



# FROM TAX COLLECTOR TO FISCAL PANOPTICON: A SOCIAL HISTORY OF A CENTURY OF FEDERAL INCOME TAXATION

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*Abstract*

At the current juncture of fiscal uncertainty and pending tax reform, this Article offers an historical perspective by setting taxation in the context of demographic trends. The Article divides the last century of Federal income taxation legislatively into four periods from enactment in 1913, to codification in 1939, recodification in 1954, and recodification with reform in 1986. In the first quarter-century, income taxation largely applied to wealthy, white merchants, doctors, and lawyers, who dealt with their Collectors, who in turn were locally prominent political appointees. All this changed during the second phase, when World War II transformed the income tax into a mass revenue generator, popularized by the Treasury. Meanwhile, the patronage appointment system proved prone to corruption. In 1952, an Internal Revenue Service (IRS) reorganization marked a shift from local Collectors to centralized tax administration. Automation became a priority, despite a tragic failure of technology and management in 1985. Notwithstanding reform in 1986, the tax law became more and more complex, especially due to tax expenditures that effectively charged the tax collector with socio-economic benefit administration. That is, the IRS effectuated disbursement, through tax rebates and refundable credits. Boasting that it had become “the world’s largest financial institution,” the IRS had the job of scanning sensitive information of hundreds of millions of persons, both those who paid tax and those who didn’t. In the electronic age, the IRS has become a fiscal panopticon.

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<b>Table 1. Federal Tax Administration over a Century</b>							
Year	Event	Ind. returns (Mn)	As a % of	U.S. pop (Mn)	Internal Rev. employees	All returns (Mn)	Returns/ employee
1913	Income tax law enacted	0.358	0.368	97.2	4,000	0.675	169
1914	F. 1040 introduced	0.358	0.361	99.1	3,972	0.657	165
1916	Emergency Revenue Act	0.437	0.429	102.0	4,718	0.778	165
1917	Withholding repealed; war profit tax	3.47	3.36	103.3	5,053	3.86	764
1924	Revenue Act, EIC, BTA	7.37	6.46	114.1	15,884	8.11	511
1930	<i>Lucas v. Earl, Poe v. Seaborn</i>	3.85	3.13	123.2	11,979	5.30	442
1935	Social Security Act	4.67	3.67	127.4	16,523	5.32	322
1939	IRC codified	7.65	5.84	131.0	22,623	7.16	316
1942	Revenue Act, Tax Court of U.S.	36.6	27.1	134.9	29,065	27.8	956
1943	Current Payment Tax Act	43.7	32.0	136.7	36,338	40.5	1,115
1944	Individual Income Tax Act	47.1	34.0	138.4	46,171	52.7	1,141
1948	Revenue Act, joint filing	52.1	35.5	146.6	52,143	74.4	1,427
1953	BIR reorganized as IRS	57.8	36.1	160.2	53,463	93.2	1,743
1954	IRC recodified	56.7	34.8	163.0	51,411	88.9	1,729
1969	Tax Reform Act	75.8	37.4	202.7	66,064	110.7	1,676
1975	Tax Reduction Act	82.2	38.1	216.0	82,616	126.0	1,525
1976	Tax Reform Act	84.7	38.8	218.0	85,455	127.1	1,487

1978	TCE established	89.8	40.3	222.6	86,258	136.7	1,585
1982	TEFRA; F. 1040-EZ introduced	95.3	41.0	232.2	83,756	170.4	2,034
1986	Tax Reform Act recodified IRC	103.0	42.8	240.7	96,395	188.0	1,950
1988	Taxpayer Bill of Rights	109.7	44.8	245.0	115,494	194.3	1,682
1996	Taxpayer Bill of Rights II	120.4	44.6	269.7	107,751	208.9	1,939
1998	Restructuring & Reform Act	124.8	45.2	276.1	111,712	224.5	2,009
2001	EGTRRA	130.3	45.6	285.5	97,707	227.9	2,332
2010	Affordable Care Act	141.2	45.7	308.7	107,621	230.4	2,141
2013	Acting Comm'r removed	146.0	46.3	315.1	95,883	240.1	2,504
Year	Event	Indiv. returns (Mn) <sup>1</sup>	As a % of	U.S. pop. (Mn) <sup>2</sup>	Internal Rev. employees <sup>3</sup>	All returns (Mn) <sup>4</sup>	Returns/employee

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<sup>1</sup> Int. Rev. Serv. (IRS) Statistics of Income (SOI) HIST. SUMMARY (1913-65) Table 38 at 207-08; SOI BULL. Hist. Data Table 9 (1950-2008); IRS Pub. 55-B, *Data Book* (2010, 2013) Table 2, col. 2 at 4.

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<sup>2</sup> U.S. Bur. of the Census, STATISTICAL ABSTRACT OF THE U.S.

(2003) No. HS-1, *Population: 1900-2002*; Census, *Population*

*Distrib'n & Change: 2000 to 2010* (Mar. 2011); Census Bur.

Projects U.S. Population of 315.1 Million on New Year's Day (Dec. 27, 2012).

<sup>3</sup> IRS Pub. 1694, *IRS HISTORICAL FACT BOOK: A CHRONOLOGY, 1646-1992* at 249-50; IRS Pub. 55-B (1996-2013).

<sup>4</sup> COMM'R OF INT. REV. (CIR) SOI COMPILED FROM RETURNS FOR 1916 (1918) 14-15 (including 1913-16 personal & corporate income tax returns but no excises); SOI COMPILED FROM RETURNS FOR 1917 (1919) 7 & 15 (including personal, corporate & partnership income tax returns but no excises); SOI FROM RETURNS FOR 1924 (1926) 1 & 12 (including personal, corporate & partnership income tax returns but no excises); CIR, *THE WORK AND JURISDICTION OF THE BUREAU OF INTERNAL REVENUE* (Washington, DC: Gov't Printing Office, 1948) XI, Table III (1927-47) (including income, profit, estate & gift tax returns but not excises); CIR ANN REPS. (1948-88); IRS Pub. 55-B *supra* note 3.

## I. INTRODUCTION

In 1913, Congress imposed the income tax exclusively on high-income individuals. At that time, the predecessor bureau to the Internal Revenue Service (IRS) largely performed duties as a hands-on collector of various tariffs, excise taxes, and other remittances. In 1942, Congress enacted the “greatest tax bill in American history” largely to fund the U.S. effort in World War II, expanding the income tax to the middle class.<sup>5</sup> Then the Treasury made an historic effort to popularize the income tax, famously deploying the Disney cartoon character Donald Duck as a mascot of the public fisc.<sup>6</sup> A parallel effort to popularize the income tax among a growing taxpayer base has not occurred since then.

In the second half of the last century, the tax system was automated. Demographically, women became a more significant taxpayer population. In recent decades, a diverse low-income population has emerged as an important customer base of an increasingly “faceless” IRS. In part, the customer base grew due to legislative proliferation of refundable credits. As a result, the IRS started as a tax collector but became a fiscal panopticon by scanning data for social expenditures as well.

## II. Establishment of Income Tax as a “Class” Tax, 1913-1938

During the first 25 years under study, Congress imposed the federal individual income tax on the high-income

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<sup>5</sup> Randolph Paul, *TAXATION IN THE UNITED STATES* 294 (1954).

<sup>6</sup> Carolyn Jones, *Class Tax to Mass Tax: The Role of Propaganda in the Expansion of the Income Tax During World War II*, 37 *BUFF. L. REV.* 685, 716 (1989).

population.<sup>7</sup> The income tax helped fund the American effort in World War I, and after reductions during a post-war economic expansion, sustained the government during the Great Depression. During this period, the number of employees of the Treasury's Bureau of Internal Revenue (BIR) multiplied,<sup>8</sup> while legislative, administrative, and decisional law formed a foundation for taxpayer rights.

### **A. Tax Law Events**

#### **1. Constitutional Amendment and World War I, 1913-1918**

In 1913, three quarters of the states ratified the Sixteenth Amendment, affirming constitutional authority to tax income.<sup>9</sup> That year, Congress enacted, and President Woodrow Wilson signed, legislation imposing tax of one percent on individual income over \$3,000 (\$4,000 for married couples), up to seven percent on incomes over \$500,000.<sup>10</sup> The average American worker, putting in twelve hours a day and earning \$800 a year, remained unaffected by the tax.<sup>11</sup> The legislation, which also

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<sup>7</sup> See Revenue Act of 1916, Pub. L. No. 63-16.

<sup>8</sup> In 1913, the BIR had 4,000 employees; in 1938, 22,045. IRS Pub. 1694, *supra* note 3, at 249.

<sup>9</sup> U.S. CONST. amend. XVI.

<sup>10</sup> Revenue Act of 1916, Pub. L. No. 63-16; *see also* IRS. Pub. 1694, *supra* note 3, at 86. This legislation allowed a personal exemption deduction of \$3,000 plus \$1,000 for a spouse.

<sup>11</sup> IRS Pub. 1694, *supra* note 3, at 86.

taxed corporate income, provided for income tax withholding by certain payers of income.<sup>12</sup>

Until this time, the BIR had administered assorted excises and tariffs relating to alcohol, tobacco, oleomargarine, and stamps.<sup>13</sup> To implement the income tax, the BIR on January 5, 1914, issued a four-page tax return with instructions, numbered in the order issued by the Treasury Department and still known as the ubiquitous Form 1040.<sup>14</sup> That year, the individual income tax accounted for less than eight percent of BIR collections.<sup>15</sup>

On September 8, 1916, months before entering World War I, President Wilson signed the Emergency Revenue Act, doubling the income tax from one to two percent on incomes above \$3,000 (\$4,000 for married couples).<sup>16</sup> Meanwhile, the

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<sup>12</sup> Revenue Act of 1916, Pub. L. No. 63-16. Generally, this legislation required withholding by insurance companies or other payers of periodic income, and by fiduciaries or others in custody of income of another over \$3,000.

<sup>13</sup> 1914 CIR ANN. REP. 3; 1920 CIR ANN. REP. 8.

<sup>14</sup> IRS Pub. 1694, *supra* note 3, at 87.

<sup>15</sup> 1914 CIR ANN. REP. 3.

<sup>16</sup> Emergency Revenue Act, Pub. L. No. 64-271, 39 Stat. 756; *see also* IRS Pub. 1694, *supra* note 3, at 90. In addition to impending war, expenses like those for Mexican border patrol required revenue. *See* PAUL, *supra* note 5, at 110.

surtax on incomes above \$20,000 was increased on a graduated scale to a maximum rate of fifteen percent.<sup>17</sup>

In 1917, the United States entered World War I, an act that prompted Congress to raise the highest marginal rate of the income tax to sixty-seven percent.<sup>18</sup> That same year, after public criticism, especially complaints from employers and employees about new administrative burdens and effective pay reductions, Treasury Secretary William McAdoo recommended the repeal of withholding, or collection at the source. Congress complied, but left in its place information reporting, or information at the source.<sup>19</sup>

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<sup>17</sup> IRS Pub. 1694, *supra* note 3, at 90.

<sup>18</sup> PAUL, *supra* note 5, at 113; IRS Pub. 1694, *supra* note 3, at 251. The highest rate applied to a \$2,000,000 bracket. The 1917 legislation allowed a personal exemption deduction of \$200 for a dependent child. See War Revenue Act, Pub. L. No. 65-50, § 1203.

<sup>19</sup> See Charlotte Twight, *Evolution of Federal Income Tax Withholding: The Machinery of Institutional Change*, 14 CATO J. 3 (1995); Robert Higgs, *Wartime Origins of Modern Income-Tax Withholding*, THE FREEMAN (Nov. 1, 2007), <https://fee.org/articles/wartime-origins-of-modern-income-tax-withholding/>. Information reporting required a Form 1099 “setting forth the amount of such gains, profits, and income and the name and

By 1918, only fifteen percent of American families had to pay income taxes, and the tax payments of the wealthiest one percent of American families accounted for about eighty percent of the revenues from the individual income tax. This wealthiest one percent of taxpayers paid marginal tax rates ranging from fifteen to seventy-seven percent.<sup>20</sup>

## 2. Progressivity and Transparency, 1919-1925

In 1919, individual and corporate income, including wartime excess profit, taxes amounted to almost sixty-eight percent of BIR collections.<sup>21</sup> At the same time, the federal individual income tax was steeply progressive. “A married man earning the average family income of about \$2,300 would have owed no income tax. A better-off family earning \$5,000 would owe just \$51, while a very wealthy family with income of

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address of the recipients of such income.” 33 C.F.R. § 34 (1918), implementing the War Revenue Act.

<sup>20</sup> W. ELLIOT BROWNLEE, *FEDERAL TAXATION IN AMERICA: A SHORT HISTORY* 63 (2d ed. 2004).

<sup>21</sup> 1920 CIR ANN. REP. 8. Excess profit taxes were war revenue measures imposed on income and gain of individuals and corporations over a floor enacted to approximate “normal” peacetime income. See PAUL, *supra* note 5, at 118.



\$100,000 would owe \$22,557.”<sup>22</sup> By 1923, the income tax affected only twelve percent of families.<sup>23</sup>

In 1923, the Treasury, under the leadership of Secretary Andrew Mellon, proposed rate reductions, an earned income credit (EIC), and capital loss provisions, along with the repeal of certain excises.<sup>24</sup> Secretary Mellon defended his proposed EIC, which at that time applied to the wealthy who paid income tax, as follows:

“The fairness of taxing more lightly incomes from wages, salaries, or from investments is beyond question. In the first case, the income is uncertain and limited in duration; sickness or death destroys it and old age diminishes it; in the other, the source of income continues; the income may be disposed of during a man’s life and it descends to his heirs.”<sup>25</sup>

At that time, Secretary Mellon did not criticize taxes on savings. In June 1924, President Calvin Coolidge signed a Revenue Act

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<sup>22</sup> Anne L. Alstott & Ben Novick, *War, Taxes, and Income*

*Redistribution in the Twenties: The 1924 Veterans’ Bonus and the Defeat of the Mellon Plan*, 59 TAX L. REV. 373, 393 (2006).

<sup>23</sup> Alstott & Novick, *supra* note 22, at 394.

<sup>24</sup> PAUL, *supra* note 5, at 132.

<sup>25</sup> BROWNLEE, *supra* note 20, at 77 (citing to ANDREW W. MELLON, TAXATION: THE PEOPLE’S BUSINESS 56-57 (NY: Macmillan, 1924)).

More than a half-century later, the EIC would be reincarnated in a form applicable to low-income taxpayers.

significantly reducing income taxes and establishing the EIC.<sup>26</sup> Tax reduction came at a time of postwar return to normalcy, economic growth, and politics associated with the Administration and Secretary Mellon (perceived as a Wall Street icon) that commentators branded “benevolent oligarchy.”<sup>27</sup>

The Revenue Act of 1924 also contained several notable procedural provisions. Principally, it allowed for the public listing of the name, address, and payment amount of every taxpayer, as well as disclosure on request of congressional committees, state officials, and as prescribed by regulation, the public.<sup>28</sup>

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<sup>26</sup> Revenue Act of 1924, Pub. L. No. 68-176, 43 Stat. 253. Generally, the EIC was twenty-five percent of up to \$10,000 (comparable to almost \$130,000 in 2011) in wages, salary, and personal service compensation less allocable deductions, but unearned income up to \$5,000 was creditable in any case. *Id.* at § 209. Despite its particular name, the original EIC had a tax reduction effect across the board. By contrast, Congress was to enact a refundable Earned Income Tax Credit in 1975 as a targeted anti-poverty measure, a decade after the introduction of refundable credits, as discussed below.

