1923

Correspondence Regarding Taxation, Dec, 1923; Recommendations to the Bureau, The Condition of the Work, Recommendations as to Legislation

American Institute of Accountants. Committee on Federal Legislation

AMERICAN INSTITUTE OF ACCOUNTANTS

Correspondence regarding taxation, Dec. 1923. Typewritten.

December 7, 1923

The Secretary of the Treasury,
Washington, D. C.

Attention Mr. Mellon

Dear Sir:

The enclosed notice has been issued by the American Institute of Accountants to all of its members with the hope that the members will take sufficient time to give expression to their views on the defects of the Income Tax Law or the administration thereof. We have handed a copy of this to Commissioner Blair and desire to place a copy before you to advise you of the situation.

I also enclose herewith copy of an article "Readjustment Relief Provisions of the 1918 Revenue Act" which was published in "Administration" magazine for March 1921. There is great need for correction of the injustices set forth in these articles, not only for the past but also for the future.

There is at the present time before the Department communications from the tanner's industry on the matter of the serious losses which they sustained in 1920 on the realization of the 1919 inventories and, no doubt, a similar situation applies to other industries for the years 1920 and 1921. This matter should receive the earnest consideration of the Department and of Congress.

Yours very truly,

Frank Thomson.

Chairman, Committee on
Federal Legislation
American Institute of
Accountants

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December 7, 1923

Judge Cordell Hull, Chairman,
Democratic National Committee,
710 Bond Building,
Washington, D. C.

Dear Judge:

I enclose a copy of a notice which has been sent to all members of the American Institute relating to Federal Income Tax Laws. We hope that the Institute will be able to get from the members some constructive criticism.

Colonel Montgomery wrote me recently that he had had some correspondence with you and suggested that, as Chairman of the Federal Legislation Committee of the Institute, I should get in touch with you.

I have asked the Colonel to give us a draft of a proposed admendment to the Income Tax Law providing for the taxation of "earned" incomes at a lower rate than other classes of income. When I receive that I will be glad to take the matter up with you.

Yours very truly,

Frank Howson

Chairman, Committee on
Federal Legislation
American Institute of
Accountants

Enc.
FL:GS

December 7, 1923

Mr. Edward E. Gore, President,
American Institute of Accountants,
111 W. Monroe Street,
Chicago, Illinois.

Dear Mr. Gore:

Yesterday I had a personal interview with Mr. Blair, Commissioner of Internal Revenue, and presented him with a copy of the Notice of the Special Committee on Taxation to the Institute Members and stated that it was the purpose of the Institute to endeavor to produce some constructive criticisms and suggestions. The Commissioner stated that the Department would welcome any such constructive suggestions or criticisms.

I enclose a copy of the report of the Tax Simplification Board which has been sent to Congress.

Yours very truly,

Frankhauser.

Enc.
FL:GS
Copies to
Mr. Hennegin
Mr. Kelly
Mr. Richardson ✓

For Release MONDAY AFTERNOON, December 3, 1923.

The President of the Senate.

Sir:

In accordance with Section 1327 of the Revenue Act of 1921, the Tax Simplification Board makes the following report:

Since its last report, the personnel of the Board has been changed by the resignation of Mr. J. E. Sterrett, of those representing the public, and the appointment by the President of Mr. William N. Davis as his successor. Of those representing the Bureau, Messrs. E. W. Chatterton and Carl A. Mapes were succeeded by Messrs. C. R. Nash and James G. Bright.

