals (1) all cases which originate within the Division and which are placed either on a calendar for hearing within the territorial jurisdiction of the Division, on the Washington calendar, or on the calendar for an adjoining Division, and (2) all cases which, although originating in other Divisions (except an adjoining Division), are placed on a calendar for hearing within the territorial jurisdiction of the Division. Any such case may be settled without hearing by the Board if the Head of the Staff Division and the Division Counsel concur, but if either thinks such settlement inadvisable the case must proceed to a hearing before the Board. The Commissioner may by written order withdraw from a Staff Division any case not docketed before the Board and provide for its disposition under his personal direction, and he together with the Chief Counsel may withdraw a case docketed before the Board, but a copy of such order and the reasons therefor must be furnished to the Secretary. Aside from this exception, however, a taxpayer will not be able to have his case considered in Washington. Substantially the same procedure will be followed in refund cases as is described above for the cases involving deficiencies, except that refunds of over \$20,000 agreed to by a Staff Division are subject to review in Washington.

Successful administration of this decentralized consideration of the controverted cases should have several significant consequences:

1. *Prompt and effective disposition of cases by the Internal Revenue Agents in Charge.*

The Internal Revenue Agents in Charge should be able both to dispose of the cases in their offices much more promptly and to conclude a greater number of settlements. The taxpayer who receives a thirty-day letter and the opportunity to file a protest will realize that unless he files a protest the second ring of the

postman means a deficiency letter. No longer can he delay until the case has been forwarded to Washington and he is given a new invitation to a conference. If he files the protest and reaches an agreement with the Internal Revenue Agent in Charge, the latter may close the case then and there. While his decision is subject to review and change in Washington, it is upset in only a few cases. Moreover, the Internal Revenue Agent in Charge will be prompted to conclude a settlement rather than to attempt to maintain an extreme position in view of the taxpayer's right of immediate appeal to the Technical Staff. For these reasons it is to be expected that many more settlements will be concluded while the cases are in this preliminary stage. The preliminary figures with respect to the first months of operation of the decentralization program confirm this expectation.

2. Improved deficiency letters.

The quality of deficiency letters should be considerably improved. In the office of each Internal Revenue Agent in Charge, one or two specially skilled persons will prepare all of the deficiency letters in cases which do not have Technical Staff consideration. In those cases which have been appealed by the taxpayer to the Technical Staff, the deficiency letters will in effect be prepared by the Technical Staff as respects the issues appealed to it by the taxpayer and will be checked by the attorneys who would later be called upon to defend the letters before the Board. This is a distinct departure from the previous practice, for these technicians and attorneys in the past did not see the deficiency letters until after they had turned into Board petitions. The taxpayer's prayer for a deficiency letter which clearly states the reason for the deficiency¹⁸ seems about to be answered. In addition, the percentage in amount of deficiencies sustained either by Board decision or settlement after petition to the Board should rise appreciably.

3. Fewer petitions to the Board.

Under the prior practice a case would obtain Technical Staff consideration only after it had been converted into a Board petition. Under the new procedure, however, a hearing by this skilled group is available to the taxpayer prior to the issuance

18. Paul, A Plea For Better Tax Pleading (1933) 18 *Corn. L. Q.* 507.

of the deficiency letter. As consideration of his case will be made by the same officials regardless of whether it occurs before or after the filing of a petition, there will be no longer any advantage in this regard in postponing such consideration until the later time. Moreover, the Appeals Division attorneys who must defend the cases before the Board will be able to assert their legal views in the administrative stage and will not be forced to concede the case at the last minute as they have been at times compelled to do in the past. While there will always be many cases settled subsequent to the filing of a petition, it is to be expected that a significant number of the 70 per cent of the Board dockets now settled without Board hearing will be terminated in the administrative stage. The preliminary figures point in this direction, for in the last six months of 1939 there were 1,593 petitions filed with the Board, as compared with 2,049 in the corresponding period in 1938. The reduction in petitions should break up the present congestion in the Board and permit the cases requiring judicial consideration to flow more smoothly.

It must be noted, however, that in many instances the blame for the delayed disposition of a case lies at the taxpayer's door. A significant number of Board petitions are still being filed by taxpayers who did not file a protest with the Internal Revenue Agent in Charge, or, after a hearing by that official on their protest, did not refer their cases to the Technical Staff. Some of these cases involve only legal issues requiring judicial decision for their determination, so that administrative consideration is ineffective. But in many instances the taxpayer with a poor case files his petition in order to secure further time in the hope that this deliberate delay may somehow yield a windfall. In other cases a taxpayer who has obtained too favorable a consideration by the Internal Revenue Agent in Charge on some of the issues will not appeal the other issues to the Technical Staff, for the Staff in reexamining the first issues may determine them against him and he will thus bear the burden of proof in the Board, whereas if these issues are reexamined after the filing of a petition and an additional deficiency is consequently asserted, the burden of proof will then rest upon the Commissioner. Further, a proper disposition of the case can not be made in the administrative stage unless the taxpayer discloses all of the relevant facts and documents. Thus, to an important degree the

cure rests with the taxpayer as the administrative machinery is available to him if he desires to utilize it.

As stated above, if either the Head of a Staff Division or the Division Counsel believes settlement of a Board proceeding is inadvisable, the case will be tried on the merits before the Board. This aspect of the procedure has been criticized on the ground that the attorney should be in supreme command of a docketed case. This criticism is sought to be supported by reference to the attorney-client relationship in private practice and to the assertion that under such relationship the attorney must either control the litigation or abandon his client. But whether or not the assertion is a correct description of the situation in private practice, it must be remembered that the Commissioner of Internal Revenue and the Chief Counsel for the Bureau of Internal Revenue stand in an unusually rigid relationship of attorney and client. Each is a statutory Governmental officer, the office of such is bound to the other by statutory ties, and neither officer may abandon the other. Moreover, the criticism overlooks the fact that the personnel in the field offices are representatives of these officials and not the officials themselves. It is but natural to expect that there will be disagreements in some of the Board cases, and consequently an operating rule is necessary to dispose of such disagreements if the procedure is to function smoothly. The rule adopted is that in the event of disagreement the case must be tried on the merits before the Board. This solution adequately protects the Government's interests under a decentralized procedure and can hardly be objected to by the taxpayer for he is merely required to submit his case to a judicial tribunal.

4. Better preparation for Board hearings.

In the past, the major portion of the work upon a Board case was often done in the week or two preceding the day it was scheduled to be heard. In many instances the Appeals Division attorney who was to try the case first saw it at that time. Such a procedure obviously made for insufficient preparation. But the Appeals Division attorney now stationed in the field office is in a position adequately to prepare his case prior to trial. Additional time, better spreading of the load, availability of witnesses, and similar factors are responsible for this change. The taxpayer will also benefit as increased knowledge on the part of

the Appeals Division attorney means more stipulations of fact and shorter hearings. Many a case was dragged through a protracted hearing in the past because the Appeals Division attorney was not sufficiently familiar with the case to consider a stipulation of fact. Under the new procedure, however, there is already a pronounced trend toward the increased use of stipulations of fact. The Board of Tax Appeals will also benefit from this development as it will be required to devote far less time to consideration of factual issues. In addition, the increased time available to the Appeals Division attorney for study of a case will produce sounder settlements in cases which are concluded without a Board hearing.

5. Increase in taxpayer convenience.

It should not take much argument to convince the taxpayer who resides in St. Louis that it is far simpler to appear with his attorney and his books and records before a Technical Staff man in St. Louis than to proceed to Washington to discuss his case. The decentralized procedure of the Bureau makes readily accessible to the taxpayer a single, unified agency empowered to exercise for the Commissioner all of the authority which the Department or any of its branches possesses in the review of protested tax determinations made by the Internal Revenue Agents in Charge, in the settlement of contested cases, and in the defense of proceedings before the Board. The savings in time and expense, the increased opportunity for the taxpayer to accompany his attorney if he desires, the speedier consideration of cases, the incentive to rely upon documents and personal testimony rather than correspondence—all are clear gains to the taxpayer.