<sup>27</sup> PAUL, *supra* note 5, at 132.

<sup>28</sup> Revenue Act of 1924, § 257; *see also* DEP’T OF THE TREAS., REPORT TO THE CONGRESS ON SCOPE AND USE OF TAXPAYER CONFIDENTIALITY AND DISCLOSURE PROVISIONS (2000); JOINT COMM. ON TAX’N (JCT),

Additionally, the Act created a Board of Tax Appeals (BTA) as an adjudicator to supersede an administrative committee that had advised the Commissioner of Internal Revenue on appeals of assessments before payment.<sup>29</sup> Later that year, the appeal process was further professionalized when the BTA ruled that Certified Public Accountants and attorneys were the only representatives qualified to appear before them on behalf of taxpayers.<sup>30</sup> The BTA turned out to be popular enough that three years later, with 18,000 appeals pending, the Commissioner formed a committee of external members and revenue agents to help clear the docket.<sup>31</sup> This committee was to be the forerunner of the IRS Appeals function.<sup>32</sup>

### **3. Great Depression and Tax Enforcement, 1926-1934**

As had those of 1921 and 1924, the Revenue Act of 1926 generally reduced taxes, lowering the top marginal individual income tax rate from forty-six to twenty-five percent.<sup>33</sup>

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JCS-1-00, STUDY OF PRESENT-LAW TAXPAYER CONFIDENTIALITY AND DISCLOSURE PROVISIONS AS REQUIRED BY SECTION 3802 OF THE INTERNAL REVENUE SERVICE RESTRUCTURING AND REFORM ACT OF 1998 (2000).

<sup>29</sup> PAUL, *supra* note 5, at 136.

<sup>30</sup> BTA Rule 2, 1924-2 CUM. BULL. 428 (Jul. 19, 1924).

<sup>31</sup> IRS Pub. 1694, *supra* note 3, at 114.

<sup>32</sup> *Id.*

<sup>33</sup> Revenue Act of 1926, Pub. L. No. 69-20, 44 Stat. 9 at 21; *see also* IRS Pub. 1694, *supra* note 3, at 252.

Nevertheless, post-World War I economic growth facilitated ongoing reliance on income taxation rather than excises and tariffs, while policymakers continued to advocate for a broad-based income tax.<sup>34</sup> That year, progressive Congressman Cordell Hull (D-Tenn.) insisted that a “tax system vitally important as is the income tax should apply to a respectable number of persons.”<sup>35</sup> In 1927, individual income tax alone accounted for almost thirty-two percent of BIR collections.<sup>36</sup>

The Revenue Act of 1928 contained a couple of salient provisions. This Act reduced the corporate tax rates from thirteen and a half to twelve percent. The Act also expanded the BIR’s interpretive power by authorizing prospective application of Treasury Regulations, even when a regulation reflected not new law but a court-ordered interpretation of pre-existing law.<sup>37</sup> Practically, this legislation made it unnecessary to re-open settled cases upon a regulatory change; theoretically, the Act

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<sup>34</sup> Alstott & Novick, *supra* note 22, at 384.

<sup>35</sup> Joseph J. Thorndike, *The Republican Roots of New Deal Tax Policy*, TAX ANALYSTS (Aug. 28, 2003),

<http://www.taxhistory.org/thp/readings.nsf/ArtWeb/DC6A3F1BAAo3052A85256DFE005981FB?OpenDocument>.

<sup>36</sup> 1927 CIR ANN. REP. 1 (reporting total collection of \$2,865,683,129.91) & Table 1 at 53 (reflecting individual income tax of \$911,939,910.82).

<sup>37</sup> Revenue Act of 1928, Pub. L. No. 70-562, 45 Stat. 791.

elevated the tax regulator from the role of mere interpreter of pre-existing law.<sup>38</sup>

In 1929, the stock market crash brought an end to a decade of tax reduction, ushering in the Great Depression.<sup>39</sup> In 1930, high-level courts handed down three decisions affecting federal income taxation.

First, the Supreme Court denied the effect for federal tax purposes of California executive Guy Earl's assignment of income to his wife.<sup>40</sup> Had the couple been able to split income by contract, each of them could have paid less tax.<sup>41</sup> Later, that result was achieved by operation of law for another west coast couple, when the Court opined that the European-style community property regime in the state of Washington

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<sup>38</sup> PAUL, *supra* note 5, at 140. This perception arose at a time when a school of thought known as legal realism was casting aside a notion of law as a formal essence of which courts were mere interpreters in favor of a realist depiction of law as that which judges decide in practice. See MORTON J. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW, 1870-1960* 213-46 (1992).

<sup>39</sup> See PAUL, *supra* note 5, at 148.

<sup>40</sup> *Lucas v. Earl*, 281 U.S. 111 (1930).

<sup>41</sup> Patricia A. Cain, *The Story of Earl: How Echoes (and Metaphors) from the Past Continue to Shape the Assignment of Income Doctrine*, in *TAX STORIES: AN IN-DEPTH LOOK AT TEN LEADING FEDERAL INCOME TAX CASES* 305 (2002).

automatically made spouses owners of half of each other's income.<sup>42</sup>

Finally, the Federal Court of Appeals in New York created the so-called *Cohan* rule.<sup>43</sup> This decision allowed a reasonable amount of business deductions by Broadway star George M. Cohan, even though he had not produced receipts.<sup>44</sup> Taken together, these court cases demonstrate that the federal income tax was inextricably involved in American family and business affairs.

The Revenue Act of 1934 imposed graduated tax on capital gain, and restored the EIC, which had lapsed two years earlier.<sup>45</sup> This Act also codified the positions of General Counsel of the Treasury and Assistant General Counsel for Internal Revenue, whose first incumbent was Robert Jackson, later a Supreme Court Justice.<sup>46</sup>

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<sup>42</sup> *Poe v. Seaborn*, 282 U.S. 101 (1930); *see also* Dennis J. Ventry Jr.

*Saving Seaborn: Ownership not Marriage as the Basis of Family Taxation*, 86 IND. L.J. 1459 (2011).

<sup>43</sup> *Cohan v. Comm'r of Int. Rev.*, 39 F.2d 540 (2d Cir. 1930).

<sup>44</sup> *Id.*

<sup>45</sup> Revenue Act of 1934, Pub. L. No.73-216, 48 Stat. 680. The 1934 Act allowed marital exemptions and dependency credits for surtax purposes. PAUL, *supra* note 5, at 179. Subsequently, the Revenue Act of 1943, Pub. L. No. 78-235, § 107, 58 Stat. 21, would repeal the EIC.

<sup>46</sup> IRS Pub.1694, *supra* note 3, at 122.

Underscoring the role of government tax attorneys, in 1934 the Roosevelt administration's Justice Department brought former Secretary Mellon before a grand jury, which declined to indict him for some three million dollars of asserted deficiencies.<sup>47</sup> Instead, the BTA heard and ultimately accepted the magnate's version of his case, revolving around deductions of charitable donations intended for a National Gallery of Art.<sup>48</sup> This case exemplified the high-profile nature of tax enforcement in this period.

#### **4. Social Security and Tax Compliance, 1935-1938**

In 1935, Congress enacted, with President Roosevelt's signature, the Wealth Tax Act, increasing surtax rates on income above \$50,000 from sixty-three to seventy-nine percent.<sup>49</sup> Congress also passed the Social Security Act, financing new public insurance through a payroll tax on employers and employees of one percent of the first \$3,000 of salaries and wages, collected through withholding administered by the BIR on behalf of a Trust Fund.<sup>50</sup> That year, the Supreme Court famously characterized taxes as "the lifeblood of government, and their prompt and certain availability an imperious need."<sup>51</sup>

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<sup>47</sup> PAUL, *supra* note 5, at 151.

<sup>48</sup> Mellon v. Comm'r, 37 BTA 977 (1937).

<sup>49</sup> Revenue Act of 1935, Pub. L. No. 74-407, 49 Stat. 1014; *see also* IRS Pub. 1694, *supra* note 3, at 127.

<sup>50</sup> Social Security Act, Pub. L. No. 74-271, 49 Stat. 620; *see also* IRS Pub. 1694, *supra* note 3, at 127.

<sup>51</sup> Bull v. U.S., 295 U.S. 247, 259 (1935).

In 1937, bills to prevent tax avoidance came before Congress. For example, Congress heard that, to avoid tax, taxpayers would incorporate country estates as businesses to convert personal expenses into business deductions.<sup>52</sup> In 1938, legislation expanded the use of closing agreements, which had been in place for ten years, as a settlement mechanism between a taxpayer and the BIR.<sup>53</sup> Thus, concerns with compliance and compromise that persist today already had appeared before World War II.

### **B. Demographic Trends**

While the federal income tax grew from a minor into a major source of revenue, the economy went from post-World War I growth to the Great Depression. Unemployment peaked, but before “and after the Great Depression, unemployment was largely a blue-collar affliction.”<sup>54</sup> Meanwhile, the income tax affected a high-income population composed largely of white businessmen and professionals.<sup>55</sup>

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<sup>52</sup> PAUL, *supra* note 5, at 206-07.

<sup>53</sup> Pub. L. No. 75-554 (1938), § 801, 52 Stat. 447, amending the Second Liberty Bond Act, Pub. L. No. 70-562 (1928) § 606.

<sup>54</sup> THEODORE CAPLOW ET AL., *THE FIRST MEASURED CENTURY: AN ILLUSTRATED GUIDE TO TRENDS IN AMERICA, 1900-2000* 46 (2001).

<sup>55</sup> Although taxpayer statistics were not reported by race, between 1910 and 1920, thirty-one to twenty-three percent of the population identified as “Negro and other” was illiterate, compared to five to four percent of the Native and Foreign-born White population. U.S.



In 1916, married women filing separately, and single women accounted for less than eight percent of income tax returns and less than ten percent of income or of tax.<sup>56</sup> Meanwhile, merchants, manufacturers, lawyers, and doctors filed more than twenty-seven percent of returns.<sup>57</sup> By 1938, married and single women filed on their own (not counting community property filings) almost twenty-one percent of returns reflecting more than 15 percent of income.<sup>58</sup>

Despite the boom and bust of economic cycles, attitudinal trends established in the first quarter of the century stabilized. These attitudes were measured in a study of the pseudonymous Middletown, which has become a landmark in American sociology. The Middletown study included the following questionnaire items for participants:

- It is entirely the fault of a man himself if he does not succeed.

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BUREAU OF THE CENSUS, HISTORICAL STATISTICS OF THE U.S.:

COLONIAL TIMES TO 1970 (1975) H664-668 at 382. At least in the early years, a significant proportion of people subject to income tax were in occupations requiring literacy. By 1938, the scope of the income tax had expanded, yet there was still a \$1,000 exemption. See IRS Pub. 1694, *supra* note 3, at 252.

<sup>56</sup> C IR, SOI COMPILED FROM RETURNS FOR 1916, *supra* note 4, at 6-7.

<sup>57</sup> *Id.* at 5 & 7.

<sup>58</sup> B IR, SOI FOR 1938 PART I, 20.

- The fact that some people have so much more money than others shows that there is an unjust condition in this country that ought to be changed.<sup>59</sup>

The study repeated the questionnaire over the century. In 1924, forty-seven percent of respondents agreed with the first statement, while thirty percent agreed with the second; 1977, forty-seven and thirty-eight percent, respectively; and 1999, sixty-five and forty-four percent, respectively.<sup>60</sup> According to the pollsters, rates of agreement or disagreement with these statements “did not vary dramatically” over the years in

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<sup>59</sup> CAPLOW, ET AL., *supra* note 54, at 188. Since 1923, Middletown (Muncie, Indiana) has been the subject of landmark research on American social institutions, where replication of surveys over time permits inferences about evolution of values. See ROBERT & HELEN LYND, *MIDDLETOWN: A STUDY IN MODERN AMERICAN CULTURE* (1929); see also ROBERT & HELEN LYND, *MIDDLETOWN IN TRANSITION: A STUDY IN CULTURAL CONFLICTS* (1937); CAPLOW, ET AL., *MIDDLETOWN FAMILIES: FIFTY YEARS OF CHANGE AND CONTINUITY* (1982); CAPLOW, ET AL., *ALL FAITHFUL PEOPLE: CHANGE AND CONTINUITY IN MIDDLETOWN'S RELIGION* (1983).

<sup>60</sup> CAPLOW, ET AL., *supra* note 54, at 189.

general.<sup>61</sup> To the extent that an individualist ethic has prevailed in the U.S., it has not wavered greatly.

By the middle of the century, advocates were to argue that the federal income tax was a shared responsibility. Then they would have to overcome individualist attitudes such as those already established in Middletown.

### C. Implications for Tax Administration

In 1913, the BIR expanded. New offices included a Personal Income Tax Division, a Correspondence Unit to answer questions about the new tax, and a legal counsel function to prepare opinions interpreting the legislation, totaling 277 employees in Washington, D.C. and 3,723 around the country.<sup>62</sup> In 1914, field personnel included sixty-three collectors (all of whom were political appointees), 1,568 deputy collectors, forty Internal Revenue agents, thirty-four income tax agents, thirteen corporate agents, and two corporate inspectors.<sup>63</sup>

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<sup>61</sup> *Id.* at 188 (“the percentage of Middletown adolescents agreeing with the Protestant Ethic remained level from 1924 to 1977 but increased from 1977 to 1999, while the proportion agreeing with action against economic inequality increased in each of the three surveys from 1924 to 1999”).

<sup>62</sup> IRS Pub. 1694, *supra* note 3, at 87.

<sup>63</sup> WORK AND JURISDICTION OF BIR, *supra* note 4, at 95. From the Civil War through codification in 1939, Collectors (or their predecessors) were appointees of the President upon the advice and consent of the

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Senate. *See* Revenue Act of 1862, ch. 119, § 5, 12 Stat. 422, 423 (June 7, 1862); Revenue Act of 1872, ch. 13, 17 Stat. 401 (Dec. 24, 1872); I.R.C. § 3941 (1939). In 1862, their salary was \$3,000 per year. *See* 12 Stat. 423. In 1914, 53 Collectors received \$4,500 in salary while the other ten received between \$3,442 and \$4,329. *See* 1914 CIR ANN. REP. 8. In addition to salary, the '39 Code memorialized the authority of the Treasury Secretary "to make such further allowances, from time to time, as may be reasonable, in cases in which, from the territorial extent of the district, or from the amount of internal revenue taxes collected, it may seem just to make such allowances" to Collectors or Deputy Collectors. I.R.C. §§ 3944, 3990 (1939). The Commissioner could suspend for cause but not dismiss a Collector. *See* I.R.C. § 3944 (1939). As of mid-century, the position of Collector was "not, strictly speaking, subordinate to that of the Commissioner of Internal Revenue, although he is bound by the rules and regulations of the Bureau. Until recent years the deputy collectors had no civil service status and were appointed and discharged at the will of the collectors," although internal revenue agents were civil servants. WORK AND JURISDICTION OF BIR, *supra* note 4, at 85-86.