The Act creating the Board provides that "it shall be the duty of the Board to investigate the procedure of and forms used by the Bureau in the administration of the internal revenue laws, and to make recommendations in respect to the simplification thereof." It will be observed that the Act does not prescribe specifically the officer to whom or body to which the recommendation shall be made. Generally speaking, the procedure of and forms used by the Bureau are prescribed by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury and are administered and promulgated by their subordinate officers. Our Board has, therefore, followed the course indicated by common sense and has made its formal recommendations to the Secretary and the Commissioner, and has made numerous informal recommendations and suggestions to the responsible heads of Units and Divisions of the Bureau. It soon became apparent to our Board, however, that certain basic improvements in procedure could only be effected by legislation and that simplification of procedure in some vital respects could only be secured by changes in substantive provisions of the Revenue Act. With respect to such matters we assume that it is our privilege and duty to make our recommendations to Congress. Economic phases of taxation are not in our commitment and any reference thereto in our report is only incidental and for the purpose of showing that they have not been lost sight of in dealing with administrative problems. Essentially we shall, and of right should, deal with adjective law as contrasted with substantive law.

Our report naturally falls into three divisions, namely,

Recommendations made to the Bureau
The Condition of the Work
Recommendations as to Legislation.

RECOMMENDATIONS MADE TO THE BUREAU

To enumerate the various recommendations and suggestions that our Board has made to the officers in charge of the Bureau would be tedious and of no benefit. Suffice it to say that our Board has been availed of by taxpayers as a kind of grievance committee and, we believe, properly so; for specific instances of hardship resulting from the administration of the tax laws have frequently disclosed ill-advised procedure which was readily remedied by those in the Bureau, when called to their attention. To say that the complaints made to the Board by taxpayers were not inconsiderable, is to put the matter mildly. Some were borne of misapprehension and these we took pains to answer simply and directly.

Of the more fundamental recommendations made since our last report, the following are deserving of particular mention:

The Committee on Appeals and Review.

The work of this Committee was the subject of an investigation by our Board prior to the filing of our last report. As the result of the recommendation therein referred to, the production of this Committee was substantially increased.

In order to understand our further recommendation in respect of this Committee, it is necessary to explain briefly its function. Section 250 (d) of the Revenue Act of 1921 gives the taxpayer the right to appeal from a proposed additional assessment of income tax. It was to hear these appeals that the Commissioner created the Committee on Appeals and Review. While their decisions are in the nature of recommendations to the Commissioner, it was assumed and the taxpayer believed that the recommendations would be approved except in extraordinary circumstances and would be changed only after a further hearing. Cases involving alleged fraud were not referred to the Committee, nor did it review the decisions on claims for credit or refund, the Commissioner having placed these matters under the jurisdiction of the Solicitor of Internal Revenue. It was found that the decisions of the Committee on appeals by taxpayers from proposed additional assessments were reviewed by the Solicitor's office and were approved, amended or reversed by that office. It also developed that the Committee was required to give advice to the Income Tax Unit on questions arising during the audit of returns.

Our Board felt that it was of supreme importance that the appeal of the taxpayer be decided by the tribunal which heard the evidence and the arguments, and not by some other officer or tribunal before whom or which the taxpayer had not appeared. We also felt that all appeals by taxpayers, whether from additional assessments or from tentative impositions of penalties, should be heard by the judicial tribunal which had been set up by the Commissioner. It also seemed that the Committee on Appeals and Review was the proper body to review claims for credit and refund. The practice of requiring the Committee to give advice during the audit of returns on questions which might subsequently come before it on appeal was indefensible.

Our Board, therefore, made the following recommendations:

First: That the practice of requesting an opinion from the Committee on Appeals and Review on questions arising during the audit of a return be discontinued and that questions of law be referred to the Solicitor of Internal Revenue.

Second: That in each group of three of the Committee on Appeals and Review there shall be at least one lawyer and one accountant of the highest calibre obtainable, and that every appeal in which the taxpayer is represented in person or by a representative shall be heard by one or more members of the group. However, it shall be the privilege of the taxpayer, upon request, to have his case heard by the entire membership of the group.

Third: When an appeal involves a new question of law or a question of law on which the Committee desires the opinion of the Solicitor of Internal Revenue, the Committee shall notify the Solicitor, who may, thereupon, attend the hearing at himself or through one or more of his Assistants, and state the opinion of the Solicitor's office on the question of law involved at the hearing, or later in writing, if he so desires or is requested so to do by the Committee. The recommendation to be made and the decision to be arrived at under the law and facts shall be determined by the Committee.

