

INVESTIGATION OF BUREAU OF INTERNAL REVENUE

HEARINGS

BEFORE THE

SELECT COMMITTEE ON INVESTIGATION OF THE BUREAU OF INTERNAL REVENUE UNITED STATES SENATE

SIXTY-EIGHTH CONGRESS

FIRST SESSION

PURSUANT TO

S. Res. 168

AUTHORIZING THE APPOINTMENT OF A SPECIAL COMMITTEE
TO INVESTIGATE THE BUREAU OF INTERNAL REVENUE

SEPTEMBER 18, 1924

PART 4

Printed for the use of the Select Committee on Investigation
of the Bureau of Internal Revenue



WASHINGTON
GOVERNMENT PRINTING OFFICE

1024

**SELECT COMMITTEE ON INVESTIGATION OF THE BUREAU OF
INTERNAL REVENUE**

JAMES E. WATSON, Indiana, *Chairman*

JAMES COUZENS, Michigan.

ANDRIEUS A. JONES, New Mexico.

RICHARD P. ERNST, Kentucky.

WILLIAM H. KING, Utah.

INVESTIGATION OF BUREAU OF INTERNAL REVENUE

THURSDAY, SEPTEMBER 18, 1924

UNITED STATES SENATE,
SELECT COMMITTEE INVESTIGATING
THE BUREAU OF INTERNAL REVENUE,
Washington, D. C.,

The committee met, pursuant to call, in room 410, Senate Office Building, at 10.30 a. m.

Present: Senators Couzens (chairman), Ernst, Jones of New Mexico, and King.

At the conclusion of an executive session the committee proceeded in open session at 12.15 o'clock p. m., Senator Couzens (chairman).

Present: Senators Couzens (presiding), Ernst, Jones of New Mexico, and King.

Appearances: For the committee, Earl J. Davis, Esq., of counsel; for the Internal Revenue Bureau, C. R. Nash, Esq., assistant to the commissioner; N. T. Hartson, Esq., Solicitor of Internal Revenue.

The CHAIRMAN. We will proceed, gentlemen.

Mr. DAVIS. I would like to read this resolution.

The CHAIRMAN. You may do so.

Mr. DAVIS (reading)

Resolved, By the special committee of the Senate, appointed pursuant to Senate Resolution No. 168, adopted to investigate the Bureau of Internal Revenue of the Treasury Department, that Earl J. Davis, L. C. Manson, Barbara C. Thomas, are hereby designated as the agents of this committee for the purpose of examining all or any of the income-tax returns filed in the Bureau of Internal Revenue, and to copy therefrom any and all information which may be useful to this committee, at any time prior to the making of a final report by this committee.

(The above resolution was unanimously passed.)

Senator KING. I want to say to the Secretary that we will want some sort of an arrangement as to prohibition also, and at this time I might request verbally that we be given the same cooperation in regard to prohibition matters that the committee desires to go into, but as soon as we get ready for that we will pass a similar resolution designating persons to examine the records in the prohibition department and make such copies as the committee may regard as necessary in the course of our work.

The CHAIRMAN. Of course, we will ask the cooperation of the department in that matter.

Senator KING. I think you may understand that whoever will go there will go as agents, and we will pass the resolution.

Secretary MELLON. There will be no difficulty about that.

The CHAIRMAN. As I said previously, Mr. Frazier, former employee of the Internal Revenue Department, now with the Seaboard National Bank, volunteered some expert testimony concerning the decentralization of the collection of income tax, and if agreeable to the committee I would like to have Mr. Frazier tell us what his experience is and what his recommendations are concerning the decentralization of the work of the Internal Revenue Bureau.

STATEMENT OF MR. FRANK E. FRAZIER

Mr. FRAZIER. I was formerly an officer of the Internal Revenue Bureau and internal revenue agent in charge of the Wisconsin division for a time.

I have not lost interest in the service because of the fact that I have resigned from it.

You gentlemen probably know that there are two large field organizations in the Internal Revenue Service proper aside from the prohibition, one being called the collection service, which is under the supervision of 65 collectors. There are over 7,000 people in that service, something like 2,500 of them being field investigators. That was the number the last time I heard anything about it. That is one force which is primarily engaged in the collection of the internal-revenue receipts and in both the office and field audit of all income-tax returns, 1040-S, and now that has been extended up to \$15,000 gross income.

Then there is the other large force of some 3,000 people who are known as internal-revenue agents and inspectors, under 34 internal-revenue agents in charge. These officers are all under civil service, whereas in the collection service very few are. None of the field collection service are under civil service. The agents and inspectors are men who have passed the regular auditor examinations given at the request of the Income Tax Unit, and practically all of them have taken the six weeks of intensive training in the Income Tax Unit in Washington. I think that on the whole they average up fully as high in efficiency as the auditors assigned to office audit in the bureau in Washington.

At present these 3,000 agents and inspectors do not perform any office audit; that is, the corporation, partnership, and larger individual returns are not kept in the field. They are sent to Washington for office audit. Later some of them, selected by the office auditors in Washington, are sent out to these agents for field audit.

Now, the idea that you want me to enlarge upon this morning is one that has been discussed, I think, very thoroughly by all the officers of the Internal Revenue Bureau, and by almost every man in the service. Every man with whom I have ever talked shop in the service seems to get around to that some time or other during the conversation. I think that the office audit for all corporation returns, with the exception of those audited in the consolidated returns section, and possibly the engineering, should be given the office audit in the field and never come into the bureau at Washington; the fact is that the office audit of something like 7,000,000 returns a year is made in the field, and this work is current, whereas

the office audit of the corporation returns and of the larger individuals in Washington is considerably in arrears.

I believe that the decentralization of the corporation audit, the keeping of the returns in the field, will tend toward accuracy in the office audit—toward speed and toward economy both to the taxpayer and to the Government.

On the question of accuracy I would say that now when additional information is desired—at least that was the case when I was still in the service—on an office audit here in Washington, if it is not the kind of case where the auditor desires to send to the field and have the agent make an audit of the books, a letter is addressed to the taxpayer. To my own knowledge in many cases it takes more than one letter—letter after letter. I had this brought forcibly to my attention in 1921 on a case that was given to me to investigate; a case out of the city, where, as I recall, at least 14 letters were required. I do not think it was an unusual case either. Fourteen letters had been written out to a very distinguished gentleman about his return, and, as I recall it now, these letters extended over a period beyond a year.

