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## TAX SIMPLIFICATION BOARD.

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LETTER FROM THE TAX SIMPLIFICATION BOARD TRANSMITTING,  
PURSUANT TO SECTION 1327 OF THE REVENUE ACT OF 1921, A  
REPORT OF THE ACTIVITIES OF THE BOARD.

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TREASURY DEPARTMENT,  
TAX SIMPLIFICATION BOARD,  
*Washington, December 2, 1922.*

The PRESIDENT OF THE SENATE.

SIR: In accordance with section 1327 of the revenue act of 1921, the Tax Simplification Board makes the following report:

The Tax Simplification Board was created by the revenue act of 1921, section 1327, and was organized on December 2, 1921. The work of the board during the first year has been seriously interrupted by the deaths of Mr. W. T. Abbott on May 29, 1922, and Mr. J. H. Beal on August 18, 1922, two of its members representing the public. Their successors were appointed on September 26, 1922.

The board found it necessary to be in almost continuous session for several months after its appointment, much of this time being taken up with the revision of the regulations made necessary by the passage of the revenue act of 1921 and the revision of the forms of returns to be made by taxpayers under that law.

Before discussing the various matters considered by the board and its recommendations it may be helpful to review some of the problems inherent in the present method of taxation with which the Bureau of Internal Revenue has been confronted.

The Bureau of Internal Revenue is charged with the duty of administering all laws relating to internal taxation and the collection of the revenues arising thereunder. Prior to 1909 it was engaged in the collection of stamp and excise taxes almost exclusively. With the passage of the excise law of 1909 imposing a tax of 1 per cent upon the net income of corporations, the bureau began to develop along the lines of income taxation, but the amount of the tax so collected was relatively small prior to the passage of the revenue act of 1917.

The revenue act of 1917 was the first to make provision for an excess-profits tax which was imposed upon individuals, partnerships, and corporations engaged in business. The revenue act of 1918 revised the income and excess-profits taxes and limited the latter to a tax on profits of corporations. It also extended the list of other taxes. The revenue act of 1921 again made substantial changes in the forms of taxation as well as in the rates, many of the miscellaneous taxes were reduced or repealed, and the excess-profits tax law was repealed as of the end of 1921.

The frequent and radical changes in the tax laws have added materially to the administrative difficulties of the bureau and have caused a substantial increase in the volume of its work. This increase came at a time when the country was in the midst of its war activities and it was impossible to secure a personnel adequate to cope with the situation. As a result, there have been inevitable delays in the settlement of taxes and a large accumulation of unfinished work. The opportunities of other and more remunerative employment that came to men having some knowledge of tax law and its administration have resulted in a high percentage of personnel turnover, thereby causing a further retardation of the work.

While much thought and consideration have been given in this country to tax legislation, comparatively little attention has been paid to the equally important and difficult subject of tax administration. Countries having larger experience in income taxation have made more adequate provision for administration, and it is the opinion of this board that it is important that study and thought be given to this subject.

A brief discussion of some of the major problems arising in the administration of the tax laws which have been imposed by the revenue laws of 1917 and later years will serve to illustrate the need for a more adequate administration.

The excess-profits tax introduced the factor of invested capital which had to be used in measuring tax liability. In theory this factor looks simple, but in practice it has proved to be complex, with resulting discriminations between taxpayers who are situated substantially alike. The business development in the United States during the past half century has been unparalleled in history. Business is no longer conducted in small units under individual ownership, but is carried on in large and constantly growing units, and there are thousands of corporations which in size have now far outgrown anything that was formerly deemed possible. Many of them have grown from small beginnings and have been conservatively managed, writing off items against current earnings which, under management less conservative, would have been added to the property account and thus have swollen the surplus. Other companies have been organized and conducted on the opposite theory, developing large surpluses through the addition to property accounts of items which should have been written off. Still others have gone through one or more reorganizations under which property values have been shifted about and lost sight of or ruled out under the terms of the law. With few exceptions among important businesses, the determination of true invested capital calls for extended examination and is subject to many adjustments. Even after such

an examination, there is no certainty of resulting accuracy. Quite aside, then, from the tendency of the excess profits tax law to put upon the smaller and more conservatively managed corporations an onerous and discriminatory burden, the difficulties to be found in the determination of invested capital are almost insurmountable.