Fourth: That appeals from assessments or proposed assessments of penalties in fraud cases where prosecution is not contemplated by the Solicitor be heard and determined by the Committee on Appeals and Review.

Fifth: In cases involving credits or refunds, or claims in abatement, the taxpayer shall have the right to appeal the case to the Committee on Appeals and Review.

Sixth: When an appeal is taken by a taxpayer or a review is directed by the Commissioner, the Division or Section from whose decision the appeal is taken or the review directed, shall furnish to the Committee and to the taxpayer a succinct statement of questions involved from its standpoint. The taxpayer shall thereupon furnish to the Committee on Appeals and Review and to the Division or Section from which the appeal is taken or the review directed, a succinct statement of the questions which he deems to be involved in the appeal or review.

Our Board felt that the result of putting these recommendations into force would be that the taxpayer would feel that his appeal was in the hands of a competent body; that the hearing given would be adequate and that he would more readily and willingly present all his evidence before the appellate tribunal and be disposed to abide by its decision. Our Board begs to report that its first, second and sixth recommendations were readily agreed to by the Commissioner and have been substantially put into force. The Commissioner did not approve the fourth and fifth recommendations and they have not been made effective. The third recommendation was the subject of considerable discussion and difference of opinion, but our Board is glad to report that it has finally been approved by the Commissioner and put into effect. This recommendation and the investigation which preceded it and the discussion which followed it, convinced practically everyone who participated in the discussions that it would never be possible to give to the taxpayer the fair and independent review to which he is of right entitled as long as the appellate tribunal is directly under, and its recommendations subject to the approval of, the officer whose duty it is to administer the law and collect the tax. As long as the appellate tribunal is part and parcel of the collecting machinery it can hardly maintain the attitude essential to a judicial tribunal. It is the situation which was developed in this way that leads our Board to make the recommendation relative to the establishment of a Board of Tax Appeals hereinafter set forth.

Our recommendation in respect of the procedure before the Committee on Appeals and Review will be found in the Appendix to this report.

Reopening of Closed Cases

In surveying the work of the Income Tax Unit, it was discovered that even after the return of a taxpayer had been audited, an additional tax liability found, the amount thereof assessed and subsequently paid by the taxpayer, and the case marked closed, it frequently happened that the case was re-opened by an auditor or other official of the Income Tax Unit, of his own motion on account of some new ruling or decision. The taxpayer was, thereupon, notified and the questions of additional tax liability or overpayment were again gone into, although the amount thereof had been previously settled. As long as such procedure prevailed, the work of the Income Tax Unit was materially increased and there was no chance of the taxpayer knowing definitely what his tax liability was short of the period of the Statute of Limitations and, indeed, not even then; for in many cases he had been induced to sign a waiver of the Statute. This practice appeared to our Board to be disastrous to the orderly procedure of the administration of the Revenue Law, grossly unfair to the taxpayer and productive of little, if any, benefit to the Government.

Our Board brought this situation to the attention of the Commissioner and, in pursuance of our recommendation, he issued an order that cases once closed should not be re-opened except in case of fraud or gross error.

A copy of this order appears in the Appendix to this report.

Ownership Certificates and Information as to Dividends.

It had been the practice of the Bureau to require the holders of corporate bonds to attach ownership certificates to the interest coupons when they deposited them for collection. These certificates were sent by the depositary bank through various banks to the debtor corporation and then sent by it to the Bureau, where they were assorted and attached to the return of the taxpayer who had deposited the coupon. It was discovered that the sorting of these certificates required a great amount of work, expense and time, and resulted in very little, if any, increase in revenue to the Government. The use of ownership certificates appeared to be the only instance in which information returns of payments less than $1,000 were required. It was discovered that a vast amount of the holders of corporate bonds were persons who had no taxable income due to exemptions. It appeared to our Board that the additional

revenue resulting from the use of ownership certificates was not worth the time and expense involved in sorting them and that efforts to obtain information as to income by other means would be more productive of tax.