This gentleman took the position that the audit should have been made in his home town. There was an internal revenue agent in charge there, and the taxpayer remarked to me that he believed the thing could have been settled on the ground in 5 or 10 minutes. My investigation developed the truth of that remark: That the point would have been settled in a few minutes if you had the office audit in the field where the return was filed.

I would not cite that case if I did not think that it was duplicated many times—thousands of times. I believe that even though the service is improving all the time, that condition must exist to a certain extent still, because the logical place to audit those books, to check over a return is where it is filed and where you can send out a notice for the man to come in and clear up the points that there may be some little dispute about, or some points which may not be quite clear.

Mr. DAVIS. What case is that if you do not have any objection to giving that?

Mr. FRAZIER. I would rather not give the name. The report is on file, and if it is desired by the committee, the bureau officials, I am sure, will give it. The case was one from a city in New England.

The CHAIRMAN. I might say to the gentlemen from the department that if they want to ask any questions of Mr. Frazier, that they may ask questions so that we may get the points clear before the committee.

Mr. FRAZIER. Getting back to accuracy, I would say that this is nothing new which I am suggesting. There are hundreds of men in the service that believe as I do. Already you are auditing millions of returns in the field, giving the office audit there. When one question is asked, the answer often means you must ask another question. If you are writing a letter you are not in a position to follow up promptly the answers that lead to other questions.

Of course you understand some of these returns are filed in cities where we have no head office, but the great bulk of the corporation returns of the United States are filed in cities where we have offices,

and I believe the number of cases that would require correspondence from those offices is very limited.

I believe that there is no question at all about the speed, and that there would be a great saving in time, were corporation returns given the office audit in field offices.

Under the plan followed by the bureau in the office audit of the 1040-A, and the 1040-S, up to \$15,000, there is practically no letter writing. They have completed the office audit of these returns in New York City for the last year.

The CHAIRMAN. Is not that an unusual thing?

Mr. NASH. They are organized better this year. We have, I presume, already audited at least 75 per cent of all returns filed last March.

Mr. FRAZIER. That is where they have the office audit in the field. These are not the big complicated corporation returns. None of those are given the office audit there, but I think they could be. You have the agents' forces already organized; your field deputies now make the office audit of the 1040-A's, and the 1040-S.

Mr. NASH. That is no longer true. That was the procedure when Mr. Frazier was supervisor, but to-day we have an audit division in each collection district.

Mr. FRAZIER. In the New York office, where the work is current, the field deputies have worked the office audit.

Mr. NASH. The audit in New York is being conducted under the direction of the bureau.

Mr. FRAZIER. In auditing the corporation returns, if the corporation returns were left in the field, I would use the entire field force of Internal Revenue agents for a short period after the filing period, in addition to a certain number of auditors whom I would transfer from the bureau at Washington.

The CHAIRMAN. Do you see any objection to auditing the returns in the field?

Mr. NASH. No, sir, not a certain portion of them.

The CHAIRMAN. In discussing this matter with the Secretary, I understood the Secretary to say there was a gradual development of the idea—

Secretary MELLON. That is true.

The CHAIRMAN (continuing). Of decentralizing this work to a greater extent than I understood it to be when Mr. Frazier first brought the question up. The Secretary pointed out the difficulties of jumping at it all at once, and the department did believe in decentralization.

Secretary MELLON. Yes, as I said, my idea was that there was a field for decentralization there, that that method could accomplish all the settlements with better results than the practice that exists. We found obstruction to a complete decentralization, and I think the department has been working up to that as rapidly as possible.

Mr. NASH. Working on the fifteen thousand gross basis, on individual returns, means that practically all the individual returns are audited in the field. There are less than 400,000 individual returns filed in Washington this year, out of a total of over 7,000,000 filed throughout the country.

Mr. FRAZIER. The 1040-A's run up to that themselves, do they not?

Mr. NASH. A little better than 5,000,000. The total may exceed that figure this year.

We also give every taxpayer who is being examined by a revenue agent the opportunity of having his case heard before the revenue agent in charge, before the audit of the agent is sent to Washington. The taxpayer is given a copy of the examining officer's report, and 20 days in which to file an appeal with the agent in charge, before that report is transmitted to Washington. Our statistics show that now in 90 per cent of our tax adjustments the taxpayer and the examining officer reach an agreement before that report is transmitted. When the report reaches Washington it is subject to final review.

The CHAIRMAN. That involves no necessity of his coming to Washington?

Mr. NASH. Unless he has a disagreement it is unnecessary for him to come to Washington. We also have had a traveling committee of the Committee of Appeals and Review traveling in the west, and they have given every taxpayer west of Chicago who desires to have his case heard at some point close to his home the opportunity of having it heard in St. Paul, Kansas City, Los Angeles, San Francisco, and various other points in the west. The committee is sitting in Los Angeles now.

Senator ERNST. Are the disagreements of which you speak frequent or otherwise?

Mr. NASH. Ninety per cent of our cases are closed without any disagreement.

The CHAIRMAN. Is it your disposition to gradually work this out in the whole system?

Mr. NASH. Yes, sir.

Secretary MELLON. That is so, and I think that what has been accomplished since I have been there has been accomplished as rapidly as is desirable and as rapidly as we could safely proceed.

The CHAIRMAN. Then I understand the disposition is to keep on going? There is no disposition to stand in the way, but rather to proceed until it is all decentralized?

Secretary MELLON. We have adopted the policy of decentralization and are putting it into effect as rapidly as it is safe to do so.

The CHAIRMAN. What do the obstructions seem to be in the way of this decentralization work?

Mr. NASH. In the first place there was no adequate place in the field to put the work. We did not have the proper organization.

The CHAIRMAN. You have local offices, do you not?

Mr. NASH. It was not desirable, for administrative reasons, to decentralize entirely into the collectors' offices, due to the fact that the employees were not civil service employees, and they were not people who were paid high salaries, and not people technically qualified to handle the more difficult returns. The classification act has improved that condition somewhat, but, as Mr. Frazier stated, the great number of employees in collectors' offices are not civil-service employees and, therefore, they are employees subject to change in the change of administration.