Mention may be made of several aspects of the decentralization program which unless analyzed carefully may cause concern. It has been contended that the substitution of ten field divisions and thirty-eight offices of the Technical Staff for the unit previously centralized in Washington will make for a lack of uniformity in the consideration of cases. A moment's reflection will destroy the plausibility of this contention. To begin with, consideration of the great majority of the cases has been decentralized for years in the various offices of the Internal Revenue Agents in Charge. The fact that the remaining cases

were considered in Washington provided a surface appearance of complete uniformity. But of necessity the Income Tax Unit review in Washington was divided among at least five separate audit review divisions, and the Technical Staff review was scattered among at least twelve groups, each headed by a Senior Technical Adviser. What has occurred through decentralization is the substitution of 38 buildings in 38 cities for one building in Washington. The same large number of men who are necessary to effective disposition of the cases is still an integral part of the procedure. If anything, an increased effort will be made to obtain the maximum of uniformity through the improvement of standards and yardsticks of general application. Every case concluded in the Staff Divisions will be subjected to a "post review" in Washington which, quite properly, will not disturb the disposition of the cases reviewed but will insure that any divergence from the accepted Bureau standards will not be repeated. The Washington staff will likewise be on the alert to issue rulings in situations in which a possible lack of uniformity may be foreseen in the absence of direction from Washington. In addition, the various Staff Divisions may, and do, refer questions to Washington where it is apparent that a lack of uniformity may result from localized consideration.

Concern may arise as to the disposition of cases whose ramifications spread to several field divisions. Thus, a distribution by a corporation may involve stockholders residing in many States. Or a controversy may concern a trustee in one part of the country and a beneficiary in another. A consolidated return may involve corporations in several scattered States, or the return of a single corporation may relate to properties and businesses in various parts of the country. Yet the problems of coordination which these situations present likewise existed under the former procedure for initially these cases must be considered in the various offices of the Internal Revenue Agents in Charge. Procedures have been devised over the years to deal with these cases, and these procedures are still in effect. If the proper coordination has not been achieved by the time the case is considered by a Staff Division, that Division may competently deal with the case through the aid of supplementary conferences held under the auspices of the other Divisions.

The benefits of this decentralized procedure are so clear that

it is natural to wonder that its appearance has been so long delayed. Apart from the inertia of Government and taxpayers, such a step had to await the slow growth of a centralized unit sufficiently skilled and equipped to permit of its decentralization. But it must be remembered, however, that the present decentralization is but the culmination of a trend that has existed almost from the start. In the first years of the income tax nearly the entire administrative machinery was centralized in Washington. This machinery proved inadequate to handle the large volume of disputed cases resulting from the war years. Consequently, in the early nineteen twenties the first step in the direction of the decentralized consideration of tax controversies occurred when the Internal Revenue Agents in Charge were authorized to conduct conferences and settle disputed cases. The next step was taken by the former Committee on Appeals and Review when it adopted the practice of hearing cases outside of Washington. During the same period the Board of Tax Appeals was slowly developing its circuit calendars. To keep pace with this development, the Appeals Division was required to send its attorneys to the various cities in which Board hearings were being held. The volume of settlement work in connection with the circuit calendars became so large that members of the Technical Staff soon joined the Appeals Division attorneys on their field trips. As a result, since 1933 decentralization existed in the form of circuit riding by the Appeals Division attorneys and the Technical Staff members. But this circuit riding provided many administrative problems and was not very efficient. The present decentralized procedure, which is clear-cut and absolute, remedies these defects. The criticisms levelled against the present system as an untested innovation in tax procedure are thus clearly unwarranted when the system is viewed in its historical perspective.

The development of the decentralized procedure now instituted can still be marked in terms of months rather than years. While the basic foundations of the decentralized procedure seem unquestionably sound, problems are bound to arise in its day-by-day application. The interests of sound tax administration require that the Bureau, the taxpayers, and all others concerned strive to insure the proper solution of these problems so that the promises of the decentralized procedure will be fulfilled.

Professor Traynor recognized that his proposals depended upon decentralized consideration of tax controversies and stated that the proposals were but a logical extension of a program of decentralization. Consequently, when more information becomes available as to the actual effects of the decentralized procedure, we will be in a position to determine the desirability of adopting Professor Traynor's proposals. While informative statistics on the operation of the new procedure must necessarily await its functioning over a period of time, such statistics should be carefully considered when they are issued. The tell-tale factors to be watched are: the number of settlements in the Offices of the Internal Revenue Agents in Charge; the number of deficiency letters issued and petitions filed with the Board in cases having had Technical Staff consideration, as compared with cases in which a hearing was had only in the office of the Internal Revenue Agent in Charge, and as compared with cases in which even such latter hearing was not desired; the number of petitions settled administratively without Board hearing; the reduction by amount in the various steps of the procedure in deficiencies asserted; and the various time schedules.

II. JUDICIAL PROCEDURE—THE PROBLEMS OF APPELLATE REVIEW

While many of the basic problems of administrative procedure may be solved by the decentralization of the Technical Staff and the Appeals Division, the difficulties caused by the complicated, almost weird, pattern of judicial consideration of tax cases have yet to be dealt with by either the Government or taxpayers. Professor Traynor's article has already described these difficulties at length. The judicial stage in tax cases is marked by an excessive amount of litigation¹⁹ caused by two principal factors—

19. In the fiscal year 1938-1939, tax cases constituted 14.3 per cent (97 out of 676) of the cases in which the United States was a party and in which *certiorari* was denied by Supreme Court, 22.2 per cent (28 out of 126) of the cases decided in which the United States was a party (excluding obligatory jurisdiction), and 13.5 per cent (125 out of 922) of all cases acted upon in which the United States was a party. In the fiscal year 1937-1938, the percentages respectively were 13.9 per cent (100 out of 718), 25.4 per cent (42 out of 165) and 14.1 per cent (142 out of 1004). In the last term of the Court, 13 per cent of the Court's written opinions were devoted to Federal taxation; for the last three terms, the percentages were 25, 18 and 30, respectively. In the fiscal year 1938-1939, 12 per cent or 391 of the 3206 cases decided by the circuit courts of appeals were tax

the lack of uniformity resulting from the large number of tribunals having original and appellate jurisdiction in tax cases and the "conflict motif" engendered by the system of appellate review of Board of Tax Appeals cases.

With respect to original jurisdiction in tax cases, the most important tribunal is the Board of Tax Appeals, which is a specially-created agency composed of members possessing skilled knowledge of tax law and deciding about 1,100 cases a year.²⁰ But in addition there are 86 other tribunals which are relatively unskilled in this field and which decide about 190 cases a year.²¹ eleven tribunals, the circuit courts of appeals and the Court of Claims which together possess jurisdiction over refund cases and suits against collectors, the Board being limited to deficiency cases.²² While the vast majority of income, estate, and gift tax cases, about 80 to 85 per cent in decided cases, proceed through the Board of Tax Appeals, the availability of these other tribunals makes for confusion and lack of uniformity in judicial action. Even considering the district courts and the Court of Claims as a unit, we find an indefensible procedural tangle caused by the retention of the suit against the collector—"an anomalous relic of bygone modes of thought."²³

The existing system of appellate review of Board cases is perhaps more responsible for the present excessive amount of tax litigation than any other single factor. This system is marked by a unique procedure under which the decisions of the

cases; in the fiscal year 1937-1938, 12 per cent or 380 of the 3094 cases were tax cases. About 82 per cent of the tax cases in the Supreme Court, and 87 per cent in the circuit courts of appeals, involve the income tax; 2 per cent in the Supreme Court and 8 per cent in circuit courts of appeals involve the estate tax; and the remaining cases involve other taxes. Figures for earlier fiscal years are given in Traynor, *supra* note 1, at 1429. For the cases in the district courts and the Court of Claims, see note 21, *infra*.

20. In the fiscal year 1938-1939, the Board closed 1311 dockets by decision; in the fiscal year 1937-1938, it closed 1108 dockets.

21. In the fiscal year 1936-1937, the district courts decided 185 income and estate tax cases and the Court of Claims 60 cases. The annual averages for the fiscal years 1934-1935, 1935-1936, and 1936-1937 were 201 cases for the district courts and 52 for the Court of Claims. In the fiscal year 1938-1939 about 137 income and estate tax cases were decided by the district courts. In the same year, there were about 58 such cases decided by the Court of Claims, and about 27 in the fiscal year 1937-1938.

22. While the assertion of a deficiency is a prerequisite to Board jurisdiction, a taxpayer may claim an overpayment in a case pending before the Board.

23. *George Moore Ice Cream Co. v. Rose* (1933) 289 U. S. 373, 382.