Our Board, therefore, recommended the discontinuance of ownership certificates with the exception hereinafter mentioned and, also, recommended that corporations be required to make returns of information of dividends paid to stockholders, a much more prolific source of additional revenue than information relative to interest paid on bonds.

In studying the question, however, it developed that it would be necessary to continue the use of ownership certificates in connection with so-called "Tax Free Covenant Bonds," that is to say, bonds containing a covenant on the part of the corporation that it would pay the Normal Federal Income Tax up to two per cent (2%), for which the bondholder should be liable on interest paid on its bonds; for the reason that the covenant of the corporation in such cases is to pay the tax for which the holder of the bond is liable, and there would be no means of determining whether or not the bondholder was liable for the tax unless he filed an ownership certificate.

This recommendation has been approved and put into effect. It is estimated that it will cut the work of the Sorting Section in half and will result in the elimination of a great amount of vexation on the part of the taxpayer with no appreciable loss in revenue and that the requirement of information from corporations as to the payment of dividends will result in the collection of more tax than the ownership certificates ever produced.

A copy of the recommendation of our Board in this respect appears in the Appendix hereto.

Forms of Return

In the discharge of the duties imposed upon it, our Board has given careful consideration to the forms in use in the Bureau and has made a number of recommendations with the object of simplifying the same. The forms concerning which complaints are chiefly made are those upon which the taxpayer is required to make return of his income.

The form of return which must be gotten up for a taxpayer whose net income is in excess of five thousand dollars must of necessity be somewhat complicated. It is necessary to provide tables for the computation of the surtax and blanks for the itemization thereof. Special schedules must be provided for the application of the twelve and one-half per cent optional tax on capital gains. Where the taxpayer is engaged in business, some detail of the receipts and disbursements must be given in order to render an effective audit possible. It was found that the work imposed upon the taxpayer of giving some details in his original return was much less burdensome than requesting additional information at the time of the audit.

Our Board is pleased to report, however, that it has collaborated with the officials of the Bureau and has evolved a very simple form of return for individuals with net incomes of not more than five thousand dollars derived chiefly from salaries and wages. This return will be used by the vast majority of taxpayers. It consists of a single sheet of ordinary letter size paper.

A copy of this return appears in the appendix hereto.

Survey of the Unit

Our Board came early to the conclusion that it would be highly beneficial to have a survey of the Income Tax Unit made by a man trained in business organization and systems. For reasons which appeared to be sufficient, the task was postponed until last summer. A survey was thereupon conducted which resulted in recommendations of changes and reorganization designed to eliminate red tape, fix responsibility and do away with the confusion and loss of time incident to transferring cases from one division to another. These recommendations were put into effect by the Deputy Commissioner in charge of the Income Tax Unit.

A copy of his order directing these changes appears in the Appendix to this report.

To describe the old organization and the improvements accomplished by the changes would require more space than is thought proper in this report.

While the survey did not have the scope that our Board desired in that it merely considered changes which could be made in the existing machinery, and did not take into consideration the adequacy of the machine as a whole, or the possible adoption of a new system of procedure, the recommendations undoubtedly were beneficial in fixing responsibility and speeding up the work. The fundamental idea underlying the recommendations was, that where a return is submitted to a division for audit, that division shall be required to complete the audit without transferring the return to another division. While this objective has not been achieved entirely, it is undoubtedly true that a great deal of shifting of responsibility has been eliminated.

Classification of Returns on Basis of Gross income

Under the present procedure, returns of individuals showing net income of five thousand dollars or less are left in the various collectors' offices and are audited there. Individual returns showing net income of more than five thousand dollars and all corporation returns are forwarded to Washington and are audited here. The purpose of this allocation is to bring the more complicated returns and those involving the larger amounts of tax to Washington. It is confidently asserted by those at Washington and it is probably true that the audit here is more thorough than in the Collectors' offices. A taxpayer, however, may have a very large gross income and, by reason of deductions due to losses, interest, or some other allowable item, his net income is brought below five thousand dollars; yet this is the very kind of return which should have an intensive audit to determine whether or not the deductions are proper. Our Board has, therefore, recommended that the returns to be left in the Collectors' offices be those showing a gross income of $15,000, that amount being, in the opinion of the Bureau, such as will leave in Collectors' offices approximately the same number of returns as are now left there under the existing rule.