Even as the BIR hired, competition from private employers emerged, then as now. From October 1, 1919, to June 31, 1920, nearly one thousand employees left the agency.<sup>64</sup>

In 1930, the Treasury devoted some ten million dollars to erect a Constitution Avenue building, which still contains the IRS National Office, originally housing 3,391 Internal Revenue employees, 147 from the BTA, twenty-two from the Customs Court and Patent Appeals, and 252 from the Public Buildings and Public Parks Commission.<sup>65</sup>

Initially, individual income tax returns came before collectors for audit, which then meant detection of errors on the face of the return.<sup>66</sup> Taxpayers could appeal to the Commissioner.<sup>67</sup> Soon the BIR formalized this process through the 1918 organization of the Solicitor's office, followed the next year by the empanelment of an Advisory Tax Board to advise the Commissioner on appeals.<sup>68</sup> In 1924, the Solicitor created a Reviews Division to hear and determine all protests against the determination of a deficiency by the Income Tax Unit.<sup>69</sup> As discussed above, taxpayers also now had judicial recourse to the BTA.

Meanwhile, taxpayers did not accept the enactment of the income tax without political and ideological protest.

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<sup>64</sup> PAUL, *supra* note 5, at 127.

<sup>65</sup> IRS Pub. 1694, *supra* note 3, at 117.

<sup>66</sup> WORK AND JURISDICTION OF BIR, *supra* note 4, at 101.

<sup>67</sup> *Id.* at 90.

<sup>68</sup> *Id.* at 96, 105.

<sup>69</sup> IRS Pub. 1694, *supra* note 3, at 107.

Demanding repeal of the high rates that paid for America's participation in World War I, a tax club movement convened, with hundreds of protest meetings in small towns throughout the South and Midwest. Against the New Deal, grassroots campaigns arose in several states calling for a Constitutional amendment to limit the top rate of income tax.<sup>70</sup> Thus, the first quarter century of the federal income tax introduced a bureaucratic workplace that was burgeoning yet not without contestation from outside the government, including legal and political challenges from taxpayers.

Around this period, a celebrated legal scholar who visited America from Germany developed several relevant observations about bureaucracy that were to inform the discipline of sociology. In pertinent part, he suggested that formal standardization would allow government offices to administer a large volume of cases efficiently and dispassionately but at a cost of substantive discretion, *i.e.*, "without regard for persons" in a "dehumanized" manner.<sup>71</sup> This observation is useful in understanding the tensions inherent in tax administration.

### III. Transformation into a "Mass" Tax, 1939-1953

The second period in the past century of federal income taxation witnessed a monumental expansion. At first, the tax applied to less than six percent of the population. Ultimately, it applied to approximately thirty-five percent. The tax helped to lift the country out of the Great Depression, finance World War

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<sup>70</sup> See ISAAC W. MARTIN, RICH PEOPLE'S MOVEMENTS: GRASSROOTS CAMPAIGNS TO UNTAX THE ONE PERCENT 74 (2013).

<sup>71</sup> FROM MAX WEBER: ESSAYS IN SOCIOLOGY 215-16 (H.H. Gerth & C. Wright Mills trans. (Oxford U. Press 1946).

II, and ultimately reestablish the economy.<sup>72</sup> The BIR proceeded through this change initiated by the wartime administration.

## **A. Significant Tax Laws**

### **1. Internal Revenue Code of 1939**

In 1939, a highly successful businessman netting \$16,000 paid income tax of \$1,000, while an average lawyer or doctor paid twenty-five dollars, and an average blue-collar worker paid nothing.<sup>73</sup> By the end of the Great Depression, while the economics of John Maynard Keynes had begun to influence policymakers, the “conscious purpose of public spending was more to provide help to distressed citizens than it was to stimulate recovery.”<sup>74</sup> That year, Congress codified the various revenue acts into the Internal Revenue Code, consolidating the tax law.<sup>75</sup>

### **2. Revenue Act of 1942**

In 1942, America was at war, for the second time in a generation. President Roosevelt told Congress: “In this time of grave national danger, when all excess income should go to win the war, no American citizen ought to have a net income, after

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<sup>72</sup> See *supra* Table 1 at notes 1-4.

<sup>73</sup> IRS Pub. 1694, *supra* note 3, at 132.

<sup>74</sup> PAUL, *supra* note 5, at 225. “The Keynesian remedy for depression was ... an increase in public expenditures which would compensate for an excess of savings or a deficiency of investment.” *Id.* at 229.

<sup>75</sup> I.R.C. (1939), Pub. L. No. 76-1, 53 Stat. pt. 1.

he has paid his taxes, of more than \$25,000.”<sup>76</sup> On October 21, 1942, Congress enacted the “greatest tax bill in American history” (but did not confiscate income over \$25,000 as proposed by the President).<sup>77</sup>

The Revenue Act of 1942 sharply increased income tax. This Act lowered the top bracket from five million to 200,000 dollars. At the same time, the Act raised the top marginal rate to eighty-eight percent from eight-one percent, introduced the Victory Tax (a five percent surcharge on income over \$624), and lowered exemptions to \$500 from \$750 (\$1,200 from \$1,500 for married couples), but allowed deductions for medical expenses.<sup>78</sup> More than twenty-seven percent of the population would now have to file returns.<sup>79</sup> Treasury General Counsel Randolph Paul observed: “The income tax was now a mass tax.”<sup>80</sup>

To herd newly identified taxpayers into the fold, the Administration conducted a mass media campaign. On June 13, 1942, President Roosevelt established an Office of War

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<sup>76</sup> Message to Congress on an Economic Stabilization Program, 1 PUB. PAPERS 48 (Apr. 27, 1942).

<sup>77</sup> IRS Pub. 1694, *supra* note 3, at 136.

<sup>78</sup> Revenue Act of 1942, Pub. L. No. 77-753, 56 Stat. 798; *see also* IRS Pub. 1694, *supra* note 3 at 252. The Revenue Act of 1942, § 504 also changed the name of the BTA to the Tax Court.

<sup>79</sup> *See supra* Table 1 at notes 1-4.

<sup>80</sup> PAUL, *supra* note 5, at 318.



Information (OWI).<sup>81</sup> That year, listeners could hear songs from Irving Berlin and Danny Kaye advertising tax payment as part of the war effort.<sup>82</sup> Over thirty-two million viewers in 12,000 theaters saw Donald Duck announce that taxes “will keep democracy on the march” in a cartoon scripted by the Treasury.<sup>83</sup> Some in Congress took umbrage at the \$80,000 cost of this animation, and Walt Disney suffered characterization as a “propagandist.”<sup>84</sup> Yet Disney was in good company within a few years when an eclectic group of performers such as Roy Rogers, the Andrews Sisters, George Burns and Gracie Allen, and Yehudi Menuhin joined the cast of wartime Treasury promoters.<sup>85</sup>

In an early exercise of targeted marketing, the Treasury promoted tax compliance among the rich, the poor, women, and minorities. Foreshadowing product placement, an OWI manual suggested characters for motion pictures, one of whom emerged in a Hollywood movie as a wealthy man saying that it “suits me if they tax me 100 percent!”<sup>86</sup> A 1944 OWI magazine

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<sup>81</sup> Exec. Order No. 8922, 6 FED. REG. 5477 (Oct. 28, 1941) as amended by Exec. Order No. 9182, 7 FED. REG. 4468 (June 16, signed June 13, 1942); see Jones, *supra* note 6, at 701.

<sup>82</sup> Jones, *supra* note 6, at 714.

<sup>83</sup> BROWNLEE, *supra* note 20, at 117-18.

<sup>84</sup> Jones, *supra* note 6, at 717.

<sup>85</sup> *Id.* at 710-14.

<sup>86</sup> *Id.* at 718. The cited motion picture was David O. Selznick’s *Since You Went Away*, “a film of wartime domestic life,” portraying a

advertisement for “plain folks” stated: “We’ll pay our taxes willingly” because “these sacrifices are chicken feed, compared to the ones our sons are making.”<sup>87</sup> That year an OWI guide for women advised: “Tell homemakers that even if they personally are not going to fill out their tax return this year, they should urge their husbands to do so early.”<sup>88</sup> In 1945, Commissioner Joseph Nunan announced tax requirements in newsreels, at least one of which was tailored “to some 400 theatres catering to Negroes.”<sup>89</sup>

### 3. Current Payment Tax Act of 1943

This media blitz was only the surface. Mass income tax implementation ran deeper. Treasury officials realized that collection at the source would “achieve a more convenient method for the payment of income taxes”.<sup>90</sup> They waged a political campaign against concerns articulated by

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“radiant ideal” of the American family, despite “anxiety about the family’s financial plight” since “Papa is only a captain and they must presumably subsist on his pay.” Bosley Crowther, “*Since you Went Away*,” *A Film of Wartime Domestic Life, With Claudette Colbert and Others, Opens at the Capitol*, N.Y. TIMES (July 21, 1944) (available at <http://www.nytimes.com/movie/review?res=9B07E1DA1F3CEE3BBC4951DFB466838F659EDE>).

<sup>87</sup> Jones, *supra* note 6, at 727.

<sup>88</sup> *Id.* at 715.

<sup>89</sup> *Id.* at 718.

<sup>90</sup> PAUL, *supra* note 5, at 330.

Commissioner Guy Helvering. He cautioned against forcing “upon industry the payment of large sums for the administrative cost of the withholding tax.”<sup>91</sup> A compromise plan emerged, named after Beardsley Ruml, an official of the New York Federal Reserve Bank and of Macy’s department store. Promoting forgiveness, he agreed to start withholding only if the Treasury would forgive taxes otherwise due that year (*i.e.* for the last year before there was withholding).<sup>92</sup> As historians have explained, legislation ultimately required current payment of individual income tax but forgave three quarters of the previous year’s tax (or if less, that of the year before).<sup>93</sup>

On June 9, 1943, Congress enacted and President Roosevelt signed the Current Tax Payment Act, imposing a twenty percent withholding tax and establishing a system of withholding and quarterly estimated tax payment still in place today.<sup>94</sup> The withholding system under this Act became

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<sup>91</sup> *Id.*

<sup>92</sup> See Dennis J. Ventry, Jr. & Joseph J. Thorndike, *The Plan that Slogans Built: The Revenue Act of 1943*, *TAX ANALYSTS* (Sept. 1, 1997),

<http://www.taxhistory.org/thp/readings.nsf/cf7c9c870b600b9585256df80075b9dd/671f701c110a19d985256e430079173d?OpenDocument>.

<sup>93</sup> *Id.* at ¶ 26.

<sup>94</sup> Current Tax Payment Act of 1943, Pub. L. No. 78-68, 57 Stat. 126; see also IRS Pub. 1694, *supra* note 3, at 137.

effective on July 1, 1943.<sup>95</sup> Then-Treasury economist Milton Friedman, not now known as a champion of the welfare state, has reminisced that withholding was an inevitability in the quest for war revenue.<sup>96</sup>

#### 4. Individual Income Tax Act of 1944

Despite the convenience of withholding, the mass population of taxpayers still had to file tax returns.<sup>97</sup> Observing that it took an hour and a half to fill out a return in 1943, Treasury Secretary Henry Morgenthau asked his aides to “think of some way of bending the law to make this thing more palatable.”<sup>98</sup> Even after the BIR rolled out the 1944 Form 1040

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<sup>95</sup> PAUL, *supra* note 5, at 348. Under the 1939 I.R.C. § 53, returns were due for the calendar year on March 15, while returns for the fiscal year were due on the fifteenth day of the third month thereafter.

<sup>96</sup> MILTON & ROSE D. FRIEDMAN, *TWO LUCKY PEOPLE: MEMOIRS* 120-23 (1998).

<sup>97</sup> As of 1942, the BIR had offered as an alternative to the four-page Form 1040 a two-page Form 1040A, Optional Individual Income Tax Return, to “be filed instead of Form 1040 by citizens (or resident aliens) reporting on the cash basis if gross income is not more than \$3,000 and is only from salary, wages, dividends, interest, and annuities.”

<sup>98</sup> Jones, *supra* note 6, at 731.

with “its junior sister Form 1040A,”<sup>99</sup> journalists criticized the tax returns as “so complicated as to defy description in a newspaper during a paper shortage.”<sup>100</sup> On January 10, 1944, President Roosevelt recommended substantive tax “simplification to reduce the burdens of compliance of the many million taxpayers by elimination of returns where feasible.”<sup>101</sup>

On May 29, 1944, Congress enacted the Individual Income Tax Act, introducing a ten percent standard deduction and replacing the Victory Tax with a three percent tax.<sup>102</sup> The standard deduction relieved taxpayers with adjusted gross income of \$5,000 of the burden of itemizing deductions generally relating to business.<sup>103</sup> Although the income tax now affected the masses, in 1945 the richest one percent of households paid thirty-two percent of the revenue.<sup>104</sup>

### 5. Revenue Act of 1948

On April 2, 1948, Congress cut taxes, overriding the veto of President Harry Truman, who opposed revenue reduction at a time of inflation. The legislation contained, among other relief measures, an option for married couples to file joint returns

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<sup>99</sup> PAUL, *supra* note 5, at 383.

<sup>100</sup> *Id.*

<sup>101</sup> SAMUEL I. ROSEMAN, THE PUBLIC PAPERS AND ADDRESSES OF FRANKLIN D. ROOSEVELT 28 (1945).

<sup>102</sup> Individual Income Tax Act of 1944, Pub. L. No. 78-315, §§ 9(a), 106(a), 58 Stat. 231; *see also* IRS Pub. 1694, *supra* note 3, at 138.

<sup>103</sup> *See* S. REP. NO. 78-885, at 2 (1944).

<sup>104</sup> BROWNLEE, *supra* note 20, at 116.

with an increased standard deduction.<sup>105</sup> Since 1918, optional joint returns had allowed aggregating spousal income (producing a marriage penalty in some cases). The 1948 Act resulted in a tax double what a single person would pay on half the aggregate income.<sup>106</sup> Thus, the Act leveled the field for couples who did not reside in states with European-style community property (Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, and Washington).<sup>107</sup> As discussed above, in 1930 the Supreme Court had confirmed that couples residing in these states could split community income, no matter which spouse had earned it.<sup>108</sup> Spouses in common law property states were denied the benefit of automatic income splitting and had to file on an aggregated basis. A federal joint income tax bracket resolved this problem. Professor Stanley Surrey, who had served as Tax Legislative Counsel in the Truman and Roosevelt administrations, explained that the

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<sup>105</sup> Revenue Act of 1948, Pub. L. No. 80-471, 63 Stat. 110. Prof. Surrey argued that “a strong tax structure would at this time be our most effective anti-inflationary weapon,” Stanley S. Surrey, *Federal Taxation of the Family – The Revenue Act of 1948*, 61 HARV. L. REV. 1097, 1098 (1948).