Board, numbering about 1,100 a year, are subject to review by eleven tribunals, the circuit courts of appeals and the Court of Appeals for the District of Columbia. The Board is thus compelled to function under the guidance, expressed in decisions, dicta, and reasoning, of eleven masters. It is obvious that certainty and finality can under this system come only with decision by the Supreme Court. That Court, however, will rarely review a circuit court of appeals decision in the absence of a conflict, so that the usual result is certiorari denied.²⁴ But as the denial of certiorari means not that the decision is right but that it does not merit review at that time whether right or not, excessive litigation to produce a conflict and thus force review by the Supreme Court is the inevitable result. Professor Traynor cites instances where certiorari has been denied to a circuit court of appeals decision but years later, after a conflict has developed, certiorari has been granted and a decision rendered which is contrary to that reached in the earlier circuit court of appeals case in which certiorari was denied.²⁵ With such litigation comes a disparity in tax law from circuit to circuit. Often a decade may pass before uniformity is restored through a decision of the Supreme Court. For example, in 1930 the Board of Tax Appeals decided that a loss realized by a taxpayer on a sale of property to a corporation wholly-owned by him was not a deductible loss.²⁶ In 1934 this decision was reversed by the Court of Appeals for the District of Columbia.²⁷ The Supreme Court denied certiorari.²⁸ Thereafter the ninth, eighth and second circuit courts of appeals rendered similar decisions.²⁹ The Board

24. In the fiscal year 1938-1939, petitions for *certiorari* were filed in about 123 tax cases and the petition was denied in 97 cases; in the fiscal year 1937-1938, there were about 146 petitions filed and 100 denials. About 80 per cent of the cases involve the income and estate taxes.

25. Traynor, *supra* note 1, at 1409.

26. B. B. Jones (1930) 18 B. T. A. 1225.

27. Jones v. Helvering (App. D. C. 1934) 71 F. (2d) 214.

28. Helvering v. Jones (1934) 293 U. S. 583.

29. Commissioner of Internal Revenue v. Eldridge (C. C. A. 9, 1935) 79 F. (2d) 629; Commissioner of Internal Revenue v. McCreery (C. C. A. 9, 1936) 83 F. (2d) 817; Foster v. Commissioner of Internal Revenue (C. C. A. 2, 1938) 96 F. (2d) 130; Smith v. Higgins (C. C. A. 2, 1939) 102 F. (2d) 456; Helvering v. Johnson (C. C. A. 8, 1939) 104 F. (2d) 140. Perhaps the seventh circuit court of appeals should be added to the list. Commissioner of Internal Revenue v. Edward Securities Co. (C. C. A. 7, 1936) 83 F. (2d) 1007, *aff'g per curiam* Edward Securities Corp. (1934) 30 B. T. A. 918.

bowed before these authorities and likewise allowed such losses.³⁰ But the Commissioner persisted in his view that the losses were not deductible. In 1939 his persistence bore fruit when the circuit court of appeals for the seventh circuit decided a case on a theory contrary to the other decisions.³¹ The Supreme Court consequently granted certiorari to review the question, and in 1940 rewarded the Commissioner's tenacity with a decision denying the deductibility of such losses.³² But between the consideration of the issue by the Board and its final determination by the Supreme Court was a decade of uncertainty and litigation.³³

The judicial procedure which Professor Traynor suggested as a substitute for the present system is as follows: Original jurisdiction in all income, estate, and gift tax cases would be confined to one tribunal, the Board of Tax Appeals, which would be given jurisdiction over refunds as well as deficiencies. To expedite consideration of the cases and to compensate for the elimination of the localized district courts, the Board would be decentralized into five boards, each composed of three members and having exclusive jurisdiction in a defined geographical area. Appeals from these five boards would be taken as a matter of right to a single Court of Tax Appeals, whose decisions in turn would be subject to review on certiorari by the Supreme Court. Denial of certiorari to a decision of this court would mean that a final answer had been obtained to the issue involved, for there would be no opportunity to compel later Supreme Court review as at present exists through the device of producing a conflict. It is suggested that a new Court of Tax Appeals be created, or that the jurisdiction of the Court of Appeals for the District of Columbia or the Court of Claims be enlarged for this purpose. Statistics are presented to prove the feasibility of this and the other suggestions.

30. E. g., *Corrado & Galiardi* (1931) 22 B. T. A. 847; *A. S. Eldridge* (1934) 30 B. T. A. 1322, *aff'd* in *Commissioner of Internal Revenue v. Eldridge* (C. C. A. 9, 1935) 79 F. (2d) 629; *Ralph Hochstetter* (1936) 34 B. T. A. 791.

31. *Commissioner of Internal Revenue v. Griffiths* (C. C. A. 7, 1939) 103 F. (2d) 110, *rev'g* *George W. Griffiths* (1938) 37 B. T. A. 314.

32. *Higgins v. Smith* (1940) 60 S. Ct. 355; *cf.* *Griffiths v. Helvering* (1939) 60 S. Ct. 277, *aff'g* *Commissioner of Internal Revenue v. Griffiths* (C. C. A. 7, 1939) 103 F. (2d) 110.

33. Nor is the uncertainty ended in view of the four-to-four affirmance in *Helvering v. Johnson* (1940) 60 S. Ct. 293, of the decision in *Helvering v. Johnson* (C. C. A. 8, 1939) 104 F. (2d) 140, allowing the loss where the taxpayer's wife owned 49 per cent of the stock in the vendee corporation.

These suggestions likewise precipitated a flurry of criticisms,³⁴ for the most part coupled with admissions, sometimes express, sometimes tacit, that the existing picture had been fairly portrayed. Few of the criticisms appear convincing. With respect to the shift of district court jurisdiction to the Board,³⁵ there is little substance in the contention that the opportunity to appear before a district court in a tax case is essential to the maintenance of "confidence and cooperation between the citizen and his government." Integrity and fairness can exist even though a person be called "Member" rather than "Judge." If need be, the guarantees thought to be inherent in life tenure may be supplied. Likewise, it does not seem to follow that abolition of the suit against the collector with the consequent elimination of the jury trial in tax cases would result in the destruction of a barrier which "has become a traditional local right" and which, "whether used or not, is a real factor in preserving confidence in the judicial remedy." As a matter of fact, there were only four jury trials in the fiscal year 1938-1939 and five in the fiscal year 1937-1938, so that it is difficult to believe that our ancient liberties would be swept aside if the jury trial were eliminated.

The suggested decentralization of the Board has given rise to the criticism that the present uniformity of Board decisions will be replaced by conflicts among the new Boards, as dissenting opinions will become coordinate decisions. But we find that the same critics look upon the present conflict of decisions among the circuit courts of appeals as healthy. In any event, conflicts among the Boards would not be readily engendered in view of the right of appeal to the proposed Court of Tax Appeals. Moreover, the suggested decentralization of the Board is really a question of detail. The important point is that the Board should hold hearings in the various localities with such regularity that petitions filed with it may move to hearing without delay. Prompt consideration by the Board of the petitions filed with it would insure orderly and effective consideration of cases in the

34. See articles cited in note 10, *supra*.

35. It has often been recommended that the Board should be given jurisdiction over refund claims concurrently with the district courts. While this proposal in itself would be unobjectionable, it is merely a half-way measure that would serve to make existing facilities more convenient to taxpayers but would not remove the basic difficulties.

administrative stage, for both taxpayer and the Government would know that the filing of a petition means a trial in a few months rather than a year or more of delay. It has been suggested that the Board establish regular calendars in the various important cities, the frequency of the hearings being determined by the number of proceedings in each locality. But as over 95 per cent of the cases are now heard outside of Washington, whether the expeditious consideration of cases be achieved under the present method of decentralized hearing and centralized decision or under the proposed method of decentralized Boards is not of much moment.

The proposal for a single Court of Tax Appeals to exercise the appellate review now possessed by the circuit courts of appeals was the target for the greatest barrage of criticisms. A typical contention was that the goal in tax litigation is a "truly right answer" and that conflict among the circuit courts of appeals aids in achieving this objective. Whatever may be true of the existence of "truly right" decisions in other fields of the law, with respect to many, if not most of our tax cases, the rightness or wrongness of the decision is not the only concern. Certainty and uniformity are equally compelling criteria of the judicial review of tax cases, and neither can be achieved if conflicts are encouraged and finality long delayed. Many a tax question is no nearer a "right" decision after four or five circuit courts of appeals have battled over it than when the first court pronounced its judgment. All that has happened is that each of the several reasonable but contradictory positions has been given the stamp of judicial approval. Meanwhile a confused Bureau and bewildered taxpayers, who would be quite content to adjust themselves to the first decision if it were left unchallenged, are forced to struggle along as best they can until the Supreme Court selects one of the available alternatives and it becomes the "right" answer, at least until Congress acts. Coupled with the argument of the "right" answer is the plea for "greater assistance from the Supreme Court in the development of the system of taxation" and the consequent criticism of any system of review which would deprive tax cases of that Court's "broad vision." Only a handful of tax cases, however, involve far-reaching consequences, and these would in any event be considered by the Supreme Court under the proposed system. And one may

well believe that an already burdened Supreme Court would be quite content to exercise its broad vision in cases more provocative than the humdrum, technical tax matters with which it is now forced to deal by reason of conflicts among the circuit courts of appeals.³⁶ Another criticism grounds itself, not upon the desirability of conflicts, but upon the theory that the Board and the Commissioner should follow a decision of a circuit court of appeals as it is "high authority," so that conflicts may be thereby eliminated. Many tax decisions, however, cut two ways, so that while a decision may in one situation give the advantage to the taxpayer, in another situation the advantage will go to the Commissioner. With taxpayers in all the other circuits free to litigate the question, the Commissioner's acquiescence will not end the controversy on the issue. Likewise, a realistic Commissioner sworn to protect the revenues cannot drop an issue after defeat in one circuit when experience tells him that he has a real chance to secure a different result in another circuit and ultimately to win in the Supreme Court.