Another factor involving exceptional difficulty is found in the administration of the provisions of the revenue acts which allow a deduction for the depletion of minerals and other natural resources. This also has the appearance of justice and comparative simplicity. What is actually involved, however, is the valuation as of March 1, 1913, or other basic date, of all the natural resources of the country which are under operation for profit. Most of this property is under the ground and hidden from sight. It must be brought to the surface at varying and uncertain dates in the future, at varying and uncertain costs, and sold on the basis of the market as it exists from time to time in the future. The quantity of property can in but few cases be measured. It can only be approximated, and its value, based upon these uncertain factors, must be reduced to a present sum which in theory will be paid by a willing purchaser to a willing seller. The valuation of the railroad properties of the country has been under way for years, and that problem is easy as compared with the valuation problems incident to the calculation of the allowance for depletion. In view of the time that has been consumed in the valuation of the railroads, and in further view of the much greater difficulty encountered in valuation of natural resources, it is apparent that in the time at its command the Bureau of Internal Revenue can not do better than make a very rough approximation of the value of natural resources. Either the taxpayer is deprived of a part of a deduction contemplated under the law or the Government fails to receive revenue to which it is entitled. Mistakes are inevitable and may run into large figures, and inequalities in the taxing of different individuals and companies are bound to occur.

The considerations applying to depletion which have just been partially outlined apply to a degree to the allowance of a deduction for depreciation. Property acquired prior to March 1, 1913, is depreciable upon the basis of its value at that date and not upon cost, and thus the uncertainties attaching to a valuation at a past date are encountered in connection with a large amount of property.

The allowance of a deduction for amortization of war facilities involves such questions as the determination of what is to be classed as a war facility, and in the case of property undisposed of, its value to the taxpayer under the terms of the act. Where property has been sold or demolished, the determination of the allowance is relatively simple, but in many cases the property has not been disposed of and remains in the hands of the taxpayer and to some extent will be useful in his business. The amortization problem is unique, and the aggregate of the amounts involved makes it a problem of the first magnitude. By section 214(a) (9) of the revenue act of 1921 it is provided that the commissioner may, and at the request of the taxpayer shall, reexamine the returns, and if he then finds, as the result of an appraisal or from other evidence, that the deduction originally allowed was incorrect, there shall be a redetermination of the taxes. It is important, therefore, that settlement of amortiza-

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tion claims be made with justice, in order that the taxpayer may have no disposition to avail himself of this provision for redetermination.

Other serious problems confronting the Bureau of Internal Revenue are found in the returns of taxpayers, particularly corporate taxpayers, where a large amount of tax is involved. Every question in a large tax case becomes one of importance, and the contentions of the taxpayer are strenuously insisted upon, requiring extended consideration. The importance of these large tax cases is demonstrated by the fact that in the case of corporate returns 10 per cent of the total number covers something like 80 per cent of the total tax from this source.

It is evident from the foregoing that the bureau has been confronted with problems difficult of prompt solution. It was inevitable under all the circumstances that there would be delays, irritating to taxpayers and resulting in a large accumulation of work, particularly in connection with the more complicated and difficult corporate returns and in the larger claims for refund, credit, and abatement filed by taxpayers as the result of additional assessments. The delay in the audit of the individual and smaller corporation returns has been much less serious, as is indicated by the statistics published by the bureau from time to time.

The situation, however, is not altogether discouraging. The excess profits tax law has been repealed, and when the returns subject to this tax have been audited and settled one of the troublesome problems will disappear. The allowance for amortization of war facilities is another temporary problem which will soon be eliminated.

The board has been and still is giving careful consideration to the difficult problem of simplifying and rendering more certain and easy of calculation the reasonable allowance for depletion of natural deposits which has been permitted as a deduction from gross income by all the revenue acts since 1913.

The board has kept before it as its chief objective the simplification of the procedure, particularly in the Income Tax Unit. A number of formal recommendations have been made to the Secretary of the Treasury and numerous suggestions have been made to the Commissioner of Internal Revenue and to the responsible heads of sections and divisions to the end that formalities, delays, and duplication of work might be eliminated. Practically all of these recommendations and suggestions have been adopted and put into effect. Some of the more basic recommendations have required time to work out and are in process of being made effective. The more important changes inaugurated in the bureau in pursuance of these recommendations and suggestions are as follows:

### CLAIMS.

Shortly before the appointment of the board an inventory of the unsettled claims for abatement, credit, and refund disclosed that 163,277 claims were on hand involving a total of \$1,006,000,000. It had been the practice, in the case of an overassessment, for the taxpayer to file a claim for abatement, credit, or refund, as the case might be. When the claim arrived it was necessary to secure the papers from the files and practically to make a reaudit of the case.