<sup>106</sup> Patricia A. Cain, *Taxing Families Fairly*, 48 STA. CLARA L. REV. 805, 808-17 (2008).

<sup>107</sup> Randolph E. Paul, TAXATION FOR PROSPERITY 290 (1947).

<sup>108</sup> *Poe v. Seaborn*, 282 U.S. 101 (1930).

“married couple is thus viewed as a unit” (instead of two individual taxpayers) for federal tax purposes.<sup>109</sup>

### **B. Demographic and Governmental Trends**

Emergence from the depths of the Great Depression and the demands of World War II was a turning point for the U.S. economy and population. Business as well as Social Security and other government programs begin to expand.<sup>110</sup> At the same time, the “corporate share of business activity increased at the expense of proprietorships and partnerships.”<sup>111</sup>

The number of high school and college graduates continued to increase in the reestablished economy,<sup>112</sup> while homeownership grew, especially among middle-aged whites.<sup>113</sup> In the postwar period, the effect of the home mortgage interest deduction cannot be overlooked.

Upon “the ebbing of patriotism as a factor in income-tax compliance,” an historian has written, “Congress relied increasingly on tax expenditures and other measures ... to enhance the popularity of the new tax regime.”<sup>114</sup> These

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<sup>109</sup> Surrey, *supra* note 105, at 1114.

<sup>110</sup> See CAPLOW, ET AL., *supra* note 54, at 196.

<sup>111</sup> *Id.* at 246.

<sup>112</sup> *Id.* at 52.

<sup>113</sup> *Id.* at 96.

<sup>114</sup> BROWNLEE, *supra* note 20, at 129. Nevertheless, the “income tax code instituted in 1913 contained a deduction for all interest paid, with no distinction between interest payments made for business, personal,

measures included income splitting on joint returns of married couples as well as the home mortgage interest deduction. Despite the government's efforts to popularize the income tax, thousands of citizens petitioned for a Constitutional tax ceiling to limit tax increases even in wartime.<sup>115</sup>

As the position of the traditional middle class solidified, the place of minorities and women also began to expand. In the general population, the proportion of minorities began to increase dramatically.<sup>116</sup> In the workforce, demographic diversification proceeded as the proportion of adult and older men declined.<sup>117</sup> In 1939, women, either separately from their

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living, or family expenses. There is no evidence in the legislative history that the interest deduction was intended to encourage home ownership or to stimulate the housing industry at that time. In 1913 most interest payments represented business expenses. Home mortgages and other consumer borrowing were much less prevalent than in later years." S. COMM. ON THE BUDGET, 110TH CONG., REP. ON TAX EXPENDITURES (Comm. Print 2008). *See also* Dennis J. Ventry Jr., *The Accidental Deduction: A History and Critique of the Subsidy for Mortgage Interest*, 73 L. & CONTEMP. PROBS. 233 (2010).

<sup>115</sup> *See* MARTIN, *supra* note 70, at 90 *ff.*

<sup>116</sup> CAPLOW, ET AL., *supra* note 54, at 18.

<sup>117</sup> "The labor force participation rate of adult men gradually decreased from 86 percent in 1900 to 75 percent in 1998. \* \* \* The decline in



husbands, as family heads in their own right, or as single individuals, filed 1.8 million or 23.4 percent of individual income tax returns.<sup>118</sup> In 1951, the tax law officially recognized head of household filing status.<sup>119</sup> In 1953, women filed 10.8 million or 18.7 percent of returns.<sup>120</sup> From 1939 to 1953, the U.S. population increased from 131 million to 160 million; for those same years, the proportion of return filers within the population multiplied from six to thirty-six percent.<sup>121</sup>

Congress recognized additional population segments. For example, in 1943, Congress enacted a \$500 deduction for the blind.<sup>122</sup> In 1948, legislation converted this to a \$600 exemption along with an equal exemption/deduction for the elderly.<sup>123</sup> Expansions of the tax law, economy, and population segments all portended increasing diversity among taxpayers.

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labor force participation was most conspicuous for men aged sixty-five and older.” *Id.* at 32.

<sup>118</sup> B IR, SOI FOR 1939 PART I, 18.

<sup>119</sup> Revenue Act of 1951, Pub. L. No. 82-183, § 301.

<sup>120</sup> B IR, SOI FOR 1953 PART I, 10.

<sup>121</sup> *See supra* Table 1 at notes 1-4.

<sup>122</sup> Revenue Act of 1943, Pub. L. 78-235, § 115, 58 Stat. 21.

<sup>123</sup> Revenue Act of 1948, Pub. L. No. 80-471, § 201; *see also* IRS Pub. 1694, *supra* note 3, at 142.

### C. Expansion and Reorganization of the Revenue Agency

From 1939 to 1953, the BIR workforce more than doubled from 22,623 to 53,463.<sup>124</sup> At the same time, individual income taxation became a major federal revenue source, rising from approximately one dollar to thirty-three billion dollars.<sup>125</sup> These amounts lifted the individual income tax from twenty to forty-seven percent of total BIR collections of \$5.2 and \$69.7 billion in fiscal years (FY) 1939 and 1953, respectively.<sup>126</sup> In addition to sheer manpower, streamlined processing methods enabled the BIR to handle a seven-fold increase in the volume of returns.<sup>127</sup> Inside the BIR, a major reorganization confirmed its transformation into a modern bureaucracy, as old-fashioned political appointments became a thing of the past.

On November 1, 1943, the BIR established a Processing Division in New York City as a central location equipped with electronic typewriters, to receive the first wave of increased volume of income tax returns.<sup>128</sup> Four years later, the Processing Division moved to Kansas City, where within a couple of years the BIR employed mass mailing to send forms and instructions to every corner of the growing country.<sup>129</sup> In 1948, the BIR introduced punch card equipment in Cleveland, and the following year deployed the technology in seven more

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<sup>124</sup> IRS Pub. 1694, *supra* note 3, at 249.

<sup>125</sup> CIR ANN. REP. (1939) 2; CIR ANN. REP. (1953) 5.

<sup>126</sup> IRS Pub. 447, *The U.S. Tax System: A Brief History* (1960) at 39.

<sup>127</sup> *See supra* Table 1 at notes 1-4.

<sup>128</sup> IRS Pub. 1694, *supra* note 3, at 137.

<sup>129</sup> *Id.* at 142, 145.

Collectors' districts.<sup>130</sup> By the 1950 filing season, the BIR added computers to its complement of equipment for calculating liability on returns.<sup>131</sup>

While methods and technology advanced the BIR still had to modernize its political organization, a system of appointments that was entrenched by mid-century. On February 27, 1951, Commissioner George Schoeneman testified that the BIR fired more than fifty employees each year for taking bribes.<sup>132</sup> On September 14 and October 11, 1951, two BIR Collectors in Boston and St. Louis, Dennis Delaney and James Finnegan, were indicted for bribery.<sup>133</sup> In 1953, the House Ways and Means Committee, chaired by Rep. Cecil King (D-Cal.) and later by Rep. Robert W. Kean (R-N.J.), reported on an investigation of the BIR, revealing more improprieties.<sup>134</sup> Ultimately, seven more Collectors, an Assistant Commissioner, the Chief Counsel, and the Assistant Attorney General of the Tax Division of the Justice Department left office in disgrace.<sup>135</sup>

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<sup>130</sup> *Id.* at 145.

<sup>131</sup> *Id.* at 148.

<sup>132</sup> *Id.* at 150.

<sup>133</sup> *Id.* at 151-52.

<sup>134</sup> H.R. REP. NO. 82-2518 (1953).

<sup>135</sup> Improprieties extended to conspiracy with organized crime, false certification of tax payments, and similar corruption. See Joseph J. Thorndike, *Reforming the Internal Revenue Service: A Comparative History*, 53 ADMIN. L. REV. 717, 755-59 (2001); Bryan T. Camp,

The patronage position of Collector, in place at the inception of the federal income tax, provided antiquated and inadequate leadership under a mass tax. Originally, local Collectors may have achieved better tax compliance in their own communities.<sup>136</sup> By 1924, corruption had warranted a Senate investigation of the BIR,<sup>137</sup> and apparently the temptation created by the massive 1942 expansion of the tax was too great for appointees of the President to withstand. President Truman observed that the Collectors, as White House appointees, were “not fully responsive” to their direct superiors, whom he identified as the Commissioner of Internal Revenue and Secretary of the Treasury.<sup>138</sup>

On January 14, 1952, President Truman proposed Reorganization Plan No. 1 in part to clean out the corruption by replacing patronage appointments with the career civil service.<sup>139</sup> On March 15, 1952, Congress accepted the plan.<sup>140</sup> The Commissioner and Chief Counsel were the only remaining political appointees.<sup>141</sup> The reorganization integrated most field revenue programs under district directors, instituted regional commissioners, and consolidated inspection functions under a separate Inspection Service. The reorganization established the

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*Theory and Practice in Tax Administration*, 29 VA. TAX REV. 227, 241 (2009).

<sup>136</sup> Thorndike, *supra* note 135, at 756.

<sup>137</sup> IRS Pub. 1694, *supra* note 3, at 108.

<sup>138</sup> Thorndike, *supra* note 135, at 761.

<sup>139</sup> IRS Pub. 1694, *supra* note 3, at 154.

<sup>140</sup> *Id.*

<sup>141</sup> I.R.C. §§ 3900, 3931 (1939); I.R.C. §§ 7801, 7803 (1954).

basis for a three-tiered geographical structure comprising the National Office, regional offices, and district offices. Intersecting this structure were functions (*e.g.* assessment, collection) in place of offices organized by type of tax (*e.g.* income, excise).<sup>142</sup> On July 9, 1953, the reorganized agency got a fresh start under the new name, Internal Revenue Service.<sup>143</sup>

No more was the face of the IRS that of a local partisan Collector. Overall, this period showed that an agency administering a law applicable to little more than a twentieth of the population could be massively reorganized by an administration determined to reach every third person.<sup>144</sup> At first, the administration popularized taxation by recruiting spokespersons from show business. By the end, the IRS was a bureaucracy reaching into every district of the country through regional directorates reporting to the National Office, already ensconced on Constitution Avenue in Washington, DC.

Wartime taxation was achieved by heroic government intervention unmatched in peacetime. In any case, the mid-century revenue imperatives successfully popularized the income tax in what the IRS Historian aptly called “a marriage of convenience that survived.”<sup>145</sup> Since then, federal income tax has been embedded with the American people.

#### **IV. Standardization and Complexity, 1954-85**

During the three decades of the third period under study, the U.S. underwent post-World War II modernization, experienced in the IRS as automation. Substantively, the

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<sup>142</sup> Thorndike, *supra* note 135, at 762.

<sup>143</sup> IRS Pub. 1694, *supra* note 3, at 158.

<sup>144</sup> See *supra* Table 1 at notes 1-4.

<sup>145</sup> IRS Pub. 1694, *supra* note 3, at 135.

federal income tax system became a source of fiscal stability. Demographically, the volume of individual taxpayers slightly outpaced national population growth.<sup>146</sup> Administratively, the IRS tried to do more with machines, gradually leading to a meltdown.

### A. Significant Tax Laws

If the federal income tax and World War II had “a marriage of convenience that survived,” the implication would be that mass revenue thereafter was sufficient to fund government expenditures as they arose in wartime or peacetime. Whereas specific tax legislation had raised revenue for World Wars I and II, U.S. military expenditures in Korea and Vietnam during this ensuing period arose from already existing, if high, taxes.<sup>147</sup>

Additionally, the tax structure lent itself to social spending through tax expenditures forming a “hidden welfare state.”<sup>148</sup> According to a commentator, “the benefits of tax

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<sup>146</sup> See *supra* Table 1 at notes 1-4.

<sup>147</sup> BROWNLEE, *supra* note 20, at 128 (“The highly elastic revenue system paid for the strategic defense programs of the Cold War and, without any general or permanent increases in income taxation, for the mobilizations for the Korean and Vietnam Wars as well.... the post-World War II increases in federal revenues went largely for the expansion of domestic programs”).

<sup>148</sup> CHRISTOPHER HOWARD, *THE HIDDEN WELFARE STATE: TAX EXPENDITURES AND SOCIAL POLICY IN THE UNITED STATES* 1 (1997).

expenditures accrue disproportionately to more affluent citizens and powerful corporations.”<sup>149</sup>

Whatever may have been the political and social dislocations from 1954 to 1985 – encompassing the Cold War, civil rights movements, and ultimately a conservative shift called the “Reagan revolution”<sup>150</sup> – the tax system helped prevent them from becoming fiscal upheavals of a magnitude seen earlier in the century. Significant rules and policies of the tax system during this period included codification of social tax expenditures as well as an alternative minimum tax, and administrative provisions to streamline and professionalize the tax system.

### 1. Substantive Provisions

On August 16, 1954, Congress with President Dwight Eisenhower’s signature recodified the Internal Revenue Code, making some 3,000 income tax changes.<sup>151</sup> In a provision that ultimately was to grow into “the largest source of federal financial support for child care,” child-care expenses became deductible for widows, single parents, and certain other taxpayers.<sup>152</sup>

On December 30, 1969, Congress enacted with President Richard Nixon’s signature a Tax Reform Act (TRA ’69) lowering

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<sup>149</sup> *Id.* at 6.

<sup>150</sup> BROWNLEE, *supra* note 20, at 147.

<sup>151</sup> Pub. L. No. 83-591; IRS Pub. 1694, *supra* note 3, at 160.

<sup>152</sup> Mary Louise Fellows, *Rocking the Code: A Case Study of Employment-Related Child-Care Expenditures*, 10 YALE J. L. & FEMINISM 307, 310 n. 11 (1998).

tax rates and increasing the personal exemption but imposing an alternative minimum tax.<sup>153</sup> TRA '69 included tax relief for single taxpayers through a modification of the rate schedules that collaterally “had the consequence of generating a marriage penalty” for the first time since 1948.<sup>154</sup> The new rate schedule for single individuals reflected a congressional response to complaints of “a new class of taxpayers – singles and unmarried couples.”<sup>155</sup>

On March 29, 1975, Congress enacted with President Gerald Ford’s signature a Tax Reduction Act (TRA '75). Among other things, TRA '75 created the Earned Income Tax Credit (EITC), which supplemented the wages of low-income working parents.<sup>156</sup> The EITC’s historic innovation was refundability, or the use of a tax provision to effectuate a net payment from the

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<sup>153</sup> Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 287; *see also* IRS Pub. 1694, *supra* note 3, at 191 (TRA '69, § 951, I.R.C. § 7441, also moved the Tax Court from the Executive to the Judicial Branch under U.S. CONST. art. I, § 8).

<sup>154</sup> EDWARD J. MCCAFFERY, *TAXING WOMEN* 34 (1997).