The principal criticism of a single Court of Tax Appeals runs along the following lines: Tax law is not an isolated distinct branch of the law but is influenced by, and in fact dependent upon, the general substantive law. The large majority of tax cases, perhaps 80 per cent of the important cases, turn on some principle of substantive law. Specialized tribunals are therefore not sufficiently equipped to deal with tax cases, and the broad experience of the circuit courts of appeals in the field of substantive law is necessary to prevent the segregation of tax law and its decline to "a maze of artificial and highly technical rules." Tax practice would be confined to "so-called tax experts" and "a specialized tax bar," so that the taxpayer would be deprived of the services of attorneys who are "trained and experienced in the fundamental principles of jurisprudence" and who possess "broad vision and wide experience in the general practice of the law." The dire results predicted to follow the creation of a single Court of Tax Appeals should make us squirm a bit when we think of the specialized Board of Tax Appeals and our tax bar. The validity of the criticism depends on the answers to three questions: What percentage of tax cases does turn on principles

36. Cf. Lowndes, *Taxation and the Supreme Court*, 1937 Term, Part II (1938) 87 U. of Pa. L. Rev. 165, 200.

of non-tax law? How adequately could a tax tribunal deal with such cases? Are the advantages of a single Court of Tax Appeals to be preferred over the disadvantages which may perhaps exist as a consequence of the answers to the first two questions? The first question is relatively unexplored. Professor Traynor's survey indicates that only about 10 per cent of the cases turn on "local" substantive law.³⁷ The number of tax cases which are dependent upon general substantive law may be higher but presumably not very much so. The second question also has not been fully answered, although Professor Traynor indicates that, in most of the above 10 per cent of the cases, the substantive law could readily be determined by a single reference to the case or statutory law of the jurisdiction involved. A study of the tax decisions of recent years along the lines indicated by these two questions would be most helpful, for none of those who have resorted to this argument has buttressed it with factual or statistical data. Until these questions are answered, there can be no answer to the vital third question, that of balancing the various considerations involved in a single Court of Tax Appeals. One may hazard a guess, based, as seem to be the assertions of those who have raised objections on this score, upon mere working acquaintance with tax decisions, that the answer to the first question would be "A comparatively small number of cases," to the second question, "Quite adequately," and to the third, "The balance lies with the single Court of Tax Appeals."

Some critics have raised a constitutional barrier to the creation of a single Court of Tax Appeals, asserting that the taxpayer is entitled as of right to be heard in a constitutional court and, therefore, as the proposed court would be legislative in nature, the suggested procedure lacks due process of law. One may never speak with confidence in a field in which even the Supreme Court speaks with authority only. The *ad hoc* decisions respecting legislative and constitutional courts, however, seem to indicate that more authority rests with the propositions that the single Court of Tax Appeals could be constituted as a constitutional court if an intermediate court of that nature were required,³⁸ that the opportunity for review by the Supreme Court

37. Traynor, *supra* note 1, at 1431-2.

38. *Ex Parte Bakelite Corp.* (1929) 279 U. S. 438, holding the Court

would seem adequate to provide the consideration by a constitutional court if such consideration at some stage were requisite,³⁹ and that due process of law is not denied if the taxpayer is limited to review by a legislative court created under the revenue powers of Congress.⁴⁰

A geographical objection is also raised against the proposal by reason of the inconvenience that would be caused taxpayers through the location of the court in Washington. While it may be thought that this argument of inconvenience was lost when the Capitol was located in Washington, it is quite likely that the inconvenience could be reduced through periodic sessions of the court in four or five geographically representative cities.

The preceding discussion has concerned itself with the problems presented by the existing system of judicial review, the proposals offered in solution of these problems, and the objections that have been made to these proposals. In the field of administrative procedure, the Government has acted to eliminate the admitted difficulties which the old procedure had produced. Its adoption of the decentralized procedure is a bold step which promises much needed reform in tax administration. But no action has yet been taken to meet the perhaps more critical problems of judicial procedure. One recognizes that traditional judicial ground is not so easily trod upon and that emotional reactions respecting the established judicial order are only slowly overcome by the soundest arguments. However, those who claim an interest in the proper functioning of our tax machinery, who wish to offer to the taxpayers a law as free from controversy as an income tax will permit but at the same time an expeditious,

of Customs Appeals, now the Court of Customs and Patent Appeals, and *Williams v. United States* (1933) 289 U. S. 553, holding the Court of Claims to be legislative courts, rely mainly on the historical treatment of the subjects dealt with by these courts. *O'Donoghue v. United States* (1933) 289 U. S. 516, likewise rests heavily upon history in finding the Court of Appeals for the District of Columbia to be both a constitutional and a legislative court. The argument of history would, as regards taxation, seem to permit Congress to create a constitutional court to hear only tax cases if it so desired. It would appear that Congress possesses the power to choose one or the other type of court in this regard and therefore could make its intentions clear as to the choice adopted.

39. Cf. *Anniston Manufacturing Co. v. Davis* (1937) 301 U. S. 337.

40. Cf. the statements in *Ex Parte Bakelite Corp.* (1929) 279 U. S. 438, both as to the treatment of claims against the United States (at 452) and the creation of the Court of Customs Appeals by Congress under its powers to lay and collect duties on imports and to adopt any appropriate means of carrying that power into execution (at 460).

orderly method of resolving the disputes that do arise, who desire to supplant undesirable conflict and confusion with reasonable uniformity and certainty, can find no phase of our present tax system more urgently in need of critical reexamination than the present system of judicial review.

III. CLOSING AGREEMENTS—THEIR FUNCTIONS AND ADMINISTRATIVE PROCEDURE

The provisions authorizing the Treasury Department to enter into closing agreements under the internal revenue laws have received almost no attention from writers in the administrative field, and slight notice from even those whose interests are confined to tax administration. The general unfamiliarity with these provisions justifies a preliminary description.

The closing agreement made its first statutory appearance in the Revenue Act of 1921.⁴¹ The Treasury Department had been urging for some time that it be given authority finally to close tax cases. It said that:

At present the taxpayer never knows when he is through. Every time an old ruling is changed by court decision, opinion of the Attorney General, or reconsideration by the Department, the Department feels bound to apply the new ruling to past transactions. The necessity of constantly correcting old returns and settlements is as distressing to the Department as it is obnoxious to the taxpayer.⁴²

Only the running of the statute of limitations on assessments served to establish a final barrier to the claim of the Government for additional taxes, so that prior to that time a taxpayer could not safely consider a tax year as closed. It will be recalled that under the Revenue Act of 1918 the period of limitations with respect to assessments was five years, and under the Revenue Act of 1921 it was four years. Congress responded to this plea by inserting Section 1312 into the Revenue Act of 1921, providing:

That if after a determination and assessment in any case the taxpayer has without protest paid in whole any tax or penalty, or accepted any abatement, credit, or refund based on such determination and assessment, and an agreement is

41. (1921) 42 Stat. 313, c. 136, sec. 1312.