Senator KING. Are you trying to do anything to remedy the evil to which you have just adverted? I know as soon as the last administration came in (and I am making no criticism of it) they

discharged practically all the collectors and put in people in many districts who were wholly incompetent.

Mr. NASH. You mean by the last administration the Harding administration?

Senator KING. The Harding administration; yes.

Mr. NASH. I do not believe that is true. Prior to 1913 the deputy collectors were civil-service employees. The Overman Act at the beginning of the Wilson administration threw the collection service out of civil service. There has not been any legislation to place them again under civil service. Mr. Frazier was in charge of the collectors' offices at the time the administration changed, and I was working for Mr. Frazier at that time, and there was very little immediate change in the collectors' offices in the appointment of collectors. There was a gradual change in investigating officers in the field. The turnover among the office employees was not much more rapid than among our civil-service employees, and to-day I think I can say that 40 per cent of the employees that were in the collection service during the war are still in the service and still working under our present collector.

Mr. FRAZIER. I was confronted with that Overman Act in 1913, but, nevertheless, at my request Commissioner Roper, with the approval of the Secretary of the Treasury, permitted me to fill all office vacancies in collectors' offices—over 4,000 employees—by appointing clerks; we raised the percentage of civil-service employees in collectors' offices from 22 per cent to 52 per cent. I did that because I found we would go to pieces on the change of administration if we did not have a good nucleus in each collector's office to carry the work through. The work in collectors' offices is complicated; I think Mr. Nash will bear me out in that.

Secretary MELLON. In regard to the collectors, the policy of the Harding administration was not to make changes in collectors; that is, they were allowed to serve the full term.

Mr. FRAZIER. There was no term for a collector, but whatever there was a request—

Secretary MELLON. They were allowed to serve out the full term.

Mr. FRAZIER. There is no definite term provided by law. In some districts there was an understanding that a collector would serve four years, as, for instance, in Cleveland. They agreed, Senators Pomerene and Willis, that the Democratic collector should remain through to the end of the four-year period. There are only 65 collectors; they are presidential appointees.

As to the deputy collectors—

Secretary MELLON. That was observed by the Harding administration.

Mr. FRAZIER. Yes, sir.

The CHAIRMAN. What was your experience with the way the collectors in the field carried on the work as compared with the way it was carried on at Washington?

Mr. FRAZIER. The agents' force in the field, as far as the audit of returns is concerned, is performing a much higher grade of work than is required of deputy collectors. Agents must be real auditors if they are to audit these corporation returns at all accurately. They are required, as I said before, to pass a stiff examination provided at

the request of the income tax unit. In the collection service, where all deputy collectors are appointed without regard to civil service rules, we get some good men, but we get some inefficient ones. On an average I would say that the field force of the agents, of course, is naturally of much higher grade than the field force of deputies. You pay them more, give them a chance for permanent tenure of office, where, in the case of the deputy collector, if you say "Get out," no matter how good he is, he goes.

In collectors' offices, I think we have a very good service, a very efficient force of people. I believe as a rule, you will find a little more "pep" in the field than you will find in Washington. That has been my experience.

Senator KING. Do you think that the decentralization carried to the extent you have indicated, would affect the audits in the respective fields: that is to say, might not the local officials be predisposed to favor too much the local taxpayer, whereas an audit here by persons not neighbors, not in close contact with the taxpayer, would be presumed to be a little more impartial?

Mr. FRAZIER. Senator, I would say if this office audit of corporations were performed in agents' offices, where as already stated the commissioner with the approval of the Secretary of the Treasury, has control over the appointments, I do not believe you would have the least bit of trouble along that line. I was for a time an agent in charge, and I did not have a single request from any man in political life for a favor in regard to the personnel, or a tax case, or in regard to an assignment of a particular man to a tax case.

Mr. HARTSON. Mr. Davis asked what the objections were to immediate wholesale decentralization. I would like to have you explain to the committee what some of the objections are to putting it into effect immediately.

Mr. FRAZIER. I will answer that by saying that if I were commissioner, and had the backing of the Secretary, I would start tomorrow to decentralize the office audit now performed in Washington.

Mr. HARTSON. You have an organization?

Mr. FRAZIER. There is a pretty good organization, an agent in charge, with reviewers and chief reviewers, in many cases men who have been auditors in Washington, and who I think are just as good as you will find in Washington. You have an organization there, but you would have to build up by transferring some auditors from Washington.

Mr. HARTSON. You would have to perfect the organization in the field to start with, would you not?

Mr. FRAZIER. Augment it.

The CHAIRMAN. How would you start out?

Mr. FRAZIER. I would start by picking out a unit, one agent division or collection division. I might start at Chicago—

Mr. HARTSON. Would you have as the ultimate purpose final decentralization to the extent of eliminating any audit in Washington?

Mr. FRAZIER. All of it, except as was stated.

Mr. HARTSON. Point out some of the cases which arise—cases which require a centralized audit.

Mr. FRAZIER. The consolidated returns. Also, I think that with such a small force as you have of engineers it would be pretty hard to divide them. I would look carefully into this, however, with a view to decentralizing that work, if possible.

Mr. HARTSON. Some of the returns under a complete decentralization would stay in Washington?

Mr. FRAZIER. I would keep the consolidated returns audit intact. I would not disturb that. I would keep the natural resources—engineers—

Mr. HARTSON. Would you keep them here?

Mr. FRAZIER. Yes, sir.

Mr. HARTSON. Why would you audit them here?

Mr. FRAZIER. My only thought is that it is a small force of highly technical men.

Mr. HARTSON. Four hundred.

Mr. FRAZIER. You have 75 engineers.

Mr. NASH. There are about 400 employees in the engineering division.

Mr. FRAZIER. Well, it is quite possible that could be decentralized to advantage, but I would not want to recommend that until given an opportunity to make further inquiries. If I were called upon to make a recommendation right now I would not recommend the breaking up of the consolidated returns section or the natural resources section.

The CHAIRMAN. Why not the natural resource?

Mr. FRAZIER. Until I had made a survey and had seen if a large portion of that work was in a particular section of the country. If it is scattered you would have to scatter the force; as I understand, it is highly technical. It is one you have the most trouble with.

The CHAIRMAN. It is difficult?

Mr. FRAZIER. It is my impression, as I have stated, without having made a survey.