<sup>155</sup> *Id.*

<sup>156</sup> Tax Reduction Act of 1975, Pub. L. No. 94-12; *see* Dennis J. Ventry Jr., *The Collision of Tax & Welfare Politics: The Political History of the Earned Income Tax Credit, 1969-99*, 53 NAT’L TAX J. 983 (2000); Anne L. Alstott, *The Earned Income Tax Credit & the Limitations of Tax-Based Welfare Reform*, 108 HARV. L. REV. 533 (1995).



government, rather than a collection.<sup>157</sup> A “negative tax” for purposes of maintaining income security among the populace had been anticipated (if not welcomed) at least as early as the Kennedy administration by then Treasury Assistant Secretary for Tax Policy Stanley Surrey.<sup>158</sup> Another innovation of TRA ’75 was advance rebate of tax reductions by check disbursement.<sup>159</sup> In other words, TRA ’75 enacted tax reductions that were monetized and delivered to taxpayers “approximately six weeks after the date of enactment of this bill” rather than implemented as decreases in withholding over the course of a year.<sup>160</sup> In these two key provisions – the EITC and mid-year tax cuts – TRA ’75 marked a reversal of the traditional IRS role by turning the revenue collection agency into one of fiscal disbursement and explicit stimulus.<sup>161</sup>

The administration of President Ronald Reagan set the stage for the next major tax reform after the 1954 recodification that started this period. On September 3, 1982, Congress

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<sup>157</sup> See Ventry, *supra* note 156, at 986 (discussing “negative income tax”).

<sup>158</sup> STANLEY S. SURREY, THE FEDERAL TAX SYSTEM – CURRENT ACTIVITIES & FUTURE POSSIBILITIES 156-157 (Wm. Hellmuth & Oliver Oldman eds., 1973).

<sup>159</sup> I.R.C. § 6428 (repealed 2014) *added by* Pub. L. No. 94-12 § 101, 89 Stat. 26.

<sup>160</sup> H.R. REP. NO. 94-19 at 9 (1975).

<sup>161</sup> See Ventry, *supra* note 156, at 995 (discussing “stimulative effects” of TRA ’75).

enacted with President Reagan's signature the Tax Equity and Fiscal Responsibility Act (TEFRA '82) imposing "the first major tax increase during an election year in peacetime since 1932," closing loopholes, expanding information reporting, and enhancing penalties.<sup>162</sup>

On January 25, 1984, President Reagan's State of the Union speech announced "an historic reform for fairness, simplicity, and incentives for growth. I am asking Secretary Don Regan for a plan for action to simplify the entire tax code so all taxpayers, big and small, are treated more fairly."<sup>163</sup> On November 27, 1984, Treasury Secretary Regan presented to the President a report that would become known as Treasury I, drafted by the Office of Tax Policy (OTP), recommending reduced rates on income and capital gain, increased personal exemptions, and base broadening through repeal of many deductions.<sup>164</sup>

## 2. Administrative Provisions

Over a couple of decades, the Congress and Treasury promulgated a series of administrative rules. These rules reflected the increasing complexity of tax administration.

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<sup>162</sup> BROWNLEE, *supra* note 20, at 154.

<sup>163</sup> Ronald Reagan: Address Before a Joint Session of the Congress on the State of the Union, 20 WEEKLY COMP. OF PRES. DOC. 90 (Jan. 30, 1984).

<sup>164</sup> DEP'T OF THE TREAS., TAX REFORM FOR FAIRNESS, SIMPLICITY & ECONOMIC GROWTH: TREAS. DEP'T REP. TO THE PRESIDENT (1984); *see also* IRS Pub. 1694, *supra* note 3, at 221.

On February 7, 1956, the Treasury Department confirmed representation of taxpayers before the IRS by enrolled agents, who “must observe the ethical standards of the accounting profession,” in addition to attorneys, under Circular 230.<sup>165</sup> In October 1958, the Treasury proposed rules,<sup>166</sup> finalized the following February, effective on March 15, 1959, expanding enrollment beyond attorneys and certified public accountants to applicants who passed a written examination as well as to former IRS employees, and permitting unenrolled agents to represent taxpayers in District Directors' offices with respect to examination of returns they prepared.<sup>167</sup> Within a decade, Congress imposed penalties on paid tax return preparers for certain infractions.<sup>168</sup>

On October 16, 1962, Congress enacted with President John Kennedy's signature a Revenue Act adding to the tax Code third-party information reporting, which effectively recruited

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<sup>165</sup> 21 FED. REG. 833; *cf.* Circ. 230 (Dec. 7, 1951), 31 C.F.R. § 10.3(a) & (b) (allowing enrollment of attorneys & CPAs), (j) (allowing special enrollment by examination).

<sup>166</sup> Practice of Attorneys & Agents Before the Internal Revenue Service, 23 FED. REG. 8427-28 (proposed Oct. 31, 1958); Practice of Attorneys & Agents Before the Internal Revenue Service, 23 FED. REG. 7702-03 (proposed Oct. 4, 1958) (to be codified at 31 C.F.R. pts. 10, 12, 13 and 14).

<sup>167</sup> Employees' Benefits, 24 FED. REG. 1157 (Feb. 14, 1959); 31 C.F.R. § 10.7(a) & (e); 1959-1 C.B. 745.

<sup>168</sup> H.R. REP. NO. 91-782, at 229-30 (1969) (Conf. Rep.).

payers of interest and dividends into the tax compliance system.<sup>169</sup> The legislation required the IRS to develop an Income Information Document Matching Program to find unreported income and to identify individuals who failed to file a tax return.<sup>170</sup>

On November 2, 1966, Congress enacted with President Lyndon Johnson's signature a law allowing the IRS to designate a so-called Service Center, instead of a District Director's office, as an official place for filing tax returns.<sup>171</sup> The IRS had piloted the first Service Center in Kansas City eleven years earlier.<sup>172</sup> Service Centers were to play an important role in the expansion of automation and de-personalizing tax administration.<sup>173</sup>

On October 4, 1976, Congress enacted with President Ford's signature a Tax Reform Act (TRA '76) that, as mentioned above, imposed negligence or fraud penalties on paid tax return preparers.<sup>174</sup> Moreover, TRA '76 wholly amended the taxpayer privacy law.<sup>175</sup> As previously noted, tax return information historically had been publicly accessible subject only to Executive Branch rules. In 1970, White House officials had obtained IRS information on political enemies of then President

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<sup>169</sup> Revenue Act of 1962, Pub. L. No. 87-834, 76 Stat. 960.

<sup>170</sup> IRS Pub. 1694, *supra* note 3, at 177.

<sup>171</sup> Pub. L. No. 89-713, 68A Stat. 752 (1966) (codified as amended at I.R.C. § 6091).

<sup>172</sup> IRS Pub. 1694, *supra* note 3, at 161.

<sup>173</sup> *See infra* Pt. IV.C.1.

<sup>174</sup> *See* TRA '76, Pub. L. No. 94-455.

<sup>175</sup> *See* I.R.C. § 6103 (as amended by TRA '76).

Nixon, who later left office in disgrace after the Watergate burglary scandal.<sup>176</sup> Thereafter, the 1976 statute essentially restricted the use of return information to tax administration purposes.<sup>177</sup>

In short, legislative and regulatory rules of tax administration expanded over these decades. These rules reflected the roles of third-party preparers and payers in the tax system, which in turn built facilities to manage IRS data. Finally, these data presented information that warranted stringent taxpayer privacy legislation. These administrative provisions characterized a complex federal tax system.

### 3. Summary

Between the Internal Revenue Codes of 1954 and 1986, legal complexity increased, especially in the form of social tax expenditures. At the same time, tax procedure and administration became more regimented. This regimentation facilitated standardization and automation.

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<sup>176</sup> DEP'T OF THE TREAS., REP'T TO THE CONGRESS ON SCOPE & USE OF TAXPAYER CONFIDENTIALITY & DISCLOSURE PROVISIONS 21; *see also* JCT, *Study of Present-Law Taxpayer Confidentiality & Disclosure Provisions*, vol. 1 at 255 (relating to Pres. Nixon's authorization of the U.S. Dep't of Agriculture to inspect tax returns of all farmers for statistical purposes).

<sup>177</sup> I.R.C. § 6103 (as amended by TRA '76).

## B. Demographic and Filing Trends

From 1954 to 1985, the U.S. population increased from 163 million to 238 million, or about 46 percent.<sup>178</sup> At the same time, the volume of individual income tax returns increased from 56.7 to 102 million or almost 80 percent.<sup>179</sup> In FY 1954, the IRS collected \$69.9 billion, of which individual income taxes were almost 47 percent or \$32.8 billion.<sup>180</sup> In FY 1985, the IRS collected \$742.9 billion, of which individual income taxes were more than 53 percent or \$396.7 billion.<sup>181</sup> In sum, the country and taxes grew, yet the increase to individual income taxation was disproportionately high.

The post-World War II decades were prosperous, especially for middle-class families whose real income continued to rise.<sup>182</sup> While people began to pay more taxes, their benefits, such as health insurance, expanded.<sup>183</sup> At the same time,

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<sup>178</sup> Census, STATISTICAL ABSTRACT OF THE U.S. (2003), Table No. HS-1, *Population: 1900-2002*.

<sup>179</sup> IRS PUB. 79, SOI (1954), at 3, Pt. I, Table 1; IRS Pub. 1304, INDIVIDUAL INCOME TAX RETURNS, 1985 (SOI) Table B, 6.

<sup>180</sup> CIR ANN. REP. (1954) at 4.

<sup>181</sup> CIR ANN. REP. (1985) at 2.

<sup>182</sup> CAPLOW, ET AL., *supra* note 54, at 164.

<sup>183</sup> *Id.* at 152, 164 (indicating “fringe benefits . . . were far more extensive and valuable than they had been in the past”).

poverty decreased significantly, from 22 percent in 1959 to 12 percent in 1999.<sup>184</sup>

During this period, women continued to enter the workforce in greater numbers.<sup>185</sup> The marriage rate decreased as both the average age at marriage and the divorce rate increased.<sup>186</sup> Cohabitation rose, as well, especially among young, white, adults without high school diplomas.<sup>187</sup> Tax filing reflects this trend. In 1954, heads of household filed a million returns, less than 2 percent of the total.<sup>188</sup> In 1985, heads of household filed 10 million returns, almost 10 percent of the total.<sup>189</sup>

In Middletown, the bellwether for social surveys, patriotic attitudes continued to decline.<sup>190</sup> At this point, increased

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<sup>184</sup> *Id.* at 174-75.

<sup>185</sup> *Id.* at 38.

<sup>186</sup> *Id.* at 68, 78.

<sup>187</sup> *Id.* at 72 (stating “Those most likely to cohabit were young adults, non-Hispanic whites, and people who never graduated from high school.”).

<sup>188</sup> IRS PUB. 79, *supra* note 179 at 10, Pt. I, Table C.

<sup>189</sup> IRS PUB. 1304, *supra* note 179 at 19, Table 1.3, cols. (1) & (7).

<sup>190</sup> CAPLOW, ET AL., *supra* note 54, at 210. Researchers asked survey respondents in Middletown High School to agree or disagree with statements including the following: the U.S. is unquestionably the best country in the world; and every good citizen should act according

prosperity coincided with decreased collectivist attitudes. In sum, demographic trends during the third period under study reflected economic security and social independence for segments of the population.<sup>191</sup>

### C. Implications for Tax Administration

To match the increased return volume between 1954 and 1985, the number of IRS employees rose from 51,411 to 92,792.<sup>192</sup> Managing the work involved both equipment and organization.

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to the following statement, “My country – right or wrong!” In 1924, more than nine of ten students agreed that the U.S. was the best; in 1977, more than seven of ten agreed; and in 1999, about six of ten. Similarly, the proportions favoring the slogan in the second statement declined in successive replications of the survey.

<sup>191</sup> HOWARD, *supra* note 148, at 5. Commentators may associate government-supported socio-economic security with a “welfare state,” variously defined as “an instrument of social control or social betterment; as a part of the state or a particular stage in the development of capitalist states; as a minimal safety net for those in need; social insurance for the middle classes; or everything the government does to improve the well-being of individuals and families.”

<sup>192</sup> IRS PUB. 1694, *supra* note 3, at 249-50.



## 1. Meltdown

In FY 1955, the Midwest Service Center used IBM computers to process 1.1 million Forms 1040A from the ten districts of the IRS Omaha Region, ushering in central processing.<sup>193</sup> The next step in computerization on June 1, 1961, took place in Martinsburg, West Virginia (beyond the 20-mile national security perimeter around Washington, D.C.) at the new IRS National Computer Center.<sup>194</sup> The same year, an Automated Data Processing Division, with responsibility for return processing, revenue accounting, and Service Centers, split off from the Collection Division.<sup>195</sup> In August 1961, the IRS created a position of Assistant Regional Commissioner (Data Processing) in its Atlanta Region, which, in turn, became the site of a new Service Center equipped with computers.<sup>196</sup>

These IRS actions reflected what Professor Surrey explained at the time. He observed that population growth and a broadened tax base resulted in paperwork that “threatened to engulf tax administration.”<sup>197</sup> In self-defense,” he said, the IRS turned to automation.<sup>198</sup> The inevitability of mass data

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<sup>193</sup> *Id.* at 161.

<sup>194</sup> *Id.* at 170, 173.

<sup>195</sup> *Id.* at 172.

<sup>196</sup> *Id.* at 174.

<sup>197</sup> Stanley S. Surrey, *Automatic Data Processing & Tax*

*Administration: The Potentialities of ADP & Factors Involved in its*

*Adoption*, Buenos Aires Conf. on Tax Admin., TAX POL’Y & TAX

REFORM 497-98 (1961).

<sup>198</sup> *Id.*

processing had emerged as a theme in the history of federal income tax administration.

In 1964, Commissioner Mortimer Caplin was to caution against “a tendency to overcentralize operations, to overextend capabilities and, yes, to capitulate to overmechanization and underhumanization of tax administration.”<sup>199</sup> Three years after Professor Surrey’s observation, Commissioner Caplin warned that the “IRS must constantly weigh machine capability against the actual and psychic costs to the nation.”<sup>200</sup> Nevertheless, the IRS forged ahead.

In 1966, the IRS opened an Individual Master File with a mainframe account for every individual taxpayer to process returns nationwide the following year.<sup>201</sup> In 1969, the IRS deployed the so-called Discriminant Function (DIF) of individual taxpayer statistics “for selecting returns for audit.”<sup>202</sup>

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<sup>199</sup> Mortimer M. Caplin, *Commissioner Caplin Reviews his Record as IRS Chief*, 29 VA. TAX REV. 177, 180 (2009).

<sup>200</sup> *Id.*

<sup>201</sup> IRS PUB. 1694, *supra* note 3, at 184-85.