This recommendation was indicated by logic and should be productive of additional revenue.

Decentralization

By the term "decentralization" in this report is meant and intended procedure whereby the returns of taxpayers shall be audited, questions arising in connection therewith determined, and any change in tax liability from that shown in the return settled in various local offices throughout the United States as convenient as possible to the residences of the respective taxpayers.

To this important subject our Board has given its most earnest consideration.

It is a canon of taxation that the tax should be levied at a time when and in a manner in which it is most likely to be convenient for the contributor to pay it. Under the Revenue Law of 1918 and its successors, the taxpayer is required to return his income on March 15 of the year subsequent to the year in which it was earned and to pay the tax indicated to be due in accordance with the return on that day or in quarterly installments thereafter. Under the administration of the laws, the Government assesses any additional taxes at any time within five years thereafter. The inconvience to the taxpayer of such procedure is manifest and the loss to the Government in interest alone must be enormous. In addition to this, the taxpayer is required to maintain unproductive reserves of capital during the entire period of the Statute of Limitations, which otherwise might be devoted to business enterprises and be productive of income subject to tax. The expense to taxpayers resulting from trips to Washington to settle their tax liability or from the employment of counsel here is estimated to involve tremendous sums in the aggregate. Complaints which have come to our Board, experiences which have been related to the various members thereof, and our own study of the situation have convinced us that it is next to

impossible to settle satisfactorily any complicated question of tax liability by means of correspondence between the taxpayer and the auditor at Washington.

From the standpoint of the Government's interests, it is the opinion of the Board that the audit of returns could be carried on in a number of district offices as satisfactorily as is now being done at Washington. From the standpoint of the taxpayer, there would be manifest advantages. It is difficult, if not impossible, to settle controversial points by correspondence. A personal conference usually results in mutual understanding and, even where the decision is adverse, the taxpayer feels that he has had his opportunity to make his position clear.

Prior to the enactment of the Income Tax Laws, the force of the Bureau at Washington was comparatively small, most of the work of administering the internal revenue laws being carried out in the field. Thereafter and until the present year there was a marked increase in the force at Washington as compared with that in the field. The process was one of centralization. Since the first of this year, there has been a gradual increase in the field force and a corresponding decrease in the force at Washington.

At the present time there are 34 Internal Revenue offices in the various sections of the United States, each under a Revenue Agent in Charge, who reports directly to the Income Tax Unit at Washington. While this field force makes examinations when instructed so to do from Washington, they have no power to settle and determine cases and can only report their findings to the Income Tax Unit at Washington, where the tax is settled. The present Deputy Commissioner in charge of the Income Tax Unit has recently issued an order providing for conferences between the Internal Revenue Agent in Charge and the taxpayer prior to the submission of the report of the Internal Revenue Agent in Charge to Washington. The Deputy Commissioner is to be complimented on this order and if it is carried out sympathetically it will doubtless be productive of good results. It is still required, however, that the report of the Internal Revenue Agent in Charge be submitted to the Income Tax Unit at Washington for review. The point to which we desire to draw attention is that the Internal Revenue Agent in Charge does not settle the tax under the direction of the Commissioner as the Income Tax Unit does; but makes his report to the Income Tax Unit, which thereupon proceeds to settle the tax, acting for and under the direction of the Commissioner.

The dissatisfaction on the part of the taxpayer with the present organization requires no expatiation. If the work were divided into smaller units, the personnel available to the Bureau would be able to comprehend the task and visualize the objective. Healthy competition would develop among the various district offices, which should be placed under a Deputy Commissioner or other officer directly under the Commissioner of Internal Revenue. During the War, the Ordnance Department at first attempted to handle all its activities at Washington. The result was such an accumulation of work and slowing up of progress that the Department was forced to decentralize its activities. This action was accompanied by marked expedition in the handling of work. In commenting upon the situation the Ordnance Department said, "All circumstances call for decentralization - the indicated solution for any problem, be it political, commercial, or industrial, in which size is the predominant factor."