The CHAIRMAN. You stated that by a process of decentralization, or a complete decentralization, as far as possible with those exceptions, you could do away with any great expansion in building and facilities for housing the tax unit in Washington?

Mr. FRAZIER. Yes; do away with that problem here. There would be an expense in the field in providing space for these auditors. You would not have the same number of clerks; the proportionate number in the field would be less than in Washington. You have so much correspondence in Washington that you would not conduct in the field. I do not know what the ratio is of clerks and auditors, but I know that it used to be very high, one to one, something like that, whereas in the field you would find it one to five. You would not need more than one clerk to five auditors in the field.

The CHAIRMAN. One of the things that antagonizes the taxpayer and creates delays is the eternal correspondence and delays over trifles, and as the witness suggested, the asking of one question and the answer thereto suggests a further question, and the case is drawn out, and as the case is drawn out the taxpayer becomes annoyed, and in addition to that there is an enormous overhead of stenographers and clerks to dictate letters and write letters, and you know the average production of stenographers who produce the letters, and

the filing of all those—the production of letters is a very small per cent of what it should be. They do not get up any great production, these clerks and stenographers do not.

Secretary MELLON. If you had lived with the department for the last three or four years as I have, you would have found that that situation has been very greatly improved.

Mr. NASH. In addition to the conference that the taxpayer has with the agent in charge, we have been experimenting for the last six or eight months in eight revenue agents' districts. They are Baltimore, Md.; Greensboro, N. C.; Columbia, S. C.; St. Paul, Minn.; Milwaukee, Wis.; New Haven, Conn.; Cincinnati, Ohio; and Buffalo, N. Y. Every case in any of these districts that involves the assessment of an additional tax against a taxpayer is sent out to the agent in charge of that district. He notifies the taxpayer of the proposed assessment to be made against him, and the taxpayer has the opportunity of appearing before the agent in charge and discussing his case at the office closest to his home.

I believe that the primary object of decentralization is to bring the final settlement of a tax case close to the home of the taxpayer, and that is what we are doing in these eight districts. During the last three months we have organized our internal-revenue agents' districts into supervisory districts. We have now eight supervisory districts and eight supervising agents. The supervising agents are in the field to-day going through each of the offices under our direction, with instructions to make on October 1 recommendations as to the further extension of the experiment we have been conducting in the last six or eight months. The ultimate result is going to be that every case that involves an additional assessment against the taxpayer is going to be taken out to the field, and the taxpayer will be given an opportunity to have his case heard in an office close to his home. This is the procedure that we are working on. I think it would be an impossible task to tear up our files at Washington and send out these old cases that have been hanging fire for years and that have been worked on for two or three years.

The CHAIRMAN. I think that is so.

Mr. NASH. I do think we are approaching the day when 95 per cent of our cases will be settled in the field and there will only be 5 per cent or less that will come to Washington, and they will be cases of the type Mr. Frazier described, such as natural resource, consolidated, etc.,

Mr. FRAZIER. Is there anything to be gained by the return coming in at all? They are all coming in now to Washington.

Mr. NASH. The decentralization of our bureau must be a process of evolution. We have not the organization in the field to-day to handle immediate decentralization. I do not see anything to be gained by experimenting in one district.

Senator KING. Yet you are experimenting in eight.

Mr. NASH. We are not experimenting to leave all returns in any one district.

The CHAIRMAN. Why is not that a good way?

Mr. NASH. It will require the building up of another organization, the acquiring of additional space. The expense involved is not necessary. We are satisfied now as to what the result would be.

Mr. FRAZIER. I think you would find it much less expensive to audit them that way than to bring them into Washington, with the help required; I think your expenses would be found, on experimentation, to be much less in the field.

Mr. NASH. We give all corporation returns that come into Washington a preliminary audit as soon as they are received, and not over 50 per cent go through the intensive audit.

The CHAIRMAN. What is the preliminary audit?

Mr. NASH. To ascertain the correctness of the return as soon as it is received. Fifty per cent of the corporation returns filed are correct, and they can be ascertained to be correct in a short time, and those returns are immediately filed and put out of the way, unless a claim of some sort subsequently brings them up.

The CHAIRMAN. That could be done very easily in the field, could it not?

Mr. NASH. Eventually; yes, sir.

The CHAIRMAN. You say "eventually; yes."

Mr. NASH. When our organization is properly developed for the purpose.

The CHAIRMAN. How will you develop it if you do not try it out?

Mr. NASH. I think we are trying it out. We have appointed eight supervising agents in the field to-day on this very work, and the whole tendency is to gradually reduce the force in Washington and increase to some extent the force in the field.

I agree with Mr. Frazier that it will never be necessary to build up the large organization in the field that we have had in Washington. It was war-time organization we had here, built up to meet an emergency, and it is gradually being reduced.

Mr. FRAZIER. I think the reason for centralizing this work in Washington is stated in the annual report of 1920, page 9. The law was so complex. There had been no opinions rendered on the regulations. They were compelled, in order to get any uniformity, to centralize the work for the time being. I do not raise any question on that, but in the same annual report you will find that it was the purpose originally to centralize during an emergency period only, and later to decentralize. That was four years ago. This is nothing new.

Mr. HARTSON. I would like to place emphasis on some of the objections that may be raised to decentralization, which have not been pointed out. I think the testimony you have heard so far shows the department is proceeding slowly toward an end that everybody concedes is desirable, if it can be accomplished without loss of efficiency.

The trouble with decentralization has been that it promotes a lack of uniformity in the rulings. We have had income tax laws in this country only since 1913, and we have had a number of different laws since that time. We have had a change in regulations each time. In the meantime the war came on and changed our whole system of taxation. We have another law in 1924. The war emergency superimposed the personnel problem on the changes in law. The result was a tendency that could not be humanly avoided to decide a case one way, and a different taxpayer with the same tax having his case decided another way. We have been charged with having conflicts

in rulings and, as a matter of fact, in Washington the same thing has taken place where two branches of the same office have been inconsistent. So that dealing with a new law, Mr. Chairman, dealing with a thing that the whole country, the taxpayers and the Government representatives, as well, were relatively unfamiliar with it has been, and still is, necessary to educate a force of men and to educate the taxpayers as well.