<sup>202</sup> *Id.* at 191. The DIF is as a computer algorithm that estimates the likelihood that an audit of a particular return would produce an adjustment, forming a criterion for exam selection. The DIF is based on data obtained and periodically updated from IRS National Research Program (NRP) examinations. *See* Int. Rev. Man. 4.1.1.2.6 (Oct. 24, 2006), 4.1.24.1 (Mar. 23, 2010), Exhibit 4.1.7-1(12) (May 19, 1999), 4.1.2.7 (Oct. 19, 2017) (stating DIF “is a mathematical

The same year, the IRS piloted an Integrated Data Retrieval System (IDRS) and implemented it nationally by 1973.<sup>203</sup>

In 1977, the Carter administration approved IRS plans for a \$1.8 billion computerized Tax Administration System, but Congress did not fund this initiative due in part to concern that increased computer accessibility could degrade taxpayer privacy in the post-Watergate era.<sup>204</sup> In 1979, the IRS embarked on a long-range plan to replace obsolete computer equipment used for return processing. In March 1982, a pilot Service Center in Memphis installed new equipment, and the other nine Service Centers followed the next year.<sup>205</sup> Additional applications were scheduled for “complete conversion” by January 1985.<sup>206</sup>

Despite optimistic projections, IRS managers in the field attempted to notify National Office executives that the new computers had insufficient capacity, exacerbated by inefficient software, a lack of digitally proficient employees, and a need for equipment such as tape drives.<sup>207</sup> Warnings went unheeded. As tax returns poured in, IRS employees were unable to process them. To paraphrase Professor Surrey, mechanical failure left employees to defend themselves from paperwork that

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technique used to score income tax returns for examination potential... based on available NRP data”).

<sup>203</sup> IRS PUB. 1694, *supra* note 3, at 191.

<sup>204</sup> *Id.* at 210.

<sup>205</sup> CIR & CHIEF COUNSEL IRS ANN. REP. (1982) at 22.

<sup>206</sup> CIR & CHIEF COUNSEL IRS ANN. REP. (1983) at 26.

<sup>207</sup> See SHELLEY L. DAVIS, UNBRIDLED POWER: INSIDE THE SECRET CULTURE OF THE IRS 53 (HarperCollins, 1997).

threatened to engulf them. News reports told of IRS staff around the country taking matters into their own hands as follows.

In an investigation ordered by House Ways and Means Oversight Subcommittee Chairman J.J. Pickle (D-Tex.), the General Accounting Office (GAO, later the Government Accountability Office) confirmed news reports that the Austin Service Center had improperly destroyed about 5,000 requests from business taxpayers for account adjustment. IRS executives were unaware of the destruction of correspondence, allegedly ordered in December 1984 by a manager who resigned.<sup>208</sup>

A parallel GAO investigation authorized by Senate Finance Committee Chairman Bob Packwood (R-Ore.) revealed that on July 26, 1984, a Philadelphia Service Center (PSC) custodian emptying a trash can in the women's restroom found thirty-five Form 1040s.<sup>209</sup> On April 26, 1985, a PSC janitor found in a trash barrel on the loading dock envelopes containing unprocessed documents and remittances.<sup>210</sup> In particular, over a hundred discarded envelopes contained:

- 94 remittances totaling \$333,440;
- 36 individual income tax returns;
- 24 Forms 1040 ES (Estimated Tax for Individuals); and

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<sup>208</sup> U.S. GEN. ACCOUNT. OFF. (GAO), GGD-85-89, INFO. ON IRS SERV. CTRS. IN AUSTIN, TEX. AND FRESNO, CAL. 59 (Sept. 30, 1986).

<sup>209</sup> GAO, GD-86-25FS, INFO. ON IRS PHILA. SERV. CTR. 36 (Nov. 1985).

<sup>210</sup> *Id.* at 33.

- 49 miscellaneous documents.<sup>211</sup>

This was a meltdown of mass processing. Ultimately, GAO reported, the IRS National Office scheduled delivery of the necessary hardware and software to the affected Service Centers in time for the 1986 processing season.<sup>212</sup>

It is unclear if any IRS official was ever held accountable for the meltdown of 1985.<sup>213</sup> Here the question arises whether the post-World War II tax system had grown into a complex “unto itself” beyond controls that could eliminate the risk of meltdown.<sup>214</sup>

## 2. Diverse Taxpayer Needs

In the face of the risks of automation, distinct populations presented challenges for tax administration. In 1956, the IRS responded to rural America by collaborating with the U.S. Department of Agriculture to publish a 64-page *Farmers' Tax Guide* and distribute a million copies.<sup>215</sup> Outreach

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<sup>211</sup> *Id.* at 33 (quoting a May 30, 1985, memo from IRS Int. Audit Div. to PSC Dir.).

<sup>212</sup> GAO, *supra* note 208 at 3.

<sup>213</sup> DAVIS, *supra* note 207, at 52 (asserting that “none of these culprits was ever held accountable for the massive IRS mishap of 1985”).

<sup>214</sup> DAVID BURNHAM, *A LAW UNTO ITSELF: POWER, POLITICS & THE IRS* (NY: Random House, 1989). For other reasons, commentators have characterized the IRS as a “law unto itself.”

<sup>215</sup> IRS PUB. 1694, *supra* note 3, at 162.

continued, this time launched from the metropolitan centers of New York, Miami, and Los Angeles, with the 1972 publication for readers of Spanish.<sup>216</sup> In 1970, the IRS sponsored Volunteer Income Tax Assistance (VITA) to prepare returns for low income taxpayers,<sup>217</sup> followed eight years later by Tax Counseling for the Elderly (TCE), a volunteer program to assist taxpayers age 60 and over.<sup>218</sup> To simplify returns for individuals whose income was generally earned rather than capital, the IRS issued Form 1040EZ in 1982. These events reflected various IRS reactions to emerging taxpayer needs.

### 3. Summary

The third period under study began with groundbreaking work at Service Centers and similar new sites but ended in a meltdown. As this course of events played out, the IRS was insulated from outside influence by stable fiscal policy. At the same time, taxpayer diversity continued to present needs to be met in small but significant ways.

## V. Restructuring and an Emerging New Mission, 1986-2013

The last few decades of federal income taxation reflected a maturation of a mass tax that was broadly administered in an electronic mode. At the same time, the mass tax had implications for taxpayer rights. The sobering experience of the meltdown of 1985 gave way to legislative iterations of taxpayer rights, IRS restructuring, and refundable credits. Cumulatively, these provisions were to change the nature of tax administration. The persistence of taxpayer service needs was

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<sup>216</sup> *Id.* at 199.

<sup>217</sup> *Id.* at 196.

<sup>218</sup> *Id.* at 213.

to become more poignant as Congress charged the IRS with the delivery of more socio-economic benefits.

## **A. Significant Tax Legislation**

### **1. Internal Revenue Code of 1986**

On October 22, 1986, President Reagan signed the Tax Reform Act (TRA '86). This was the product of the Treasury proposals discussed above, as revised after public comment, and historic congressional effort, led in large part by House Ways and Means Committee Chairman Dan Rostenkowski (D-Ill.) as well as Senate Finance Chairman Packwood.<sup>219</sup> TRA '86 not only recodified the tax law but simplified it by broadening the base, affording a reduction in rates essentially from 50 to under 40 percent, garnering political support.<sup>220</sup> Base broadening came through repeal of tax expenditures, especially for business (and capital), notably the investment tax credit.

While the story of TRA '86 has been amply told,<sup>221</sup> two provisions are particularly relevant here. TRA '86 eliminated filing requirements for some 6 million low income people through increased personal exemptions and standard deductions.<sup>222</sup> For low-income workers who remained on the tax rolls, the legislation significantly expanded the EITC by raising the maximum credit from \$550 to \$800 and the phase-

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<sup>219</sup> Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986).

<sup>220</sup> IRS PUB. 1694, *supra* note 3, at 254.

<sup>221</sup> See, e.g., JEFFREY H. BIRNBAUM & ALAN S. MURRAY, SHOWDOWN AT GUCCI GULCH: LAWMAKERS, LOBBYISTS & THE UNLIKELY TRIUMPH OF TAX REFORM (NY: Random House, 1987).

<sup>222</sup> BROWNLEE, *supra* note 20, at 174.

out ceiling from \$11,000 to \$13,500, while also indexing the credit for inflation.<sup>223</sup>

## **2. Rights, Reconciliation, Responsibility, and Refundability**

As the IRS added benefit disbursement to the traditional role of tax collector, it could not ignore those who were more like “customers” than taxpayers. On November 1, 1988, the IRS recognized these developing roles when it issued Publication 1, *Your Rights as a Taxpayer*.<sup>224</sup>

Nine days later, Congress enacted with President Reagan’s signature the Technical and Miscellaneous Revenue Act of 1988 (TAMRA ’88) containing a Taxpayer Bill of Rights (TBOR) that codified dissemination of taxpayer rights information.<sup>225</sup> This legislation was succeeded by TBOR II, enacted by Congress and signed by President Bill Clinton in 1996.<sup>226</sup>

Meanwhile, Congress enacted and President George H.W. Bush signed the Omnibus Budget Reconciliation Act of 1990 (OBRA ’90). OBRA ’90 expanded the EITC by increasing the

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<sup>223</sup> TRA ’86, Pub. L. No. 99-514, 100 Stat. 2085 at 2107; JCT, 99th Cong., GEN. EXPLANATION OF THE TAX REFORM ACT OF 1986 28 (1987).

<sup>224</sup> IRS PUB. 1694, *supra* note 3, at 230.

<sup>225</sup> Technical & Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, 102 Stat. 3342 (1988); H.R. REP. NO. 100-1104, at 1104 (1988) (Conf. Rep.) (requiring future editions of Pub. 1 to conform to TBOR).

<sup>226</sup> Taxpayer Bill of Rights II, Pub. L. No. 104-168, § 101, 110 Stat. 1452, 1453-54 (1996).



credit rate above that of the aggregate employer and employee Social Security tax, the payroll tax that the EITC originally came to offset.<sup>227</sup>

Further EITC amendment came in the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA '96), which substantially reformed traditional welfare programs.<sup>228</sup> As a central component of welfare reform, PRWORA '96 expanded the EITC work incentive amount while curtailing it with respect to immigration and work status in the U.S., essentially to preclude access by undocumented workers.<sup>229</sup>

In 1997, Congress enacted and President Clinton signed a Taxpayer Relief Act including a child tax credit, giving taxpayers who were parents up to \$500 per qualifying child.<sup>230</sup> Compared to the EITC, a portion of the child tax credit was to be refunded even in excess of liability.<sup>231</sup>

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<sup>227</sup> Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11111, 103 Stat. 143 (1990).

<sup>228</sup> Pers. Resp. & Work Opportunity Reconciliation Act of 1996, Pub. L. No. 104-193, § 451, 110 Stat. 2105, 2276 (1996).

<sup>229</sup> I.R.C. § 32(m) (as amended by PRWORA '96).

<sup>230</sup> Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 101, 111 Stat. 788 (1997).

<sup>231</sup> I.R.C. § 24(d), *amended by* Pub. L. No. 107-16, § 201 (expanding refundability).

### 3. IRS Restructuring and Reform Act of 1998

On September 23, 1997, Senate Finance Committee Chairman William Roth (R-Del.), opened hearings on IRS practices, procedures, oversight, and ultimately restructuring, that were to stretch well into the following year.<sup>232</sup> In confronting the IRS, Senator Roth intoned: “There is no other agency in this country that directly touches the lives of more Americans, nor is there any agency which strikes more fear into their hearts.”<sup>233</sup>

Scores of witnesses included the former IRS Historian, who had left the job frustrated with officials’ unwillingness to preserve and release historical documents;<sup>234</sup> a journalist who had authored a book-length exposé of the IRS;<sup>235</sup> four witnesses who testified on their troubles as innocent spouses wrongfully saddled with the liabilities of their husbands (or ex-husbands); former Commissioners Sheldon Cohen (1965-69), Donald Alexander (1973-77), Fred Goldberg (1989-92), and Margaret Richardson (1993-97), as well as sitting Commissioner Charles Rossotti and Treasury Secretary Robert Rubin.

Early in the hearings, a half-dozen anonymous IRS employees revealed internal excesses. For example, one witness testified that in the context of negotiating payments supposed to be affordable to taxpayers, “I have seen the IRS punish a taxpayer by not allowing reasonable, necessary living

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<sup>232</sup> *Practices & Procs. of the IRS: Hearing Before the Comm. on*

Finance, S. Hrg. 105-190, 105th Cong. 1st Sess. (Sept. 23-25, 1997).

<sup>233</sup> *Id.* at 1.

<sup>234</sup> *Id.* at 33, 35-38.

<sup>235</sup> *Id.* at 37.

expenses.”<sup>236</sup> Even if “the most serious charges against the agency were grossly exaggerated and, in many cases, simply false,” the hearings “provided a highly visible forum for antitax forces to levy sensational charges about outrageous agency behavior.”<sup>237</sup> Promising “fundamental change,” Commissioner Rossotti acknowledged the seemingly arbitrary audit selection mechanism by saying that, “I will personally not believe that we are doing the right thing with respect to audits until I feel I can explain the process to the average American taxpayer.”<sup>238</sup>

On the other side of Congress, Speaker of the House Newt Gingrich (R-Ga.) had primed his caucus for reform through a Contract with America calling for both tax cuts and a balanced budget. According to a senior academic tax historian, the 1998 tax legislation was “the only direct accomplishment of Gingrich’s Contract for America and its attacks on the IRS.”<sup>239</sup>

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<sup>236</sup> *Id.* at 145.

<sup>237</sup> TANINA ROSTAIN & MILTON C. REGAN JR., *CONFIDENCE GAMES: LAWYERS, ACCOUNTANTS, AND THE TAX SHELTER INDUSTRY*, 11, 19 (Cambridge, Mass. MIT Press, 2014).

<sup>238</sup> *IRS Oversight*, S. Hrg. 105-598, 105th Cong. 2nd Sess. (Apr. 28-30 & May 1, 1998).

<sup>239</sup> BROWNLEE, *supra* note 20, at 214.

In 1998, Congress enacted and President Clinton signed the IRS Restructuring and Reform Act (RRA '98) that among other provisions:<sup>240</sup>

- Created an Oversight Board to supervise the IRS;
- Granted the Commissioner a five-year term unaffected by a change in Administration;
- Split the Chief Counsel's chain of command, reporting to the Treasury General Counsel on tax policy and to the Commissioner on tax administration and litigation;
- Elevated the IRS Chief Inspector into a Senate-confirmed appointee to be known as the Treasury Inspector General for Tax Administration, who reported directly to the Secretary;
- Reorganized the IRS from the 1952 geographic scheme into divisions serving taxpayer groups which, after consultation with management professionals, were identified as Wage & Investment, Small Business/Self-Employed, Tax-Exempt/Government Entities, and Large

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<sup>240</sup> Taxpayer Relief Act of 1997, Pub. L. No. 105-206. The underlying bill, H.R. 2676, was passed by votes in the House of Reps. 426 to 4, and Sen. 97 to 0. H.R. ROLL CALL 577 (Nov. 5, 1997); S. VOTE NO. 126 (May 7, 1998).

& Mid-Size Business (renamed Large Business & International on October 1, 2010);<sup>241</sup>

- Funded Low Income Taxpayer Clinics;
- Expanded innocent spouse relief and made numerous reforms to procedural, collection, interest and penalty provisions, including the requirement for Collection Due Process hearings triggered by the first lien or levy action with respect to a tax liability; and
- Set goals for electronic filing.<sup>242</sup>

RRA '98 effectively laid the foundation for taxpayer service in the current era. By reorganizing into functional divisions, each of which had nationwide scope, RRA '98 led the IRS further away from local service, and closer to national centralization begun in 1952.