42. H. R. Rep. No. 1035 (1920) 66th Cong., 2d Sess., 3; cf. H. R. Rep. No. 350 (1921) 67th Cong., 1st Sess., 15; Sen. Rep. No. 275 (1921) 67th Cong., 1st Sess., 31-32; (1921) 61 Cong. Rec. 5202.

made in writing between the taxpayer and the Commissioner, with the approval of the Secretary, that such determination and assessment shall be final and conclusive, then (except upon a showing of fraud or malfeasance or misrepresentation of fact materially affecting the determination or assessment thus made) (1) the case shall not be reopened or the determination or assessment modified by any officer, employee, or agent of the United States, and (2) no suit, action, or proceeding to annul, modify, or set aside such determination or assessment shall be entertained by any court of the United States.⁴³

Like provisions, with but a minor change, appeared in the Revenue Acts of 1924⁴⁴ and 1926.⁴⁵

The device thus adopted to bar a tax year against further changes in tax liability, prior to the running of the statute of limitations, was a written agreement entered into between the Commissioner and the taxpayer, approved by the Secretary, and made final by statute as respects both Government and taxpayer. It will be noted that several limitations were placed on the use of such an agreement. There had to be both (1) a determination and assessment by the Commissioner, and (2) payment by the taxpayer of any tax or penalty, or acceptance by him of any abatement, credit, or refund, consequent upon such determination and assessment. Moreover, the agreement was confined to the over-all statement that such determination and assessment were final and could not refer merely to the treatment of a single item. These limitations were reflected in the number of closing agreements entered into under the three Revenue Acts which contained the provision quoted above:

Calendar Year	Number of Agreements Income Tax
1922	117
1923	469
1924	582
1925	310
1926	293
1927	834

43. (1921) 42 Stat. 313, c. 136, sec. 1312.

44. (1924) 43 Stat. 340, c. 234, sec. 1106. The words "after protest" were eliminated.

45. (1926) 44 Stat. 113, c. 27, sec. 1106(b), (1929) 26 U. S. C. A. sec. 1249(b).

The House Ways and Means Committee was thus in a position to state in 1928 that:

The closing of tax cases for the earlier years is a difficult problem. Statistics recently gathered show that an abnormally large percentage of closed cases are reopened by the taxpayer or the Government. Among the causes contributing thereto are claims by taxpayers, the effect of subsequent court decisions and changes in the regulations and the law. The constant reopening of closed cases must be discouraged and one of the most effective means of preventing the reopening of cases is the execution of closing agreements. Such agreements are authorized by Section 1106(b) of the Revenue Act of 1926. There are, however, a number of restrictions in that Section, the practical effect of which is to delay and often to render it impossible to secure the agreement.⁴⁶

The desire to increase the use of closing agreements was concurred in by the Treasury Department. Section 606 of the Revenue Act of 1928 was therefore adopted to supersede the prior provisions relating to this subject. It provided:

(a) Authorization.—The Commissioner (or any officer or employee of the Bureau of Internal Revenue, including the field service, authorized in writing by the Commissioner) is authorized to enter into an agreement in writing with any person relating to the liability of such person (or of the person or estate for whom he acts) in respect of any internal revenue tax for any taxable period ending prior to the date of the agreement.

(b) Finality of agreements.—If such agreement is approved by the Secretary, or the Undersecretary, within such time as may be stated in such agreement, or later agreed to, such agreement shall be final and conclusive, and, except upon a showing of fraud or malfeasance, or misrepresentation of a material fact—

(1) the case shall not be reopened as to the matters agreed upon or the agreement modified, by any officer, employee, or agent of the United States, and

(2) in any suit, action, or proceeding, such agreement, or any determination, assessment, collection, payment, abatement, refund, or credit made in accordance therewith, shall not be annulled, modified, set aside, or disregarded.⁴⁷

46. H. R. Rep. No. 2 (1928) 70th Cong., 1st Sess., 32-33.

47. (1928) 45 Stat. 874, c. 852, sec. 606, (1935) 26 U. S. C. A. sec. 1660.

This new provision dispensed with the need for a determination and assessment followed by payment or refund of tax. A closing agreement thus became permissible in any situation involved in a closed taxable year. The immediate result of this statutory change was a widespread use of closing agreements. The Bureau of Internal Revenue adopted the policy of requesting an agreement in every case in which the tax liability shown on the taxpayer's return had been increased or decreased after audit and examination. Even though no change in tax liability was made, an agreement was requested if the tax exceeded \$50,000.⁴⁸ It will be observed that the Government was thus the moving party in concluding closing agreements. Behind its desire for such agreements was the necessity of reducing the large accumulation of cases from prior years. The following figures reflect the change:

Calendar Year	Number of Agreements
	Income Tax
1928	38,381
1929	141,421

But it soon became evident that the pendulum had swung much too far. The large number of agreements made impossible their adequate review. The Bureau rapidly learned to its sorrow that in many instances additional taxes were owing but were uncollectible because a closing agreement had been concluded with the taxpayer. Likewise, taxpayers possessing valid grounds upon which to base refund claims found that the agreement barred recovery of the overpayments. As the closing agreement was entered into upon the urging of the Bureau, it was natural that these taxpayers gave expression to their wrath in severe criticism of the Bureau. The immediate result was an abandonment of the policy of soliciting closing agreements from taxpayers and the adoption in 1930 of a practice of entering into such agreements only when they were requested by taxpayers or where for some special reason it was to the Government's interest that the case be closed. This change in policy resulted in a precipitate decline in the number of closing agreements. It was followed in 1934 by a Mimeograph⁴⁹ closely restricting the use

48. Mimeograph 3697 (1929) VIII-1 Cum. Bull. 118; Mimeograph 3728 (1929) VIII-1 Cum. Bull. 124.

49. Mimeograph 4149 (1934) XIII-1 Cum. Bull. 162. The provisions of this Mimeograph are similar to those quoted on p. 429, *infra*.

of closing agreements and by a more careful review in the Treasury of agreements concluded by the Bureau, and the decline continued. By 1937 the drop had been so pronounced that only 161 agreements were entered into in that year. The following figures tell the story:

Calendar Year	Number of Agreements Income Tax
1930	87,687
1931	4,763
1932	3,241
1933	1,950
1934	349
1935	302
1936	318
1937	161

The Revenue Act of 1938 contained two important provisions, not related to the preceding history of closing agreements, which are bound to have a significant effect upon their use. The first provision altered the prior language by eliminating, after "any taxable period," the words "ending prior to the date of the agreement," so that a closing agreement could be entered into "for any taxable period."⁵⁰ The second provision was the specification of a closing agreement as a final determination of tax liability for the purposes of Section 820 of the Revenue Act of 1938. These two provisions,⁵¹ which were carried over into the Internal Revenue Code,⁵² will be discussed later.

As the law now stands, the scope of a closing agreement may be summarized as follows:⁵³

(1) A closing agreement may be made with respect to any internal revenue tax.⁵⁴

(2) The closing agreement may refer to past tax years which are already closed, to a present tax year not yet terminated, or to a future tax year which has not yet commenced.

50. (1938) 52 Stat. 573, c. 289, sec. 801.

51. (1938) 52 Stat. 573, c. 289, sec. 802, provided that closing agreements could be approved by an Assistant Secretary, as well as by the Secretary or Under Secretary.

52. The present provision respecting closing agreements is Internal Revenue Code (1939) 53 Stat. 462, sec. 3760.

53. U. S. Treas. Reg. 103, Appendix, par. 47. Cf. Paul and Mertens, *The Law of Federal Income Taxation* (1934) secs. 45.01-45.18.

54. Only a few agreements are concluded with respect to taxes other than the income tax.

(3) The closing agreement may pertain to the total tax liability for a tax year (including the absence of any liability) or to the tax consequences of any particular matter or item, such as a reorganization, a bad debt, *et cetera*.

(4) The closing agreement may relate to issues of law, to issues of fact, or, to pay homage to the Supreme Court, to "a mixed question of law and fact."⁵⁵

Under present practice, the closing agreement provided for in Section 3760 of the Internal Revenue Code serves three independent functions, which we may now consider.

A. *Use of closing agreement to close a past tax year.*

As the preceding discussion indicated, the function which the closing agreement was originally intended to serve was the final closing of a completed tax year. At the time of the agreement's introduction, the statute of limitations was comparatively long and did not offer adequate protection against unforeseen changes in tax liability. Today, however, the period of limitations upon assessment and refund with respect to the income tax is in general three years. It is questionable whether this relatively short period of uncertainty can be reduced any further without too great a sacrifice on both sides. Most taxpayers actually enjoy a shorter period, for if their returns are examined, found adequate, and stored away in the year following their filing by the taxpayers, they will rarely be disturbed. Shifts in judicial interpretation during the three-year period can hardly affect such taxpayers, for the Bureau cannot keep a cross-index of tax items involved in the various returns. If the taxpayer by refund seeks to take advantage of a shift in interpretation, he of course invites closer inspection of his return. Those taxpayers whose returns merit detailed inspection will not be able to consider their tax as finally determined until the entire three-year period has elapsed. But the difficulties of inspection and examination of such returns prevent any mechanical shortening of the period. Indeed, for many of these taxpayers the three-year period is not sufficient for a thorough examination and a resort to waivers is necessary. It has been suggested that the period of limitations be reduced to, say, eighteen months except in special cases where the Bureau, in a specified manner, indicates that more time is

55. *Helvering v. Tex-Penn. Co.* (1937) 300 U. S. 481, 491.

necessary. Yet it hardly seems worthwhile to substitute a rigid and complex procedure for one which accomplishes the result sought by such a provision and at the same time is elastic and simple of administration.