I think that it is absolutely essential to go slowly, and my own view of it would be to move slower than the head of the bureau at the present time thinks we ought to move. It is desirable to get the case of a taxpayer settled, but it is more important to the same taxpayer to be treated on the same basis precisely that another taxpayer in another jurisdiction is treated. Unless there is some centralization of our rulings, and unless there is a grouping together in a place for the purpose of education, you will have hopeless confusion over the United States.

Mr. FRAZIER. I do not think there is any danger of confusion now if you retain your present rules and regulations section and your solicitor's office. Every change in ruling and new decision would be promptly given to the field through the bulletin service, which is already established.

Mr. NASH. That is true, if you could have your legal office established in Washington and maintain it there.

Mr. FRAZIER. Yes, absolutely.

Mr. HARTSON. I would not want to estimate the number of purely legal questions that arise in the settlement of all returns. They are countless. It would be desirable to centralize the engineering force in one place. It should be remembered that the difficulty does not stop with the arrival of the answer to the legal proposition. This answer must be given application to some particular state of facts in the field, and the solicitor's office might decide a legal proposition which had a broad, general application. The opinion would go to New York and New Orleans for application there, and it might be applied in the two places quite differently, whereas if both returns were in Washington and if they were considered and audited under the same supervision there would be a better opportunity for the uniformity of the application in the settlement of those two cases.

Now, there is a time coming, and it is happily nearer to-day than it was a few years ago, when principles are going to be well established, and there will not be the dispute over the minutiae of details which come up in the legal work in the settlement of these cases. When that time comes I believe you can safely send out to the field the responsibility of settling these cases. The reason they have started to do it in regard to individuals and have not extended it to corporations is the proof of the points that are raised here, because there are fewer complications with individuals than corporations. There is a maze of difficulty in the settlement of the corporate cases, and the bureau is moving ahead with them more slowly.

Since Mr. Frazier's report, or the report mentioned by Mr. Frazier, was made in 1920, in which it is said that the war organization was built up in an emergency, the succeeding administration

has in good faith followed out the recommendation made at that time. There is a progress to-day, and there has been progress since Mr. Mellon came down. The greatest harm would result from conflicts in adjustments in different parts of the country.

Mr. FRAZIER. I think that danger has gone by.

Senator KING. You have to keep pretty close check over every section that was authorized to promulgate decisions, because, just as Mr. Hartson pointed out, there are bound to be, in the uncertainty now in the construction of the statute, certain rulings, and there would have to be some way by which a reconciliation could be had by appeal either by the Government or defeated taxpayer to the central organization in Washington.

Mr. FRAZIER. There would not be any ruling at all made by the force in the field. The agent in charge, he would do as he is doing now, follow the instructions given him by the solicitor and commissioner.

Mr. HARTSON. That is a ruling you have reference to. It is the application of an opinion to a particular state of facts, which in an individual case amounts to a ruling on that man's case.

The CHAIRMAN. It is obvious to me that you could have a crew of reviewers which would pick out these cases, if they went around to the various districts, without the necessity of all of them coming to Washington; that is applicable in industry, where you maintain large branch houses, just as well as in the Treasury Department; for instance, claims for replacement or automobiles, where different rulings may be applied by different managers, but the difficulty is not insurmountable, because you can have traveling men who can see that the rulings are applied equitably and on the same basis in all the districts. I can visualize that a man sitting in Washington, getting all the difficulties, could see them to be larger than the man with his nose to the grindstone all that time. I do not think the difficulties are as great as you point out, Mr. Solicitor. It is a difficulty, but not insurmountable.

Secretary MELLON. In some of those cases it is surprising how difficult those points are, the amount of money involved; there is a very large amount of money involved, which runs into the millions.

The CHAIRMAN. These traveling solicitors you have could see that the rule which had been adopted by the Washington office was applied to all the districts, which would be much more simple than requiring that all the returns be sent to Washington—

Secretary MELLON. There is a very great responsibility frequently involved in a case, and it is important that the law should be applied the same in all cases.

The CHAIRMAN. I admit that, but I do not admit it is necessary for it to come to Washington to be done. The reviewers can travel around, and the case can be opened.

Secretary MELLON. When you arrive at a place where the law has been settled long enough, where we have a new law, when you become familiar with all the principles, then a good bit more can be done.

The CHAIRMAN. We will never come to that time if you will postpone it until that time, because there must be internal changes.

Secretary MELLON. We have a conference for to-morrow to go over the regulations under the new law about which there are questions.

The CHAIRMAN. Did you have any more to say, Mr. Frazier?

Mr. FRAZIER. I am merely interested in the service. I was in the Government service for over 20 years, and that is one reason I am glad to be here. I feel very deeply that the bureau could help itself out of this accumulation they still have on hand, the accumulation of returns, if it would really try this out. They have had such good success with the less important returns; I think decentralization of the audit of corporation returns is worth a trial. That is my whole attitude, and I believe that so deeply that I am glad to be here to give my opinion. I will say that I have not talked with any officers of the Internal Revenue Service, with the exception of two or three, who favor maintaining a centralized audit. Many of the men in the Government service are afraid.

The CHAIRMAN. What about economy to the taxpayer and the Government with reference to decentralization?

Mr. FRAZIER. As the head of an income tax division in a large office once told me, every week and sometimes many times a week, taxpayers come to him with letters from Washington on an office audit and say, "What does this mean?" The head of the income tax division is loath to give any information on a case without having all of the papers, including the return itself, before him. He says, "I can not tell you much; here is the regulation," and before the taxpayer departs, the taxpayer himself suggests, "I had better go to Washington," and the officer says, "Yes; you had better go to Washington."

That particular city is no exception to the rule of cities nearer Washington.

Then, too, if an office auditor is on a case and sends out for a man to come in, the man comes in promptly. If he writes a letter that case is cold when he gets a reply, and it takes time and expense to dig into and go over the case again to refresh his memory.

The CHAIRMAN. What happens after he gets to Washington? Does he employ a tax expert?

Mr. FRAZIER. Undoubtedly a large majority of them do. Were the man able to come in and talk his case over and appeal to the officer in charge, who is right on the ground, and who has fresh in his mind the details of the case, there would be little delay, and the audit would be effected at an economy to the Government, as well as to the taxpayer.

The CHAIRMAN. Mr. Secretary, do you have any more you wish to say before we adjourn?

Secretary MELLON. I do not know of anything.

The CHAIRMAN. Would you be able to state how much it would cut down the force in the Washington office, the decentralization?