#### **4. Economic Growth and Recession**

In 2001, Congress enacted the Economic Growth and Tax Relief Reconciliation Act (EGTRRA '01), introducing President George W. Bush's tax cuts at the height of an economy that had boomed in the previous decade. Generally, EGTRRA '01 reduced income tax rates, in part by creating a 10-percent bracket for low-income taxpayers, reduced marriage penalties, and expanded favorable provisions for education and retirement

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<sup>241</sup> IRS News Release, *IRS Realigns and Renames Large Business*

*Division, Enhances Focus on International Tax Administration*, No.

IR-2010-88 (Aug. 4, 2010).

<sup>242</sup> H. CONF. REP. NO. 105-599 (1998).

savings.<sup>243</sup> Tax cuts were immediately delivered through advance rebate checks.<sup>244</sup> Since congressional rules permitted tax cuts only to a budgeted extent, the cuts generally were scheduled to expire in 2010.

In 2002, Congress enacted and President Bush signed a Trade Act that was not primarily a tax bill. Nevertheless, the legislation codified a refundable credit to help pay for the health-insurance premiums of families of American workers laid off by employers who moved to a country that had a free trade agreement with the U.S.<sup>245</sup>

In 2003, the Jobs & Growth Tax Relief Reconciliation Act enacted another round of tax cuts associated with the Bush Administration. This legislation supplemented the favorable rates on capital gain with reduced rates on stock dividends.<sup>246</sup>

In 2004, Congress enacted and President Bush signed the Working Families Tax Relief Act (WFTRA '04) containing a Uniform Definition of Child.<sup>247</sup> Acting on proposals from the

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<sup>243</sup> Economic Growth & Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38.

<sup>244</sup> I.R.C. § 6428(g) *as added by* Pub. L. No. 107-16, § 101(b)(1) (2001).

<sup>245</sup> I.R.C. § 35 *as added by* Pub. L. No. 107-210, § 201(a) (2002); *see also* H.R. REP. NO. 107-624, at 122 (2002) (Conf. Rep.).

<sup>246</sup> Jobs & Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108-27, 117 Stat. 752, 760.

<sup>247</sup> Working Families Tax Relief Act of 2004, Pub. L. No. 108-311, 118 Stat. 1166, 1169.

Treasury, American Bar Association, American Institute of Certified Public Accountants, and Tax Executives Institute, Congress simplified the requirements for purposes of head of household filing status, child-care credit, child tax credit, EITC, and dependency deduction.<sup>248</sup> Generally, WFTRA '04 eliminated the need to document expenses for supporting a child of a prescribed age, relationship, and residence.

In 2004, the American Jobs Creation Act introduced new deductions.<sup>249</sup> Individuals could now deduct state & local sales tax if they lived in jurisdictions without income tax. Businesses could now deduct expenses of domestic production.

In response to a serious market downturn in 2008, Congress enacted and President Bush signed the Housing and Economic Recovery Act (HERA '08).<sup>250</sup> Under the leadership of the House Ways and Means Committee Chairman Charles Rangel (D-N.Y.), HERA '08 enacted a First-Time Homebuyer Tax Credit for a portion of the purchase price.<sup>251</sup> In another nod to congressional budgetary rules, the revenue cost of the legislative provision was offset by recapture over 15 years, effectively transforming the refundable credit into an interest-

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<sup>248</sup> DEPT. OF THE TREAS., PROPOSAL FOR UNIFORM DEFINITION OF A QUALIFYING CHILD 4, 6-7 (2002); ABA/AICPA/TEI, TAX SIMPLIFICATION RECOMMENDATIONS (2002).

<sup>249</sup> American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418, 1520-21.

<sup>250</sup> Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654 (2008).

<sup>251</sup> I.R.C. § 36 as added by HERA '08.

free loan to the taxpayer.<sup>252</sup> The following year, Congress would repeal recapture for later purchases.<sup>253</sup>

Another piece of recovery legislation was the Economic Stimulus Act of 2008 (ESA '08), which generated tax rebate checks to low and moderate-income individuals.<sup>254</sup> This was the fifth time that the IRS had become a disbursing agent for rebates.<sup>255</sup>

Weeks after his inauguration, President Barack Obama signed the American Recovery and Reinvestment Act of 2009

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<sup>252</sup> *Id.*

<sup>253</sup> Pub. L. No. 111-92, 123 Stat. 2984, 2989 (2009).

<sup>254</sup> I.R.C. § 6428 *as amended by* Pub. L. No. 110-185, § 101(a) (2008).

For business taxpayers, 2008 economic emergency legislation, in a provision that would be expanded by ARRA '09 as well as 2010 extender legislation, created an election to accelerate alternative minimum tax (AMT) or research credits in lieu of that year's bonus depreciation and made the amount refundable. *See* I.R.C. § 168(k)(4) *amended by* Pub. L. Nos. 110-289, § 3081, 122 Stat. 2654, 2903 (2008), 111-5, Div. B, § 1201, 123 Stat. 115, 333 (2009) & 111-240, § 2022, 124 Stat. 2504, 2558 (2010).

<sup>255</sup> I.R.C. § 6428 *enacted by* 89 Stat. 26 (1975), *amended by* 95 Stat. 172, 172-85 (1981), 115 Stat. 38 (2001), and 122 Stat. 613 (2008); I.R.C. § 6429 (2003) *amended by* 117 Stat. 752 (2003).



(ARRA '09).<sup>256</sup> This legislation contained a signature Making Work Pay provision intended to support economic recovery through a refundable credit for low-income workers in the amount of the payroll tax, expeditiously implemented by reductions in the withholding tables.<sup>257</sup> Parallel in some respects to the EITC, the Making Work Pay benefit was not tied to family size.<sup>258</sup> Additionally, ARRA '09 temporarily modified and renamed the Hope Scholarship Credit, which Congress had enacted under President Clinton, as the refundable American Opportunity Tax Credit.<sup>259</sup>

In 2010, Congress enacted the Patient Protection and Affordable Care Act (ACA), reflecting a major goal of the Obama Administration to extend health coverage to millions of uninsured Americans.<sup>260</sup> ACA contained four health-care provisions of significance to income tax administration: a temporary credit for employers who pay for health insurance for a small number of employees;<sup>261</sup> a refundable credit for low- and

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<sup>256</sup> Pub. L. No. 111-5 (2009).

<sup>257</sup> American Recovery & Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115, 309; H.R. Rep. No. 111-16, at 1, 517-18 (2009) (Conf. Rep.).

<sup>258</sup> I.R.C. § 36A.

<sup>259</sup> I.R.C. § 25A.

<sup>260</sup> Patient Protection and Affordable Care Act of 2010, Pub. L. No. 111-148, 124 Stat. 119.

<sup>261</sup> I.R.C. § 45R (allowing credit that is partially refundable to small tax-exempt employers).

moderate-income individuals to subsidize the purchase of health insurance;<sup>262</sup> a penalty for individuals who fail to obtain health coverage;<sup>263</sup> and an excise tax on large employers who fail to offer health coverage.<sup>264</sup> In another reinvigoration of a Clinton-era social tax expenditure, ACA temporarily made refundable the credit for parents who incur expenses of adopting children.<sup>265</sup>

### **B. Economic and Demographic Trends**

In 2011, research by economists associated with the Treasury Office of Tax Analysis showed that income inequality had reached levels not seen since the Great Depression.<sup>266</sup> In 2008, the top 1 percent of earners received approximately 20 percent of personal income in the U.S.<sup>267</sup> Of the top 0.1

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<sup>262</sup> I.R.C. § 36B.

<sup>263</sup> I.R.C. § 5000A.

<sup>264</sup> I.R.C. § 4980H.

<sup>265</sup> I.R.C. § 36C.

<sup>266</sup> See Jon Bakija, Adam Cole & Bradley T. Heim, *Jobs and Income*

*Growth of Top Earners and the Causes of Changing Income*

*Inequality: Evidence from U.S. Tax Return Data* (Nov. 2010),

<https://web.williams.edu/Economics/wp/BakijaColeHeimJobsIncomeGrowthTopEarners.pdf> (last visited Dec. 29, 2011).

<sup>267</sup> Peter Whoriskey, *With Executive Pay, Rich Pull Away from Rest of America*, WASH. POST (June 18, 2011) at A-1; see also Bakija, *supra* note 266; IRS, *SoI, Individual Income Tax Rates & Shares*, 2008.

percent who earned \$1.7 million or more, 60 percent were corporate executives or other managers.<sup>268</sup>

Meanwhile, income was only a part of compensation. Fringe benefits increased in the last quarter of the twentieth century.<sup>269</sup> Generous tax expenditures for retirement benefits and other non-wage compensation supported this increase.

The data above are consistent with class trends toward inequality through the end of the twentieth century. College tuition rose sharply in the last couple of decades.<sup>270</sup> While a plethora of tax breaks subsidized college tuition (Hope Scholarship, Lifetime Learning, and American Opportunity Tax Credits; tuition and student loan interest deductions; exclusion of interest on U.S. saving bonds; deferral under Qualified Tuition Plans and Coverdell Education Savings Accounts), some economists argued that college tuition rose to absorb certain federal subsidies.<sup>271</sup> These rising costs formed another barrier between the educated and uneducated.

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<sup>268</sup> Whoriskey, *supra* note 267; *see also* Bakija *supra* note 266.

<sup>269</sup> CAPLOW, ET AL., *supra* note 54, at 160 (adding that: “Benefits such as employer-provided health insurance, bonuses, stock options, child care, tuition assistance, and vision and dental benefits expanded dramatically.”).

<sup>270</sup> *Id.* at 62.

<sup>271</sup> *See* Bridget Terry Long, *The Impact of Federal Tax Credits for Higher Education Expenses*, in COLLEGE CHOICES: THE ECONOMICS OF WHICH COLLEGE, WHEN COLLEGE, AND HOW TO PAY FOR IT (Caroline

An indicator of a major increase in private fortunes after 1980 was private philanthropy on an unprecedented scale.<sup>272</sup> Around the same time, personal debt, composed primarily of home mortgages, soared to new heights.<sup>273</sup> Previously mentioned tax expenditures loom large in both the formation of, and response to, this trend (home mortgage interest deduction, first-time home buyer credit, as well as property tax deduction, home sale exclusion, and exclusion of homeowners' implicit rental income). The combination of personal fortunes and personal debt portray a population divided by economic inequality.<sup>274</sup>

Inequality affected a diverse taxpayer population. Refundable credits proliferated for low-income taxpayers, statistically associated with particular populations.<sup>275</sup> In 2011,

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M. Hoxby ed., 2004); JT. ECON. COMM., COLLEGE AFFORDABILITY:

TUITION TAX CREDITS VS. SAVING INCENTIVES (Oct. 1997).

<sup>272</sup> CAPLOW, ET AL., *supra* note 54, at 168.

<sup>273</sup> *Id.* at 170 (stating "Approximately three-quarters of this personal debt represented residential mortgages").

<sup>274</sup> *See generally* JOS. STIGLITZ, THE GREAT DIVIDE: UNEQUAL

SOCIETIES AND WHAT WE CAN DO ABOUT THEM (2015); Thos. Piketty,

CAPITAL IN THE TWENTY-FIRST CENTURY (Harv. Univ. Press, 2014);

Thos. Piketty & Emmanuel Saez, INCOME INEQUALITY IN THE U.S. 1913-2002 (2004).

<sup>275</sup> In 2008, 24.7 and 23.2 percent of blacks and Hispanics, respectively, but only 13.2 percent of the whole population, were

researchers reported that wealth gaps between whites and minorities had grown to their widest levels in a quarter-century.<sup>276</sup> In 2009, typical household wealth was \$5,677 for blacks, \$6,325 for Hispanics, and \$113,149 for whites.<sup>277</sup> Analyzing Census data, researchers attributed the statistics to plummeting house values.<sup>278</sup>

At the end of the twentieth century, Asian and Hispanic immigrants had joined African-Americans in large cities.<sup>279</sup>

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below poverty. See Census, STATISTICAL ABSTRACT OF THE U.S. (2011), Table 710 at 464, *People Below Poverty Level & Below 125 Percent of Poverty Level by Race & Hispanic Origin: 1980 to 2008*.

<sup>276</sup> Peter Whoriskey, *Wealth gap widens between whites, minorities, report says*, WASH. POST (Jul. 26, 2011), [https://www.washingtonpost.com/business/economy/wealth-gap-widens-between-whites-minorities-report-says/2011/07/25/gIQAjftZI\\_story.html?utm\\_term=.99d748979437](https://www.washingtonpost.com/business/economy/wealth-gap-widens-between-whites-minorities-report-says/2011/07/25/gIQAjftZI_story.html?utm_term=.99d748979437).

<sup>277</sup> Rakesh Kochhar, Richard Fry & Paul Taylor, *Wealth Gaps Rise to Record Highs Between Whites, Blacks and Hispanics*, PEW RESEARCH CTR. (July 26, 2011), <http://www.pewsocialtrends.org/2011/07/26/wealth-gaps-rise-to-record-highs-between-whites-blacks-hispanics/>.

<sup>278</sup> *Id.* at 2.

<sup>279</sup> CAPLOW, ET AL., *supra* note 54, at 20.

Distinct populations took on certain socio-economic characteristics with attendant tax consequences. For example, an academic analysis of Census data showed that “African-American households are more likely to pay a marriage penalty and White households are more likely to receive a marriage bonus.”<sup>280</sup> This is because of “the significantly high percentage of African-American wives who contribute between 40 and 60% to total household income.”<sup>281</sup>

Finally, the proportion of young to old continued to decline, reflecting both a decline in birth rate and increased longevity.<sup>282</sup> Not only did the end of the century confront growing inequality, but also a question of how many people of working age ultimately would remain to support a retiring generation.

In part, these economic trends reflected prior tax policy. In particular, tax rates declined from a post-World War II high of at least 92 percent (in 1952 and 1953) to below 40 percent after 1986 (along with favorable rates for dividends and capital gains).<sup>283</sup> According to a commentator, the “dramatic increase in U.S. economic inequality over the past four decades is probably attributable to several causes, including changes in

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<sup>280</sup> See Dorothy A. Brown, *The Marriage Penalty/Bonus Debate:*

*Legislative Issues in Black & White*, 16 N.Y.L. SCH. J. HUMAN RIGHTS 287 (1999).

<sup>281</sup> *Id.* at 294.

<sup>282</sup> CAPLOW, ET AL., *supra* note 54, at 6.

<sup>283</sup> See SOI BULL. Hist. Data Table 23 (1913-2008).

U.S. tax law”.<sup>284</sup> In sum, postwar prosperity turned into turn-of-the-century inequality.

## C. Implications for Tax Administration

### 1. Electronic Administration

In 1986, the IRS collected \$782.3 billion, of which more than half, \$416.6 billion, flowed from the individual income tax.<sup>285</sup> In 2013, the IRS collected \$2.9 trillion, of which more than half, \$1.5 trillion, came from individual income tax.<sup>286</sup> While the U.S. population and number of individual income tax returns increased, IRS staffing did not increase.<sup>287</sup> Automation continued alongside enactment of complex provisions.