There does not appear to be any need for the Commissioner to exercise the power conferred with respect to closing agreements in a broad fashion, so as to achieve finality in a shorter time than is now afforded by the statute of limitations. The sparing of finicky taxpayers from the vicissitudes of judicial or administrative changes in interpretation within the three-year period does not overbalance the administrative inconvenience that such closing agreements would involve if entered into on a large scale. It is one thing to file away a return at the end of a year and go on to the next year's work, and another to enter into a binding agreement with the taxpayer at the end of such year with respect to his tax liability. Even the taxpayer himself, upon reflection, would not be anxious to sign away his right to a refund without very careful checking. The proper approach is one which the Bureau has adopted—steady improvement in the technique of auditing returns. The resort on a large scale to the formality of the closing agreement to obtain speedier finality would mean only the repetition of a serious mistake.

Although it is undesirable to utilize closing agreements in a broadside manner merely to hasten absolute finality, there undoubtedly are special cases in which such finality must be obtained promptly. Thus, a corporation seeking to recapitalize or reorganize, may be required to issue a statement concerning its tax liabilities for past years. Bureau practice recognizes this and similar needs, and the current Mimeograph states:

Ordinarily no closing agreement, Form 866, with respect to any internal revenue tax will be entered into except where there appears to be an advantage in taking such action, as in cases where, in the settlement of disputed issues, the taxpayer and the Government have made mutual concessions. Where, however, the taxpayer is able to show sound reasons for desiring a closing agreement and it is shown that the Government will sustain no disadvantage through the acceptance of the agreement, an application for a closing agreement will not be rejected solely because there is no apparent advantage to the Government. Examples of such cases are: estates, where the fiduciary desires a final closing agreement in order that he may be discharged by the court;

corporations in the process of dissolution which desire a final closing agreement to wind up their affairs; cases where in connection with the taxpayer's financial affairs, creditors demand evidence of a final determination of tax liability; and cases where taxpayers desire to follow the consistent practice of so closing their returns from year to year.⁵⁶

Tax attorneys who have experienced difficulties in securing closing agreements may perhaps be surprised at this language. It can hardly be contended that the language is unduly restrictive. The Mimeograph fairly and clearly states the proper function of closing agreements for taxable years already closed. While one may grumble at the application of the expressed policy in a particular case, a quarrel cannot be picked with the policy against which variant cases are to be tested. As respects this function of the closing agreement—that of providing finality as to the treatment of a past tax year—little more can be desired of the policy standards adopted by the Bureau.

B. Use of the closing agreement as a determination under Section 3801 of the Internal Revenue Code.

Section 3801 of the Internal Revenue Code, formerly Section 820 of the Revenue Act of 1938, is designed to mitigate the hardship caused by the statute of limitations in cases where taxpayer or Commissioner has successfully maintained an inconsistent position.⁵⁷ Suppose the taxpayer has erroneously included an item of income in his gross income for 1936. After the period of limitations has expired with respect to 1936, the Commissioner correctly asserts a deficiency for 1938 on the ground that the item belongs in the taxpayer's gross income for that year. Formerly, if the Commissioner were successful the taxpayer would be in the unfortunate position of having paid tax twice on the same item. Today he is permitted to obtain a refund, with interest, of the portion of the tax for 1936 erroneously paid with respect to the item. Obviously no adjustment for the earlier year should be made until the tax liability for the later year has been finally determined and the second inclusion of the item in gross income is beyond recall. A court or Board of Tax Appeals decision sustaining the asserted deficiency would, on becoming final, consti-

56. Mimeograph 4821 (1938) XVII-2 Cum. Bull. 254.

57. Maguire, Surrey and Traynor, Section 820 of the Revenue Act of 1938 (1939) 48 Yale L. J. 509, 719.

tute such a determination. Or if the deficiency were paid and refund claim filed, a disallowance of such refund claim, followed by a failure to bring suit within the two years allowed for the institution of a suit by the taxpayer, would provide the necessary finality. But these determinations are of a litigious nature and long delayed. Suppose the taxpayer is willing to acknowledge the soundness of the Commissioner's later position and to pay the deficiency, so that he may obtain an adjustment for the earlier year. Yet mere payment of a deficiency is not a crossing of the Rubicon; a change of mind the next day will bring a refund claim which may turn out to be successful. To avoid unnecessary delay and litigation where the taxpayer is willing to pay the deficiency and at the same time to insure the finality of such payment, Section 3801 provides that a closing agreement with respect to the item in question constitutes a final determination permitting adjustment for the error in the earlier year.

Taxpayers aware of the restrictive Bureau policy on closing agreements were quite sceptical of their being able to obtain such agreements in connection with Section 3801 and accordingly criticized the Section. Yet their criticisms completely overlooked the difference in the function served by the closing agreement under that Section. To secure the traditional closing agreement, the taxpayer quite properly had to show a special need justifying the examination that the Bureau would be compelled to make in self-protection. But under Section 3801 the taxpayer is acquiescing in the Bureau's assertion of a deficiency and desires a closing agreement confirming that acquiescence in order to obtain the consequent adjustment for the earlier year. The closing agreement is thus a mere formality, whose presence, however, is indispensable to the proper functioning of the Section. Moreover, the agreement can be restricted to the item in question, so that the remaining items for the year are left unaffected. There is thus no reason for the Bureau to refuse to enter into closing agreements for this purpose and Bureau practice recognizes this fact.⁵⁸

This use of the closing agreement as a mere formality designed

58. Mimeograph 4821 (1938) XVII-2 Cum. Bull. 254 states at 256: "A closing agreement should be executed and submitted for approval whenever such action is deemed appropriate under the provisions of section 407 or section 820 of the Revenue Act of 1938." Cf. Maguire, Surrey and Traynor, *supra* note 57, at 723-4.

to start in operation another provision of the revenue laws has administrative consequences. Section 506 of the Internal Revenue Code in a somewhat comparable situation relies upon a closing agreement confirming a deficiency under the tax on personal holding companies to set in motion the deficiency dividend machinery. It is quite likely that in the future additional devices will depend upon the conclusion of a closing agreement. The number of closing agreements concluded each year should therefore greatly increase. Yet the closing agreement machinery is still geared to the function first served by the agreement. Thus, approval by the Secretary, the Under Secretary, or an Assistant Secretary is required. Such a requirement, even if understandable with respect to the function of the closing agreement first described, is just so much red tape when the closing agreement itself is a mere formality. Even review by the Commissioner appears unnecessary in such a case.

One may also question these and like mechanics when applied to the traditional closing agreement. Congress possesses the belief that the closing agreement device is fraught with the possibilities of favoritism and apparently for this reason has refused authority to the Commissioner to conclude such an agreement without Treasury review.⁵⁹ Yet the many decisions made daily to issue or not to issue a deficiency letter permit of the same favoritism. So, also, does the settlement of a case before the Board of Tax Appeals. Nevertheless, the issuance of deficiency letters and the settlement of Board cases now rest with the Staff Divisions in the field and are not subject to review in Washington. Where in the settlement of disputed issues the taxpayer and the Government have made mutual concessions, it is desirable that the settlement be final. If the settlement occurs in connection with a proceeding before the Board, the desired finality is afforded by the Board order. As indicated above, the Staff Divi-

59. The Senate Finance Committee in 1938 recommended that the Commissioner be authorized finally to approve closing agreements, under regulations approved by the Secretary, and the Senate Bill embodied this suggestion. Sen. Rep. No. 1567 (1938) 75th Cong., 3rd Sess., 46. The Conference Committee rejected this change, and instead permitted an Assistant Secretary to approve closing agreements, in addition to the Secretary or Under Secretary. Compromises received a similar treatment, in that the Under Secretary and an Assistant Secretary were permitted to approve compromises before suit. Sen. Rep. No. 1567 (1938) 75th Cong., 3rd Sess., 47. Revenue Act (1938) 52 Stat. 578, c. 289, sec. 815. Cf. Seidman, *Legislative History of Federal Income Tax Laws (1938)* 772-774.

sion alone concludes the settlement. But if the settlement occurs prior to petition to the Board, absolute finality can be obtained only through a closing agreement, whose adoption involves review and consideration in Washington. Yet the settlement before the Board binds the Government as effectively as the closing agreement. No reason is therefore apparent why a different procedure should be required in the case of the agreement. For these reasons it would be desirable to reconsider the administrative mechanics applicable to closing agreements of each type and the extent of the review that is necessary.