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As the second examination was usually made by auditors of the bureau other than those who passed upon the return originally, it frequently occurred that the decision reached by the first auditor was overruled by the second. This procedure resulted in delay and confusion. To remedy this situation a new method of dealing with claims was adopted providing that in the case of an overassessment a certificate be prepared as a part of the audit and, after proper verification, sent to the taxpayer either in the form of a warrant for refund or a certificate applicable as a credit against taxes due at a future date.

It should perhaps be explained that a great number of claims for abatement were filed on account of the assessment of additional taxes and before the payment thereof, and these claims must be disposed of before the additional tax may be collected. The prompt determination of claims is therefore important, not only from the standpoint of the taxpayer but also in the interest of the Government.

During the past year an earnest effort has been made to reduce the number of claims on hand, and it is gratifying to state that steady progress is reported from week to week.

### LETTER WRITING.

The writing of letters within the department has been discouraged and personal conferences advocated wherever practicable. The system of reviewing and criticising letters written to taxpayers for the purpose of correcting trifling errors not affecting the essential meaning or substance of the communication has also been discontinued.

### REVIEW DIVISION.

A review division was maintained in the Income Tax Unit with a personnel composed of 313 employees and an annual pay roll of \$671,790. The purpose of the division was to review all audits made and claims passed upon by audit divisions, both as to subject matter and procedure. After an audit was reviewed it was sent back to the audit division for further action conforming to the review. This procedure involved great delay and diffusion of responsibility. The conclusion was reached that the review division should be abolished and a review section established in each audit division. This change resulted in the elimination of serious delays and yet assured a careful review of each audit.

### CONSOLIDATION OF ACCOUNTS UNIT AND SUPERVISOR OF COLLECTORS' OFFICES.

The dealings with collectors' offices were handled by two coordinate offices in Washington, viz., the accounts unit and the supervisor of collectors' offices, the heads thereof reporting separately to the Commissioner of Internal Revenue. The accounts unit was purely an accounting office. It had charge of the accounts showing disbursements not only in the collectors' offices, but of the entire Internal Revenue Bureau, and for this purpose maintained records of appropriations and control accounts. It had no power, however, to investigate or audit the collectors' accounts of collections and outstanding assessments. The supervisor of collectors' offices had charge of all matters pertaining to the collectors' offices, including not only

the checking and auditing of their accounts pertaining to revenue collections, but also the reconciliation of such accounts with the accounts kept in the accounts unit. This office also had charge of the procedure used in collectors' offices in the collection of revenue and supervised the personnel, equipment, and space. This dual system led to friction and delay, particularly in reconciliation of accounts as between the two offices. After surveying the situation and conferring with the Commissioner of Internal Revenue and the officers in charge of the above-named unit and office, the board came to the conclusion that there was great need for concentration of responsibility and for improvement in accounting methods in the functions performed by these offices. Upon its recommendation the accounts unit and the office of the supervisor of collectors' offices were consolidated into one unit and placed under the direction of a deputy commissioner in charge of accounts and collections, responsible for all matters theretofore handled by both offices and answerable directly to the commissioner. This consolidation was carried out and the matters theretofore handled by the two offices separately have since been handled with far greater facility by the consolidated unit.

#### FORMS.

A careful study has been made of the various printed forms adopted by the bureau and used in the administration of the revenue act, particularly of the forms of return upon which a taxpayer is required to report his income. It is desirable on the one hand to make forms of return as simple and clear as possible, so that they may be understood and made out by the ordinary taxpayer without the services of an expert; on the other hand, the forms should clearly outline the requirements for information fully enough to make possible an accurate audit of the return without the necessity of requesting further facts from the taxpayer. The itemization of income and deductions contained in the forms of return follows a similar itemization thereof in the revenue act of 1921. Endeavor has been made to simplify and clarify the forms to as great an extent as possible consistent with the considerations above mentioned, and with this in view numerous taxpayers and their representatives were consulted. The forms now in the hands of the printer for use in the year 1923 are the result of the combined judgment of the board working in consultation with the representatives of the bureau having charge of the drafting of the forms of return.