We do not conceive it to be the function of our Board to work out all the details of such an establishment and certainly not to state them in this report. We do not advocate the sudden disruption of the Income Tax Unit. The organization here should complete the audit of returns upon which it is now engaged. The working out of the plan of decentralization should be one of evolution and should be proceeded with step by step and in an orderly manner. Income tax laws are now apparently a permanent policy of our Government. The present procedure was worked out in the stress of war times when a mountain of work was encountered, but it behooves us now that we are on the plain of peace to establish procedure which will result in efficacious administration of the revenue laws with as little vexation to the public and as little hampering to business as possible. The Board approves the principle

of decentralization and recommends that it be put into effect.

No legislation is necessary to decentralize the Income Tax Unit. It can be carried into effect by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury. Plans for decentralization are now receiving the consideration of the Department and the Bureau, and our Board expresses the hope that a satisfactory solution of the problem will soon be worked out.

THE CONDITION OF THE WORK

The administration of the laws imposing excise taxes on telegraph and telephone messages, beverages, tobacco, admissions and dues, stamp taxes, and miscellaneous special excise taxes requires little notice. These taxes are paid currently with their imposition. The work involved in the collection of any one of these taxes is not great, but in the aggregate constitutes a considerable burden.

The administration of the tax on the employment of child labof was halted by the decision of the Supreme Court that this tax was unconstitutional. (Child Labor Tax Case, 259, U.S. 20).

The corporation capital stock tax is imposed on the fair value of the capital stock of corporations. While the determination of fair value is difficult, this division has been able to keep fairly well up with its work.

Although improvements can be made and are being made in the administration of the estate tax, this work is, generally speaking, well done. If the Estate Tax Division resists the temptation to make too minute examinations, its work can be carried on so as to be brought and kept nearly current.

Personal income tax returns showing net income of five thousand dollars or less are left in the various collectors' offices and are audited there. The work on this class of returns is practically current. Personal income tax returns disclosing net income of more than five thousand dollars and all corporation returns are sent to Washington. As a result of this procedure, approximately 1,200,000 income tax returns are forwarded to Washington each year. Returns for the year 1922, which have been sent to Washington, have not yet been touched. From the statement of progress of the work of the income tax Unit for the three months ended September 30, 1923, it appears that 246,832 returns of the year 1921 have been audited. The number of audited returns for that year are composed mostly of returns which, upon cursory examination, show that an intensive audit is not necessary and have, therefore, not gone through the regular machinery for the audit of returns where an additional tax liability is indicated. The audit of 302,765 returns for the years 1917 to 1920, inclusive, has not been completed as of this date. These returns are distributed over four years, as follows:

Year	Returns
1917	16,320
1918	55,122
1919	89,092
1920	142,231

All these returns are in or are bound for the intensive audit machinery, for the reason that those in which no additionab tax liability is indicated have been already closed.

There are numerous reasons why the Income Tax Unit is so far back in its work. Without going into these reasons at length, the main ones may be mentioned, as follows:

1. The difficulty involved and the time required in determining invested capital and deciding complicated questions arising out of the Excess Profits tax laws.

2. The making of valuations in order to compute profit or loss on the sale of capital assets.

3. The valuation of natural resources for the purpose of depletion.

4. The attempt to determine tax liability and decide questions arising in the audit of returns at Washington of taxpayers resident and property situated in different places all over the United States.

5. The importance of every question where the tax rate is high and necessity of minute investigation to do justice to the taxpayer and protect the Government.

RECOMMENDATIONS AS TO LEGISLATION

The Board of Tax Appeals.