Mr. FRAZIER. I should make a survey of the income tax unit before making an estimate, but I would say this, you would reduce your clerical force very largely, that is, your net decrease would be very large, because of the fact that you would have so much less correspondence with the office audit performed in the field. Offhand I would say that with the decentralization, complete decentralization,

as far as you can go properly, you would more than cut the income tax unit in two, as far as Washington is concerned.

The CHAIRMAN. The committee desires to thank you, Mr. Frazier, for coming down from New York and telling them what you have, because the committee is interested in anything constructive, in any constructive service helpful to the Government.

Senator KING. Mr. Hartson, would it be advisable, if it could be done, to bring all these returns, which now are found in seven buildings into one building?

Secretary MELLON. It certainly would, but you have to have the floor space for it.

Senator KING. I was wondering whether or not many of the returns in some of the seven buildings had not been disposed of so that there would be no necessity of referring to them, which would obviate the necessity of consolidating them in one building.

Mr. HARTSON. The necessity constantly arises to refer to old returns, just as in the case of 1916 returns that the committee now wants information on. It would be highly desirable to put them in one building.

Mr. NASH. The 1916 returns are put away in one building, and to get any information we will have to bring them up out of the basement. Our other returns from 1917 on are active. You probably recall legislation that went through last March which permitted the filing of claims on these returns. There have been filed 9,000 claims in connection with 1917 cases that were previously closed.

The CHAIRMAN. Cases closed, and the people are insisting on refund?

Mr. NASH. Nine thousand claims affecting 1917 cases have been filed since last March, when this last legislation was made effective. I think that at least 20,000 claims have been filed affecting 1918 cases. I might say for the committee that our returns are now filed in temporary buildings, a great number of them, all the way from Sixth Street to Twentieth Street, and it would not be surprising any day if something should happen and we would lose many valuable papers.

Secretary MELLON. The cost of the service of getting papers consolidated has been estimated at, the lowest estimate which has been made by anyone, has been a half million dollars a year. I think a million dollars a year is about the figure it costs.

Mr. NASH. It will cut our administrative cost \$1,000,000 a year in Washington, any day that we could move into one building.

Secretary MELLON. And pay for the building in a reasonable time.

Senator KING. Is it not possible to get a building sufficiently large for your purpose?

Mr. NASH. It has not been possible so far.

Secretary MELLON. We made desperate efforts to get a large area. We tried to get the Arlington Building, but these buildings are occupied. We tried to get some place where we could have more room in the same building.

Senator KING. It seems to me the Arlington Building and the Treasury Building would be sufficient.

Mr. NASH. The Arlington Building would house our Bureau completely to-day.

Secretary MELLON. We made desperate efforts to get that but it was impossible.

Senator KING. I appreciate the problem, and I think Congress ought to aid you in solving that problem, even if we have to put some of the other bureaus out, and arrange them elsewhere. This is so important. This is vital to the Government.

Mr. NASH. Our engineering files, they cost millions of dollars to build up and acquire, and involve the valuations of all the oil wells, mines, and timber lands of the country, are kept down here in a temporary building. If they were destroyed they could never be replaced except at an enormous cost. We can not get space in a permanent building for them.

(Supplemental testimony of Mr. Frazier is here printed in full, as follows:)

Mr. DAVIS. Mr. Frazier, tell us of your experience in the Government service. What department were you with prior to your service with the Bureau of Internal Revenue?

Mr. FRAZIER. Upon receiving my discharge from the Army, at the close of the Spanish-American War, at the age of 19, I entered the Government service as a railway postal clerk on the Chicago & Minneapolis R. P. O., having passed a competitive civil-service examination for that position prior to the outbreak of the war. I served later in the Philippine postal service, in the office of Second Assistant Postmaster-General at Washington, approximately five years as a post-office inspector in Cleveland and Minneapolis; then assistant chief clerk of the Post Office Department under Postmaster General Hitchcock; then chief clerk to First Assistant Postmaster General; superintendent of mails at Philadelphia; two years in the Army during the World War; Assistant supervisor of collectors office, Bureau of Internal Revenue; then supervisor of collectors offices for the United States; revenue agent in charge for the State of Wisconsin.

Mr. DAVIS. May I inquire—you were a civil-service man and politics had nothing to do with your service?

Mr. FRAZIER. Every position I held in the Government service was strictly in the classified civil service. I was not even an applicant for the better positions which I held in the Government service.

Mr. DAVIS. I am told you were and still are friendly with Commissioner Blair and the other officials of the bureau?

Mr. FRAZIER. I am glad to be able to say that every Commissioner of Internal Revenue under whom I served is a friend of mine, and I am a friend of his. They are all men of the highest integrity and ability. I felt deeply loyal to them while I was in the service, and I have lost none of that sentiment since leaving the service.

Mr. DAVIS. Your duties with the bureau really began when the problem of administering the income tax law first arose under President Wilson's term and with former Commissioner Roper in charge?

Mr. FRAZIER. Yes, sir.

Mr. DAVIS. Mr. Roper's thought in bringing you with the service was that your work in the Post Office Department fitted you for the job?

Mr. FRAZIER. Yes, sir; that is my understanding.

Mr. DAVIS. Your work in the Post Office Department related to the problem of organizing the field forces, did it not?

Mr. FRAZIER. During the last several years; yes, sir.

Mr. DAVIS. And your work with the bureau was that of organizing and directing the field forces?

Mr. FRAZIER. Yes, sir.

Mr. DAVIS. It was your problem, then, to build up this organization?

Mr. FRAZIER. That was my principal responsibility during the last few years of my service in the Post Office Department.

Mr. DAVIS. You were in charge of that work for how many years?

Mr. FRAZIER. I was in charge of the organization and management of internal revenue collectors' offices two and one-fourth years.

Mr. DAVIS. That was a longer period of time—or your experience, then, covered a longer time than that of any of the present officials?

Mr. FRAZIER. Yes, sir.

Mr. DAVIS. When you left the Washington office you went to take charge of the Milwaukee office of the bureau?

Mr. FRAZIER. Yes, sir.

Mr. DAVIS. What territory did that cover—the territory over which it had jurisdiction?

Mr. FRAZIER. The State of Wisconsin.

Mr. DAVIS. Could you describe for us the personnel of the office—that is, how many men, what their duties were, and, without mentioning names, what their qualifications were?