#### EXPEDITING OF WORK.

The board has given particular attention to the completion of the audits of income-tax returns. The importance of this work with respect to such of the audits of 1917 returns as remain unfinished is especially pressing, on account of the running of the statute of limitations. In this emergency everything possible, consistent with fairness to the taxpayer, should be done to expedite the audit of these returns. They are now being given the right of way. This course, coupled with the elimination of a number of sources of delay, has resulted in a marked increase in the dispatch of business. The determination of invested capital under the excess-profits tax law and the valuation of natural resources have been the chief obstacles in the way of completing the audits of 1917 returns. With these elements

established for the year 1917, the work of auditing the returns of subsequent years will be greatly facilitated. Generally speaking, the audit of a 1917 return and the audits of the returns of the same taxpayer for later years are made concurrently. When the difficult, but temporary, problems arising under former revenue acts have been disposed of, there is every reason to believe that the bureau can keep practically current with the audit of returns and the decision of claims. This is a consummation devoutly to be wished and earnestly to be sought.

With the object of expediting this work, various recommendations have been made by the board and carried out by the Commissioner of Internal Revenue. We shall refer to only the more important ones.

#### PRODUCTION MANAGER.

The mechanical operation of the Income Tax Unit has been placed in charge of a "production manager." This officer has been given authority to make transfers of employees from place to place in the Income Tax Unit as he may find their services are needed and can most usefully be employed. He has also been given power to make such temporary transfers as may be required for the efficient working of the unit, not, however, involving change of salary or rank. All office orders respecting duties of employees and procedure are now subject to the approval of the production manager. Since the creation of this office the statistics show a decided acceleration in the work of completing audits.

#### COMMITTEE OF APPEALS AND REVIEW.

Under section 250 (d) of the revenue act of 1921, if, upon examination of a return, a tax or a deficiency in tax is discovered, the taxpayer shall be notified thereof and given a period of not less than 30 days in which to file an appeal and show cause why the tax or deficiency should not be paid. This appeal must be disposed of before any assessment is made, except where the commissioner believes that the amount found due will be jeopardized by awaiting the decision on the appeal. These appeals are heard by a committee on appeals and review. A survey showed a considerable accumulation of undecided appeals before this committee. In order to relieve this congestion and at the same time preserve the careful consideration that was given to these important cases, the personnel of this committee was enlarged. The committee now functions in four groups of three each and the former practice of writing opinions has been discontinued, except in cases where the commissioner deems that the facts of the case and the reasons for the decision should be set forth at some length for the guidance of the Income Tax Unit or for some other reason. As a result of these changes the committee on appeals and review is now disposing of appeals with far greater facility than under the procedure heretofore followed.

#### PRODUCTION COMMITTEES.

In view of the infinite variety in the situations of taxpayers, it is but natural that difficult and involved problems are encountered in the audit of returns. Their just solution frequently requires careful examinations of the facts and interpretations of the law

applicable to the facts. The progress of these cases through the unit is, from time to time, held up, awaiting the report of the examination of the facts or an opinion as to the law. It often happens that the completion of numerous audits depends on the decision of a controlling case. This character of cases seriously impedes the auditing machinery. To relieve this situation a "production committee" was organized and put to work in each of the four audit divisions, namely, personal, corporation, special, and natural resource audit divisions. These committees are charged with the duty of ascertaining the causes of delay in these cases, particularly in the larger and more complicated cases, and supplying any data necessary to the completion of the audit, whether it be a report on the facts or an opinion on the law. Where the situation seems to require it, the production committee is to take up the case itself and complete the audit. These production committees have only recently been appointed and it is too soon to draw conclusions as to their efficacy.

#### DECENTRALIZATION.

Suggestions have come from various sources regarding decentralization of the administration of the revenue acts. After a careful consideration of these suggestions and of the proposition generally, the board is of the opinion that any general plan of decentralization is open to serious objections which makes the adoption of such a plan of doubtful expediency. Upon the recommendation of the board, however, the bureau is about to adopt the experiment of transferring a committee to some central point at a distance from Washington to hear and determine cases arising in that locality and now pending or which would come before the committee on appeals and review. Many taxpayers find it necessary or desirable to come to Washington or send their representatives here to attend the hearings on their appeals. If these hearings were conducted at or near the residence of the taxpayer, this necessity would be eliminated. If the experiment is successful, the plan will be gradually enlarged.

The board takes satisfaction in reporting that the spirit of the bureau is admirable. There is an evident desire on the part of all concerned that the accumulation of work be disposed of at the earliest possible date and that the bureau be so conducted as to win and maintain the confidence of the taxpayers. All suggestions of the board have been cheerfully received, duly considered and made operative sympathetically by the Bureau of Internal Revenue.

Respectfully submitted.

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