In the foregoing portion of our report dealing with the recommendations made touching the procedure of the Committee on Appeals and Review, we adverted to the anomaly of providing for an appeal by a taxpayer from an additional assessment of taxes proposed to be made by the Commissioner of Internal Revenue and prescribing that this appeal be taken to the officer who had announced his intention of making the additional assessment. The function of the Commissioner of Internal Revenue is to assess and collect the taxes. This function is administrative and not judicial. The appeal given to the taxpayer from the action or proposed action of the Commissioner should be to a judicial body independent of the Commissioner. It should be borne in mind that this appeal by the taxpayer must be heard and decided before the additional tax is collected. It is, therefore, important that the appellate tribunal be so constituted that its decisions may be made expeditiously and its work kept approximately current with the appeals which are taken to it. If this were not so, the collection of the public revenue would be seriously impeded. It is, therefore, essential that the number of persons on the Board of Tax Appeals may be increased or decreased according to the influx of work. To insure the proper functioning of the Board so as not to impede the collection of revenue, it would seem advisable that the appointments to the Board be made by the Secretary of the Treasury. Adequate salaries should be provided to secure the services of able men, for the questions that will come before them will be difficult and will involve large sums. In establishing such an appellate body, the following essentials should be borne in mind:

(a) The Board's decision should be independent and not subject to review by the Commissioner of Internal Revenue;

(b) Its proceedings should be informal;

(c) Its membership should be capable of expansion or contraction in order to dispose of the work;

(d) The members should be appointed by the Secretary of the Treasury.

If a taxpayer is dissatisfied with the decision of the Board of Tax Appeals he should be required to pay his tax, but should still have the opportunity of bringing a suit in court to recover back the amount paid. If the Government is dissatisfied with the decisions of the Board, it should be permitted to bring suit in court to collect the asserted tax liability, but should not be permitted summarily to assess and collect the tax.

It is the belief of our Board that if such a tribunal were established, taxpayers would feel that they would receive a fair and impartial hearing before being required to pay any additional tax assessments. We believe that the law creating the Board should be so drafted as to permit the members to function in groups in various parts of the United States.

Housing of the Bureau

The work of the Bureau of Internal Revenue is seriously impeded by totally inadequate housing conditions. It is quartered in ~~five~~ 6 buildings. The Commissioner of Internal Revenue has his office in the Treasury Building. The Deputy Commissioner in charge of the Income Tax Unit, and various other administrative officers, have their offices in Annex No. 1, at Pennsylvania Avenue and Madison Place; the Personal Audit, the Corporation Audit, and the Special Audit Division are quartered in Annex No. 2, at Fourteenth and B Streets; the Sorting Section is located at Sixth and B Streets; the Rules and Regulations Section at Twentieth and B Streets; the Natural Resources Division at Twentieth and C Streets; and the Solicitor of Internal Revenue and the Committee on Appeals and Review are housed in the Interior Department Building at Eighteenth and F Streets. The close personal contact so much to be desired in an organization of this kind is impossible when the various divisions and sections are so widely scattered. It would be an act of the first magnitude if Congress should provide an adequate building for the Bureau of Internal Revenue of such size as may seem proper after a survey of its requirements.

Elimination of Profits on Sales of Capital Assets as Income and of Losses on such Sales as Deductions.

It would be going beyond the proper scope of recommendations to be made by our Board if we should enter upon a discussion of the economic aspects of assessing an income tax on the profit realized from the sale of capital assets and allowing, as deductions from taxable income, losses sustained on their sale. It is somewhat of a stretch of the imagination to consider the profit which a man makes upon the sale of a farm, which he has held for years, as a recurring flow of income upon which an income tax should be levied, just as it is to consider the loss sustained on such a sale as a recurring outgo which should be allowed as a deduction. The Supreme court of the United States has held that Congress may tax such gains under the Sixteenth Amendment. Congress, however, is not obliged to tax this species of income nor to allow capital losses as deductions. It is absolutely impossible to secure any reliable statistics from which to estimate the effect on the public revenue of eliminating capital gains as income and capital losses as deductions. While it is true that in a comparatively new country such as ours, capital gains will ordinarily exceed capital losses, it should be borne in mind that capital gains are not taxable unless realized by the sale of the asset. Naturally, people are inclined to retain that which has increased in value and which has proved to be profitable; and, unnaturally, they are induced to retain such an asset even if they may desire to sell it, if a tax is incident to the sale. Persons owning property and having investments are able to and do take their losses at times when their doing so results in the greatest possible reduction of their tax liability. Income tax laws may provide very stringent rules for determining capital gains and losses realized by sale, but it remains for the taxpayer to determine whether or not he will sell. It is generally agreed that if capital gains had been eliminated as income and capital losses as deductions at the outset, the Government would have been far ahead in revenue. The best considered opinions of accountants, actuaries, and economists appear to us to indicate that the elimination of both capital gains and capital losses, even now, would result in no decrease in revenue to the Government over a period of years.