Mr. FRAZIER. An average of 6 clerks, 5 estate-tax agents, 65 income-tax agents. With the exception of about five of the income-tax agents they were all well qualified to audit difficult corporation income-tax returns. Several of them were competent to audit the most difficult consolidated corporation cases. All of the above employees were in the classified civil service. In this connection I desire to state that these agents and clerks were so efficient that during the last three months of my administration of the Wisconsin division it stood first in the United States.

Mr. DAVIS. Under the present system, Mr. Frazier, is there not some time when necessarily men are without work to do? In other words, it has been reported to us that in one district at least accountants who are as well qualified as any in Washington complete the cases up to \$15,000 and then are not permitted to work on the big cases, although they might have time to do so?

Mr. FRAZIER. This opens up the question as to the necessity for two forces of income-tax auditors in the field. You are undoubtedly referring to deputy collectors, not to agents or inspectors. Deputy collectors are appointed politically and serve under collectors; they audit the 1040a returns, and now they also audit 1040 returns up to \$15,000. If Congress would repeal at once that section of the Overman Act of October 22, 1913, which threw deputy collectorships out of the civil service, the necessity for two organizations of field men to do similar work would be done away with and a great economy effected. While still an officer of the Bureau of Internal Revenue I went on record to the effect that \$3,000,000 could be properly taken from the estimates if this were done. Under the present law deputy collectors look upon their positions as temporary ones; consequently the most efficient seek other positions, and when a change in administration comes you lose the greater part of

these men who have been trained at the expense of the Government. Repeal the Overman Act, consolidate all of the field forces excepting the prohibition forces, throw the office audit of practically all individual, partnership, and corporation income-tax returns to the field, and you will see the work of the Bureau of Internal Revenue current in a very short time, and you will find that the appropriations for the bureau and field can be reduced by several million dollars at an early date.

Mr. DAVIS. The objection some time has been that the organization is not made for the handling of the work in district offices; but where the organization is not so made, could not it be changed and without trouble, so that a certain number of qualified attorneys, accountants, perhaps two engineers, stenographers, and so on, could be located there?

Mr. FRAZIER. That is a simple problem.

Mr. DAVIS. For example, let us suppose that to-morrow morning Commissioner Blair said the administration would be decentralized as much as possible, that the consolidated section and the engineer section would not be so decentralized for the present at least, is there any good reason you know of that something like this could be done? For example again, suppose he should write each one of the agents in charge of a district that after January 1 or some reasonable date in the future the administration of the tax law, say, in Michigan, was to be in the hands of the agent at Detroit. Say that the agent was to be entirely responsible; he was to handle and review all the returns; the responsibility for accuracy and justice and fairness was to be put upon him; the taxpayer might have an appeal to Washington reserved, but in that event a special examiner from Washington would be sent to Detroit to act so the taxpayer would not have to come to Washington; then let the agent know that an inspection organization was to be had working out of Washington and that from time to time the work in Detroit would be subject to review and accounting without notification to the agent in charge; then call on the agent to report on his organization—what he would need in the way of additional help, how he could provide quarters for them and the expense involved, and assure him that his future standing in the service was to be judged by his record of accomplishment and expense; do you not think that with such a determination expressed by the commissioner, the organization could be rapidly reorganized and without great trouble?

Mr. FRAZIER. Yes, sir. Under the present plans the appeals board members will sit in the various cities, and there would be practically no occasion for an appeal to be heard in Washington.

Mr. DAVIS. Take your Milwaukee organization, for example. What trouble or inconvenience would such an order have put you to? How long a time would you have required to get your organization reorganized? What would have been necessary in the Milwaukee organization? Have you a good idea as to the necessity for additional room? What would have been required in this way?

Mr. FRAZIER. Practically the only change necessary would be the addition of a few auditors from Washington. It is my personal opinion that with the cooperation of the collector at Milwaukee we

could have worked out a space rearrangement that would have taken care of the additional auditors and the files. You understand that it is my firm opinion that with the throwing of the office audit to the field offices we would very soon be current; hence, it would not be necessary to provide for a permanent enlargement of the offices. For instance, we could double up the field men for their office work; for the time being have two or three field men alternate in using desks, and thereby make room for the additional auditors. I would add about 20 agents and 4 clerks to the Milwaukee force by transfer from Washington. Place all of the auditors, both field and office, on the same basis; call them all agents; use them on office or field audit, or both; after repeal of the Overman Act combine this force and the field force of the collector's office; do away with a large overhead expense. Make a drive each year with this combined field force, first on office audit, and then on field audit, keeping a part of the force on office audit the year round.

Mr. DAVIS. There is an objection advanced on the ground of uniformity in decisions? Has not it been your experience that under the present system uniformity is not obtained even within a unit in Washington?

Mr. FRAZIER. My answer to the question is: Under no circumstances, in Washington or any other city, is it possible for one man to pass on every disputed point. The auditor must be guided by the decisions and opinions already rendered. The field men already have just as complete information on these decisions and opinions as have the Washington officials. The periodical bulletins issued by the bureau go to all auditors, both in Washington and in the field.

Mr. DAVIS. Objection is made to decentralization in so far as consolidated returns are concerned, and I believe you agree with that objection. Tell us in detail what a consolidated return is—take one company, for example. Could not that company's returns be handled by the agent in charge of the district where the head office is, and would they not be handled just as effectively if not more effectively than from Washington? Most of these consolidated returns apply to the corporations which have a head office and which have books covering the entire concern in the head office from which the tax returns are made, do they not?