Overcoming the meltdown of 1985, automation continued through the last quarter-century in the form of electronic filing and matching of information. On January 24, 1986, a tax return preparer filed a return electronically for the

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<sup>284</sup> Stephen B. Cohen, *Inequality and the Deficit*, 132 TAX NOTES 273, 280, 2011 T.N.T. 139-6, Tax Analysts Doc. No. 2011-13967 (Jul. 20, 2011), similar version released as Geo. Bus. Econ. & Reg. L. Res. Paper No. 11-13.

<sup>285</sup> IRS ANN. REP. (1986) at 8.

<sup>286</sup> IRS Pub. 55-B, *supra* note 3; Table 1, *supra*.

<sup>287</sup> Table 1, *supra* (reflecting income tax returns but not, in the first half-century, excise tax workload, which would have been measured more accurately by gallons, pounds, or warehouses, as the case may be, rather than returns).

first time;<sup>288</sup> four years later, electronic filing was possible nationwide.<sup>289</sup> In the summer of 1986, the IRS deployed optical disk equipment with laser technology (a forerunner of CDs) to store and retrieve tax return information at the Fresno Service Center.<sup>290</sup> This deployment of data storage responsibilities to Service Centers underscored the continued role of these campuses. In 1990, the Automated Underreporter (AUR) Control System came on-line with capacity for some 9 million cases annually, modernizing the process by which the IRS tracked whether taxpayers declared income reported by third parties, such as banks that paid interest.<sup>291</sup>

## 2. Behavioral Analysis

Despite the efficiency of advanced technology, tax administration still faced challenges. This last quarter-century of tax administration would begin with a tax gap, a measure of noncompliance, of \$100 billion.<sup>292</sup> In 1985, IRS receipts totaled \$742.9 billion.<sup>293</sup> On November 15, 1991, the IRS sponsored a Research Conference entitled "Closing the Tax Gap:

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<sup>288</sup> IRS Pub. 1694, *supra* note 3, at 223.

<sup>289</sup> *Id.* at 234.

<sup>290</sup> *Id.* at 224.

<sup>291</sup> *Id.* at 235.

<sup>292</sup> Richard B. Malamud & Richard O. Parry, *It's Time to Do Something About the Tax Gap*, 9 HOUS. BUS. & TAX L.J. 2 (2008) (according to a prediction Commissioner Roscoe Egger had made in 1982).

<sup>293</sup> IRS ANN. REP. (1985) at 2.



Alternatives to Enforcement."<sup>294</sup> On April 27, 1992, the IRS issued a policy statement that penalties supported the IRS mission only if they enhanced voluntary compliance.<sup>295</sup> These events reflected IRS analysis of taxpayer behavior. For 2010, the IRS estimated the difference between what taxpayers should have paid and what they actually paid on a timely basis at over \$450 billion (when IRS receipts totaled \$2.3 trillion).<sup>296</sup> The IRS had reason for concern. The tax gap increased faster than collections.

Meanwhile, academicians pushed the study of economics, including public finance, beyond a neo-classical paradigm into the territory of behavioral and other social sciences.<sup>297</sup> In 2008,

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<sup>294</sup> IRS Pub. 1694, *supra* note 3, at 236.

<sup>295</sup> IRS Policy Statement P-1-18 (as of Aug. 20, 1998).

<sup>296</sup> IRS Tax Gap Estimates for TY 2008-10, <https://www.irs.gov/pub/newsroom/tax%20gap%20estimates%20for%202008%20through%202010.pdf> (last visited Jul. 3, 2017); IRS Pub. 55-B (2010); Table 1, *supra*; see also Berdj Kenadjian, *Gross Tax Gap Trends According to New IRS Estimates, Income Years 1973-1992*, 8 SOI BULL. 23, 26 (1988) Fig. C (reporting that tax compliance historically remained between 81 and 84 percent).

<sup>297</sup> Isaac Wm. Martin, Ajay K. Mehrotra & Monica Prasad, *The Thunder of History: The Origins and Development of the New Fiscal Sociology*, in THE NEW FISCAL SOCIOLOGY: TAXATION IN COMPARATIVE AND HISTORICAL PERSPECTIVE (Cambridge Univ. Press, 2009).

Professor Cass Sunstein, who soon would be appointed to lead the Office of Information and Regulatory Affairs within the Obama administration, co-authored a behavioral economic best-seller, including passages on tax incentives and compliance, entitled *Nudge: Improving Decisions About Health, Wealth, and Happiness*.<sup>298</sup> New approaches to the perennial problem of tax compliance were emerging.<sup>299</sup>

### 3. Refunds and Rebates

Refunds and rebates affected tax administration. The core mission of the tax collector had been revenue. Yet new provisions required the IRS to effectuate disbursement as well.

Despite the reform of 1986, special tax breaks accumulated in such a quantity as to change the quality of tax administration. While tax expenditures had been born with the income tax, the last quarter-century witnessed a proliferation of social tax benefits. Previously, Assistant Secretary Surray had announced the advent of negative taxes, and the Excise Tax

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<sup>298</sup> RICHARD H. THALER & CASS R. SUNSTEIN, *NUDGE* (Yale Univ. Press, 2008) 105 & 232-33. On Oct. 9, 2017, Prof. Thaler received the Nobel Prize in economics. Binyamin Appelbaum, *Nobel in Economics Is Awarded to Richard Thaler*, N.Y. TIMES (Oct. 9, 2017).

<sup>299</sup> See Marjorie E. Kornhauser, *A Tax Morale Approach to Compliance: Recommendations for the IRS*, 8 FLA. TAX REV. 599 (2007).

Reduction Act of 1965 had made a fuel tax credit refundable, when the purchaser may have been a farmer fueling a tractor.<sup>300</sup>

After the enactment of the EITC in 1975, a parade of refundable credits ensued, in response to both good and bad economic conditions. These included the additional child tax credit, trade adjustment health credit, first-time homebuyer credit, Making Work Pay credit, American Opportunity Tax Credit, ACA Premium Tax Credit, and adoption credit. Most of these refundable credits were targeted at low-income taxpayers, a diverse population not particularly well served by mass production or informed by electronic media.<sup>301</sup>

Starting in 1975, the IRS had to apply reverse engineering to the revenue collection apparatus to issue tax rebate checks under legislation again in 1981, 2001, 2003, and 2008. Like refunds, rebates were disbursements.

Tax administration had moved beyond enforcement under a new fiscal mandate codified in special tax breaks. No longer was the IRS merely the tax collector.

#### **4. Overseeing Divergent Taxpayer Interests**

In terms of taxpayer service, the number of returns per employee slowly continued to increase after the mid-century shift to a mass population of income taxpayers, since return

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<sup>300</sup> Excise Tax Reduction Act of 1965, Pub. L. No. 89-44, § 809; H. Conf. Rep't 89-525, 89th Cong. 1st Sess. 11 (1965).

<sup>301</sup> See IRS Pub. 2104-B, TAXPAYER ADVOC. SERV. ANN'L REP'T TO CONG. (2011) I, 273, 279-80.

volume outpaced IRS hires.<sup>302</sup> As recounted above, information technology and audit techniques facilitated staff efforts to tackle an increasingly complex workload.<sup>303</sup>

Automation and audit techniques call to mind the “technique of power” observed by contemporary historians.<sup>304</sup> These post-modern commentators came after the tradition of British philosopher Jeremy Bentham of the eighteenth-century Enlightenment, when many principles of Anglo-American law were enunciated. To assure “the automatic functioning of power ... Bentham laid down the principle that power should be visible

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<sup>302</sup> Table 1, *supra* (reflecting income tax returns but not, in the first half-century, excise tax workload, which would have been measured more accurately by gallons, pounds, or warehouses, as the case may be, rather than returns).

<sup>303</sup> Tax complexity deserves its own history, yet suffice it to say that simplification has been a concern at least since mid-century, an impetus behind TRA '86, and an imperative in the last decade. *See* PAUL, *supra* note 5, at 379-92; DEP'T OF THE TREAS., *supra* note 165; Pres. Advisory Panel on Fed. Tax Reform, *Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System* (Nov. 2005); *The Moment of Truth: Rep't of the Nat'l Comm. on Fiscal Responsibility & Reform* (Dec. 2010).

<sup>304</sup> MICHEL FOUCAULT, *DISCIPLINE & PUNISH 199* (NY: Vintage Books, 1979).

and unverifiable.”<sup>305</sup> Foreshadowing deterrence by apparently arbitrary audit selection techniques (of the sort bemoaned by Commissioner Rossotti above), Bentham suggested that a subject “must never know whether he is being looked at at any one moment; but he must be sure that he may always be so.”<sup>306</sup>

Like the technology that Bentham called a panopticon, the IRS had achieved a deterrent effect beyond actual enforcement capacity. As analysts of tax compliance observed, the penalty for civil tax transgressions is small; “the probability of detection is trivial; so the expected sanction is small. Yet large numbers of Americans pay their taxes.”<sup>307</sup> This analysis left sociology and psychology to help explain voluntary compliance.

Meanwhile, Commissioner Rossotti had welcomed the enactment of RRA ’98 with an insistence “on fairness and accountability throughout the agency.”<sup>308</sup> To achieve this, he had offered “a flatter management structure that will foster better communication.”<sup>309</sup> For Commissioner Rossotti,

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<sup>305</sup> *Id.* at 201.

<sup>306</sup> *Id.* For a contrasting view of regulation, see Dennis J. Ventry Jr., *Cooperative Tax Regulation*, 41 CONN. L. REV. 431 (2008); Valerie Braithwaite, *Responsive Regulation and Taxation*, 29 L. & POL’Y 3 (2007).

<sup>307</sup> Eric A. Posner, *Law and Social Norms: The Case of Tax Compliance*, 86 VA. L. REV. 1781, 1782 (2000) (fn. omitted).

<sup>308</sup> *IRS Oversight*, *supra* note 238, at 197.

<sup>309</sup> *Id.* at 200-201.

modernized technology and management would “de-mystify the audit process.”<sup>310</sup>

On May 9, 2013, news media reported that the IRS “apologized for targeting groups with ‘tea party’ or ‘patriot’ in their names, confirming long-standing accusations by some conservatives that their applications for tax-exempt status were being improperly delayed and scrutinized.”<sup>311</sup> Attempting not to collect tax but to validate exemption claimed by non-profit organizations, the IRS had engaged in “a misguided effort to come up with an efficient means of dealing with a flood of applications from organizations seeking tax-exempt status between 2010 and 2012.”<sup>312</sup> As stated, the IRS failed to marshal

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<sup>310</sup> *Id.* at 201.

<sup>311</sup> Zachary A. Goldfarb & Karen Tumulty, *IRS Admits Targeting Conservatives for Tax Scrutiny in 2012 Election*, WASH. POST (May 10, 2013), [https://www.washingtonpost.com/business/economy/irs-admits-targeting-conservatives-for-tax-scrutiny-in-2012-election/2013/05/10/3b6a0ada-b987-11e2-92f3-f291801936b8\\_story.html?utm\\_term=.edbbe6c1a453](https://www.washingtonpost.com/business/economy/irs-admits-targeting-conservatives-for-tax-scrutiny-in-2012-election/2013/05/10/3b6a0ada-b987-11e2-92f3-f291801936b8_story.html?utm_term=.edbbe6c1a453).

<sup>312</sup> *Id.* According to commentators, the spike in applications was spurred by *Citizens United v. Fed. Election Comm.*, 130 S. Ct. 876 (U.S. 2010), which effectively freed community organizations, not subject to registration as political action committees, to spend unlimited amounts on electioneering. See Lily Kahng, *THE IRS TEA*

technology and staff into an efficient process. According to the reports, the inefficiency had a chilling effect on civil society.

After investigation, the Senate Finance Committee reported that the “multi-step review procedure established by EO Technical [the IRS Exempt Organization office] in 2012 for political advocacy applications reflected a lack of concern by IRS management for the need to process the applications expeditiously.”<sup>313</sup> On May 15, 2013, news headlines confirmed that President Obama had demanded the resignation of the Commissioner then acting in charge of the IRS.<sup>314</sup>

Human judgment would become all the more important at the end of the century. Not only did the IRS confront demographic diversity in the taxpayer population, but divergent interests among those who paid tax, sought rebates, or applied for exemption.<sup>315</sup> The question remains whether steadily

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REV. ONLINE 41 (2013).

<sup>313</sup> S. REP. NO. 114–119, at 101 (2015).

<sup>314</sup> Jonathan Weisman, *I.R.S. Chief out After Protest over Scrutiny of Groups*, N.Y. TIMES (May 15, 2013),

<http://www.nytimes.com/2013/05/16/us/irs-says-counsel-didnt-tell-treasury-of-tea-party-scrutiny.html>.

<sup>315</sup> See Eric A. San Juan & Jonathan B. Forman, *The Role of the IRS in the Administration of Social Welfare Policy*, TAX POL’Y & SIMPLIFICATION COMM. AMER. BAR ASSOC’N TAX’N SEC. (Jan. 24, 2014),

increasing volume can be addressed simply by mass production, which presumably would work if taxpayers were uniform, or if increased diversity along with increased volume raises qualitatively different challenges.

## **VI. Conclusion**

Legislatively, the last century of federal income taxation fell into four periods from enactment in 1913, to codification in 1939, recodification in 1954, and recodification with reform in 1986. In the first quarter-century, income taxation was a concern largely to wealthy, white merchants, doctors, and lawyers, who dealt with their Collectors, who in turn were locally prominent political appointees.

All this changed during the second phase, when the exigency of World War II transformed the income tax into a mass revenue generator, popularized by the Treasury. The old-fashioned infrastructure of the BIR proved too prone to corruption for the modern regime, which reorganized the IRS into a machine controlled from Washington, D.C. The 1952 reorganization marked a shift from local to centralized tax administration, embodied in Service Centers. Automation carried out in Service Centers across the country continued apace through the third period until burning out in a tragic failure of technology and management in 1985.

After the expansion of impersonal technology, the last few decades brought increased oversight to the IRS, personified by the Treasury Inspector General for Tax Administration and IRS Oversight Board. Nevertheless, an inevitable modernization

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<http://jay.law.ou.edu/faculty/jforman/ABA/ABAWinter2014Background.pdf>.



of computers with their promise of efficiency overshadowed old-fashioned staff with human judgment.<sup>316</sup>

Meanwhile, the tax system was increasingly characterized by complexity, especially after the Second World War. At the same time, the perennial temptation of tax expenditures effectively charged the tax collector, who since mid-century had been the face of government to the populace, with socio-economic benefit administration. In effect, the IRS implemented disbursement, through tax rebates and refundable credits, as well as revenue collection. Boasting that it had become “the world’s largest financial institution,”<sup>317</sup> the IRS had the job of scanning sensitive information of hundreds of millions of persons, both those who paid tax and those who didn’t. In the electronic age, the IRS has become a fiscal panopticon.

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<sup>316</sup> See Dennis J. Ventry Jr., *Americans Don’t Hate Taxes, They Hate Paying Taxes*, 44 UBC L. REV. 835, 850-88 (2011) (emphasizing efficient service facilitated by technology).

<sup>317</sup> IRS Pub. 55-B (2014) iii.