C. Use of the closing agreement as a binding declaratory ruling for the future.

The two preceding functions of the closing agreement concern completed tax years and past transactions. The closing agreement serves only to impart that finality to the tax consequences which it is agreed should be ascribed to the completed transactions. Its function does not differ in kind from that performed by the doctrine of *res adjudicata* or the statute of limitations; the closing agreement merely advances the time of finality. The Revenue Act of 1938, however, permitted closing agreements to reach into the future and thereby opened for exploration an entirely new field of tax administration.

Prior to 1938 the Bureau policy with respect to rulings on the tax consequences of contemplated transactions had crystallized into a definite refusal to issue such rulings. Mimeograph 4589, issued in 1937, stated:

The Bureau is receiving a large number of requests from taxpayers and their counsel for rulings which relate to the character and extent of tax liabilities resulting from prospective as distinguished from contemplated transactions. Except upon specific authorization by the Commissioner of Internal Revenue or as indicated in (a) below, the established policy of not complying with such requests will continue to be followed. Rulings will continue to be made only under the following circumstances:

(a) The transaction must be completed and not merely proposed or planned, except where the law or regulations provide for a determination by the Commissioner of the effect of a proposed transaction for tax purposes, as in the case of a transfer coming under the provisions of Sections 901-904 of the Revenue Act of

1932, or an exchange coming under the provisions of Section 112 (i) of the Revenue Act of 1936.⁶⁰

The fact that such rulings would not be binding upon the same or a successor Commissioner, as the celebrated *Couzens* case proved,⁶¹ the belief that taxpayers would impose upon the Bureau through repeated requests for rulings on slightly altered facts until the most favorable situation were disclosed, and the fear that the Bureau might be tricked into undesirable rulings, all played a share in shaping this policy. On the other hand, however, was the inability of the honest taxpayer to obtain administrative guidance with respect to the tax consequences of a proposed transaction. A corporation might be faced with a complex reorganization in which the tax factor was a substantial one. Despite the ambiguities of the reorganization provisions and their constantly shifting interpretation, the corporation was forced to construe the law at its peril. Administrative "guidance" could come only in the form of a deficiency letter. The House Ways and Means Subcommittee in 1938 thought the benefits to be derived from real administrative guidance outweighed the possible evils, and recommended "appropriate statutory provisions * * * giving to the Commissioner of Internal Revenue discretionary authority to make declaratory rulings."⁶² Presumably in response to this recommendation, the Revenue Act of 1938 removed the restriction which had confined closing agreements to past taxable years. A taxpayer and the Commissioner may now enter into a binding agreement fixing the tax consequences of a contemplated transaction.

The desirability of this change was indicated at once. In the same Act Congress had provided in Section 112 (b) (7) that if complete liquidation of a domestic corporation occurred in the month of December, 1938 and in the manner prescribed in such Section, the recognition of the gain to the stockholders attributable to the increase in value of the corporation's assets would, contrary to the general rule, be postponed until the distributed assets were disposed of by the stockholders. The tax benefit to be derived from such liquidation was considerable. The only

60. (1937) XVI-1 Cum. Bull. 536.

61. James Couzens (1928) 11 B. T. A. 1040.

62. Report of a House Ways and Means Subcommittee on *A Proposed Revision of the Revenue Laws* (1938) 79, 55. Cf. H. R. Rep. No. 1860 (1938) 75th Cong., 3rd Sess., 67.

stumbling block was the necessity of strict compliance with the requirements of the Section, for if it were later determined by a court that one of the requirements had not been met, it would be too late to make amends. Moreover, the whole liquidation had to be completed in December, 1938. Taxpayers solved this problem by bringing their plans of liquidation to the Bureau and obtaining closing agreements confirming their compliance with the specified requirements. After the agreements were concluded, the liquidations followed. There could thus be no litigation on the matter and no defeated expectations on the part of the taxpayers.

The closing agreement has served this new function for about a year and a half. In that time the tax consequences of between fifty and sixty contemplated transactions have been ruled upon in closing agreements. The actual number of such agreements concluded in this period is about a thousand, as one transaction may involve many agreements.⁶³ Roughly 90 to 95 per cent of these agreements relate to the reorganization provisions of the Internal Revenue Code—recapitalizations, mergers, reorganizations, Section 112(i) exchanges, *et cetera*. But the remaining agreements cover a wide variety of situations—determination of tax problems under aircraft construction contracts in applying the Vinson-Trammell Act,⁶⁴ March 1, 1913 value of stock or real property, the present value of securities, the basis of property acquired on foreclosures, the gain or loss that would be recognized on a contemplated sale, the taxability of a stock dividend, the amount of income that would be realized on a proposed cancellation of indebtedness, the allocation of a cost basis among various securities, and so on. The current Mimeograph calls attention to other situations in which such a closing agreement may be used to advantage. It states that "a closing agreement as to specific matters, Form 906, should be secured whenever the taxpayer and the Commissioner have concurred in the

63. Wenchel, What Is Going On In The Chief Counsel's Office (1939) 25 A. B. A. J. 761, (1939) 17 Taxes 641; Wenchel, The Treasury's New Powers as to Closing Agreements (1938) 16 Tax Mag. 651. In 1938 there were 364 closing agreements under the income tax and in 1939, 1,221 agreements. The increase in each year is due principally to the closing agreements respecting future transactions. In addition, many rulings in future transactions have been made but not embodied in closing agreements, as the taxpayers desired merely to ascertain the position of the Bureau.

64. (1940) C. C. H. Fed. Tax Serv. par. 6113.

disposition of an item and such closing agreement is considered necessary to insure consistent treatment of such item in any other taxable period."⁶⁵ Thus the Commissioner may contend that an item of income belongs in gross income for 1939 and not in a later year as the taxpayer asserts. If the taxpayer acquiesces in the Commissioner's contention, he may protect himself by obtaining a closing agreement stating that the item will not be included in gross income for a later year. Or, a taxpayer may claim stock became worthless in 1939 and the resulting loss was a proper deduction for that year. If the Commissioner denies the deduction as premature, a closing agreement may state that if in any future year the deduction is denied because it properly belonged in 1939, that year will be reopened to permit allowance of the deduction.

Problems in the administration of this new policy come to mind at once:

(a) Prevention of "fishing expeditions." The Bureau obviously cannot be turned into a vast information bureau. Congress quite properly recognized that the granting or refusal of a closing agreement must be in the complete discretion of the Commissioner.⁶⁶ In practice, a taxpayer desiring a closing agreement respecting a future transaction must first satisfy the Bureau that a sound necessity underlies the request. If this is done, the Bureau will then work out an agreement, even permitting changes in the contemplated transaction when the conferences on the agreement disclose their desirability. The Bureau has so far found that the privilege of obtaining administrative guidance has not been abused by taxpayers.

(b) Ascertainment of facts. The Bureau must possess sufficient and reliable factual information upon which to base the ruling. Generally such information has been supplied by taxpayers; in some instances it has been gathered by independent investigation in the field. As a precaution, the taxpayer's request is made a part of the agreement, and it is stated that any misstatement of fact shall void the agreement.

(c) Compliance with agreement. The transaction when completed must be the same as the proposed transaction upon which the ruling was made. In practice the closing agreement is at-

65. Mimeograph 4821 (1938) XVII-2 Cum. Bull. 254.

66. H. R. Rep. No. 1360 (1938) 75th Cong., 3rd Sess., 67.

tached to the taxpayer's return by the Bureau or a notation made which permits the field force to ascertain if the requisite correspondence exists. In some cases the taxpayer has obtained a second closing agreement confirming his compliance with the transaction described in the earlier agreement.

(d) Proper protection respecting basis and other aspects of the transaction. If the transaction is a reorganization, for example, it is not sufficient merely to agree that no gain or loss will be recognized if it is consummated. The Commissioner in self-protection must see that the agreement fixes the basis of the property involved with respect to any future disposition. Likewise, all parties to the reorganization must be bound by the ruling, so that some of the taxpayers involved may not later obtain a different result through litigation. Thus, on a Section 112(b) (5) exchange, the basis of all of the parties should be fixed. In practice, where a reorganization involving many stockholders is the subject of a closing agreement, the Bureau obtains agreements from the important stockholders. In one case, involving over 450 stockholders, agreements were obtained from each stockholder. Necessarily, the burden of securing such subsidiary agreements falls upon the taxpayers seeking the main agreement.