Mr. FRAZIER. Under article 632, Income Tax Regulations No. 62, affiliated corporations are required to file consolidated returns. Article 633, regulations No. 62, reads as follows:

When corporations are affiliated.—Corporations will be deemed to be affiliated (a) when one domestic corporation owns directly or controls through closely affiliated interests or by a nominee or nominees substantially all the stock of the other or others, or (b) when substantially all the stock of two or more domestic corporations is owned or controlled by the same interests. The words "substantially all the stock" can not be interpreted as meaning any particular percentage, but must be construed according to the facts of the particular case. The owning or controlling of 95 per cent or more of the outstanding voting capital stock (not including stock in the treasury) at the beginning of and during the taxable year will be deemed to constitute an affiliation within the meaning of the statute. Consolidated returns may, however, be required for any taxable year beginning prior to January 1, 1922, even though the stock ownership is less than 95 per cent. When the stock ownership or control is less than 95 per cent, but in excess of 70 per cent, a full disclosure of the affiliations should be made showing all pertinent facts, in-

cluding the stock owned or controlled in each subsidiary or affiliated corporation and the percentage of such stock owned or controlled to the total stock outstanding. This information will also be required where like conditions exist and the taxpayer elects to file a consolidated return for any taxable period beginning on or after January 1, 1922. Such statements should preferably be made in advance of filing the return, but if a consolidated return is filed subject to the approval of the commissioner, the required statement should be filed as a part of the return. The words "the same interests" shall be deemed to mean the same individual, partnership, or corporation, or the same individuals, partnerships, or corporations, but when the stock of two or more corporations is owned or controlled by two or more individuals, by two or more partnerships, or by two or more corporations, the corporations will not be held to be affiliated unless the percentage of stock of such corporations held by each individual, each partnership, or each corporation is substantially the same in each of the corporations.

I think all questions as to affiliation should be considered at a central point—Washington.

Mr. DAVIS. Would not a short trial and study of the system give fairly accurate knowledge of the divisions where an engineer or more than one engineer would be needed, so that the engineering squad need not be centered in Washington or centralized here, don't you think? If anything, a very small flying squadron of engineers might be kept in Washington?

Mr. FRAZIER. I would not like to make a recommendation in regard to this phase of the audit prior to making a personal survey. I believe a survey should be made at once.

Mr. DAVIS. Or would the decentralization of both the consolidated and engineering sections cause any loss in efficiency and economy to both the taxpayer and the Government?

Mr. FRAZIER. I should not feel like making a definite recommendation beyond the suggestion that your question should be given careful consideration. I think I could reach a definite conclusion on this after a two or three weeks' investigation.

Mr. DAVIS. Now, we come to the objection as to the old cases pending. Even though these cases have been centered into Washington, could not they be more rapidly handled if returned to the divisions with instructions to close—and close at once?

Mr. FRAZIER. Undoubtedly. Put them out into the field at once, where the information necessary to a closing can be readily obtained.

Mr. DAVIS. Mr. Frazier, you have been an advocate of decentralization for some years; you made a study of it and some reports, did you not? When did you make these reports and to whom?

Mr. FRAZIER. Along with other officers of the Bureau of Internal Revenue I always was deeply interested in the administrative problems confronting the bureau. In February, 1921, following an investigation in Boston, Mass., I submitted to former Commissioner Williams, for the information of former Secretary of the Treasury Houston, a report. In the concluding paragraphs of that report I recommended decentralization of the office audit of income tax returns. When General Dawes first took up the office of Director of the Bureau of the Budget I was questioned for two days by Hon. Henry M. Dawes, and Mr. Abbot, of the Budget Bureau, regarding my own unit, the office of supervisor of collectors, as well as the bureau as a whole. In response to the questions asked by these gentlemen I stated that I favored decentralization, and I gave them my reasons for taking that position.

In submitting in 1922 or 1928 a summary of changes recommended in internal revenue laws, I included a paragraph recommending decentralization, although no change in law is necessary to effect decentralization. As indicated in answer to a previous question, however, a repeal of a part of the Overman Act of October 22, 1918, would result in great economy and make decentralization more successful.

Mr. DAVIS. What was the result of these reports? Was there any objection made to your findings or any consideration given them?

Mr. FRAZIER. I was given to understand that objection was made by the head of the Income Tax Unit.

Mr. DAVIS. Suppose a case came up of an overpayment of taxes by a man in Texas, a man with little business experience; is it not your opinion that if that man was dealing with Dallas, and the Dallas office was intent upon justice and fairness and efficiency, and dealing with only the comparatively few returns in the Dallas division, it would be far more possible the taxpayer would be notified of his overpayment? The tremendous volume or mass of work that centralizes into Washington is an inducement or encouragement to faulty practice or illegitimate practice, is it not?

Mr. FRAZIER. In many cases, undoubtedly, taxpayers would be able to settle their cases on the ground, without feeling it necessary to engage counsel; whereas, because of the fact that the audit is now centralized in Washington, they feel that they should employ the services of counsel or a tax expert. The delays incident to handling the work under the centralized plan undoubtedly induce taxpayers to employ experts or lawyers, simply in the hope of getting a decision promptly.

Mr. DAVIS. Mr. Frazier, there is one other question not related entirely to centralization: Congress is attempting at all times to simplify the law and also to check up loopholes or faulty spots in the law. The bureau helped some recently, and we are advised that the suggestions came to the Congress after lawyers had studied the questions coming into the solicitor's office. That was fine. But to increase the efficiency and improve the morale of the organization would it not be well for Congress to court the assistance and cooperation of all the men in the field? The accountants who handle returns and see the developments, must develop much information and many ideas on the tax problem. Suppose, as in the Post Office Department, Congress should set aside a small reward or a number of small rewards for the best tax suggestions received during the year, that the contest was open to all bureau employees and that the suggestions were to be sent to the Senate Committee on Finance and the House Committee on Ways and Means, and to be public records? Now, let us see what would result or we might hope would result? Would not, if encouraged, an accountant in your Milwaukee office develop some definite information as to a loophole in the law or bad practice, write his suggestions, if he knew the Congress and the bureau approved his effort, encouraged it and urged it? Would Congress not get a tremendous value out of this and would not it improve the morale of the service and more and more unite the men in their effort for better Government? Or what do you think of this

idea, and have you any suggestions to make? Is there any good reason why the bureau should object to it?

Mr. FRAZIER. About two years ago the bureau called on its field officers to suggest desirable changes in the internal-revenue laws. I think this practice should be extended so as to call on all employees of the service for suggestions, not only as to desirable changes in the laws, but desirable changes in administrative procedure. I think all of these suggestions should come to the Commissioner of Internal Revenue. The Congress might properly require the commissioners to submit annually a report summarizing all suggestions received, together with a statement as to action taken on the suggestions. I believe that the authorization of awards for the best suggestions would bring fine results.

The CHAIRMAN. We will adjourn now and meet in executive session at 1 o'clock p. m.

(Whereupon, at 1 o'clock p. m., an adjournment was taken to meet at call of the chairman.)