(e) Effect of future statutory changes. Whatever may be the power of one Congress to delegate to the Commissioner authority to bind a future Congress, no such authorization was intended in connection with the innovation introduced by the Revenue Act of 1938. The Regulations recognize this important limitation on closing agreements of this type, and state that "a closing agreement with respect to any taxable period ending subsequent to the date of the agreement is subject to any change in or modification of the law enacted subsequent to the date of the agreement and applicable to such taxable period, and each closing agreement shall so recite."⁶⁷ The clause included in each closing agreement makes it clear that the term "law" refers to the statutory law. Thus, suppose a closing agreement dealing with a contemplated reorganization provides for the basis of the property involved in the reorganization in the event of its future disposition. Before the property is disposed of, Congress pro-

67. U. S. Treas. Reg. 103, Appendix, par. 47.

vides a new basis in connection with such transactions and makes the change applicable to prior reorganizations. The basis fixed in the closing agreement must yield to the statutory rule. But the closing agreement is not to be set aside merely because a later court decision indicates that it embodies an erroneous interpretation of the statute, for the very essence of the agreement is its supremacy over the judicial interpretation.

This function of the closing agreement is still in its infancy. The small number of agreements concluded respecting contemplated transactions indicates that taxpayers are not yet aware of the potentialities of the closing agreement. An increased realization of the numerous advantages which such agreements may serve will undoubtedly be accompanied by many more requests for rulings. All this points to the necessity of evolving standards which may guide the Bureau and taxpayers in the use of such closing agreements. For example, should such agreements be limited to contemplated transactions whose tax consequences relate to only one year, such as the profit on a proposed sale, or should they be applied even to those transactions whose tax consequences cover a number of future years? In turn, the latter transactions may be further divided. A tax-free reorganization has consequences both in the year of consummation, when the consequence is the non-recognition of gain or loss, and in each succeeding year through the effect of the reorganization on the basis of the property involved. But here the prime question is that of consistency of treatment. It is not of much moment that Taxpayer *A* obtains a closing agreement providing the reorganization is tax-free, whereas Taxpayer *B* in a similar case receives judicial decision that the exchange is taxable. Such lack of uniformity is not very disturbing. But suppose Taxpayer *A* creates a trust under an alimony agreement and secures a closing agreement which, in accordance with the existing view, confirms his tax liability for the income therefrom during the life of the trust. Taxpayer *B* establishes a similar trust but does not desire a closing agreement, although he includes the income in his return. Years later, however, the judicial interpretation shifts and Taxpayer *B* then successfully contests his liability to tax on the trust income.⁶⁸ Because of the closing agreement, however, Tax-

68. Cf. the approach to alimony trusts of the second circuit court of appeals in 1936 in *Helvering v. Brooks* (C. C. A. 2, 1936) 82 F. (2d) 173,

payer *A* will not be able to secure the benefit of the changed interpretation and must continue to pay tax on the income of his trust. If such lack of uniformity is undesirable, then perhaps closing agreements should not be entered into by the Bureau in transactions of this type. In other words, in what situations and to what extent should taxpayers, and the Commissioner, be able to acquire blanket insurance against future judicial decisions? The problems presented by this type of closing agreement are of course very similar to those inherent in the application to the revenue laws of the doctrine of *res adjudicata*.⁶⁹

In addition, the administrative problems that are bound to follow from increased use of closing agreements must be explored while there is time carefully to consider their solution. As was pointed out above, the administrative system evolved for the traditional closing agreement is not desirable where the agreement is a mere formality. It would likewise seem unsound to adopt wholesale for the administration of agreements relating to transactions that are only contemplated a system designed to deal with completed transactions. As the closing agreement with respect to contemplated transactions involves many important policy considerations, the control of such agreements should be centralized close to the policy officers of the Bureau of Internal Revenue and the Treasury. The significant possibilities which the closing agreement possesses for achieving some certainty in a tax system that is today marked by extreme uncertainty must be developed to their fullest extent. Such development requires a sound administrative basis and for this reason the present system should be carefully tested to determine the extent of possible improvement.

At the same time, experimentation with this technique will better equip us to consider the desirability of a much broader and more complex system of declaratory administrative rulings. One such system, making provision for extensive hearings by the Commissioner, the issuance of rulings affecting large classes of taxpayers, the issuance of rulings upon the initiative of the Commissioner, the judicial review of such rulings, and the effect

with its later approach in *Helvering v. Leonard* (C. C. A. 2, 1939) 105 F. (2d) 900.

69. Cf. Paul, *Selected Studies in Federal Taxation* (2d series, 1938) 104, 140.

of such review upon taxpayers affected by the rulings but not parties to the litigation, has been described elsewhere.⁷⁰ There are some who feel that the closing agreement is all that is necessary; there are others who insist that the closing agreement is not an adequate substitute for a system of declaratory administrative rulings. The merits of the controversy do not even concern us except for the observation that an answer might well await further development of the potentialities of the closing agreement in this field.

CONCLUSION

Three topics have been suggested for study—improvement in the general administrative procedure, with special emphasis on the problems of decentralization; complete reexamination of the present system of judicial review of tax controversies; and development of the closing agreement to provide tax certainty with respect to certain contemplated transactions, together with a revision of the closing agreement procedure designed to bring it in harmony with the various functions now served by the agreement. The discussion of these topics is not intended as an indication that they are the only problems remaining for the student of tax administration. Limitations of space prevent consideration of many other problems equally in pressing need of solution. The absorbing question of the scope and effect of Treasury Regulations remains as baffling as ever despite, or perhaps because of, recent Supreme Court decisions in this field.⁷¹ The present law is here so uncertain that the only solution may be the formulation of statutory rules providing a comprehensive treatment of the subject. Another provocative subject, which has long been neglected, is the development of criteria for judging proposed legislation of a retroactive nature. The Revenue Act of 1939, although nearly Lilliputian in size as compared with a standard Revenue Act, contained eight retroactive provisions, about as many as were included in the Revenue Acts of 1932

70. Traynor, *Declaratory Rulings* (1938) 16 Tax Mag. 195.

71. *Helvering v. Reynolds Tobacco Co.* (1939) 306 U. S. 110; *Estate of Sanford v. Commissioner of Internal Revenue* (1939) 308 U. S. 39; *Helvering v. Wilshire Oil Co.* (1939) 308 U. S. 90; *Helvering v. Hallock* (1940) 60 Sup. Ct. 444; Paul, *Use and Abuse of Tax Regulations in Statutory Construction* (1940) 49 Yale L. J. 660; Surrey, *The Scope and Effect of Treasury Regulations Under The Income, Estate and Gift Taxes* (1940) 88 U. of Pa. L. Rev. 556; Alvord, *Treasury Regulations and the Wilshire Oil Case* (1940) 40 Col. L. Rev. 252.

through 1938. Despite the present trend toward such provisions, there are no criteria available to enable the Congress to decide, as a matter of legislative policy rather than of constitutional limitations, when to be stern and when to be merciful in response to requests for retroactive relief. In another field, there is the vital question of an Administrative Code. The Congress in 1939 took a long step forward when it codified in an Internal Revenue Code all of the statutes relating to the internal revenue in force on January 2, 1939, and enacted that Code as absolute law. But the Code made no substantive changes in the existing statutes, so the task still remains of modernizing the provisions of the Code. Such modernization is especially needed with respect to the administrative provisions of the Code. The provisions regarding assessment and collection of the various taxes and the antiquated and detailed administrative provisions of the miscellaneous taxes could stand complete overhauling. The Treasury Department is undertaking the first and most formidable step in that task, that of preparing a tentative Administrative Code as a working basis. It will probably present a suggested Administrative Code before the end of the year. Such a Code obviously demands painstaking analysis and study on all sides. Consequently, when this Administrative Code is ready for critical examination, it will afford all who are interested in tax administration an opportunity to perform genuine service in the improvement of our tax system.⁷²

Mention of these few additional topics should serve to indicate that there are many challenging problems which require immediate and concrete solutions. Long-range improvements need not and should not be abandoned. But the fact remains that those who desire a system of tax administration that will effectively serve both taxpayers and the Government, have it within their power to provide such a system for the present and are not forced to think only of a distant future.

72. Cf. address by Roswell Magill, formerly Under Secretary of the Treasury, before the American Institute of Accountants, September 29, 1938.