It can be asserted without fear of contradiction that one of the most effective measures which could be adopted to simplify the Revenue Act and the procedure thereunder would be the elimination of capital gains as income and capital losses as deductions. The most complicated provisions of the Act deal with the determination of gains and losses. A casual reading of Sections 202, 204 and 206 will demonstrate this beyond the peradventure of a doubt. We need only suggest the simplification of procedure which would result from dispensing with the necessity of establishing the valuation as of March 1, 1913, of capital assets acquired be-

fore that date and upon which a profit has been realized or a loss sustained. These questions of valuation, requiring the exercise of discretion in which honest differences of opinion are bound to arise, are not only difficult of solution, but are largely responsible for the present arrears in its work of the Income Tax Unit.

The capital gains of a dealer or trader in securities, real estate, or other capital assets constitute true income to him just as his losses constitute proper business deductions. The elimination of capital gains as income and capital losses as deductions should, therefore, not apply to a dealer or trader. The administrative difficulty of determining who is a dealer and what is a trading transaction can be eliminated by a provision that, where property is disposed of within a period of two years, or some such period, from the date of its acquisition, the transaction shall be deemed to be that of a dealer or trader and the profit realized thereby shall be included in income or the loss suffered allowed as a deduction. While the establishment of a two-year period as the criterion by which an investment transaction is distinguished from a trading transaction will not always properly separate the one from the other, the use of such a period for a like purpose has legislative sanction and its application would be fair and equitable in the vast majority of cases. The establishment of some such period as the criterion would be highly desirable from the administrative standpoint; for the difficulty of determining in the case of each transaction whether or not it was an investment transaction or a trading transaction would be unsatisfactory to a degree.

In the event that capital gains are eliminated as income and capital losses as deductions, proper safeguards should be provided to prevent true income from escaping taxation under the guise of capital transactions. While the drafting of such provisions will require care, they will be far less complicated and much more simple of administration than the present sections dealing with the determination of capital gains and losses.

Our Board earnestly recommends that Congress give careful consideration to the wisdom of eliminating capital gains as income and capital losses as deductions for the reasons and along the lines as above set forth.

In concluding its report, the Board wishes to acknowledge and express its appreciation of the uniform courtesy shown and the indispensable assistance rendered to its members by the Secretary of the Treasury, the Commissioner of Internal Revenue, and the officials of the Department and the Bureau.

Respectfully submitted.

WM. S. MOORHEAD

H. H. HILTON

WM. N. DAVIS
Representing the Public.

C. R. NASH

J. G. BRIGHT
Representing the Bureau.

Note: Mr. C. P. Smith, a member of the Board representing the Bureau, has been for several months and still is a member of the group of the Committee on Appeals and Review which is hearing cases on the Pacific Coast and it was, consequently, impossible for him to take part in the preparation of or sign this report.

A P P E N D I X

TREASURY DEPARTMENT
Tax Simplification Board
Washington

October 26, 1922.

TO THE SECRETARY OF THE TREASURY:

The Tax Simplification Board has been making an investigation of the progress being made by the Income Tax Unit in auditing returns, particularly returns for the year 1917, and the decision of appeals by taxpayers from the finding that there is a deficiency in the tax paid. It is highly desirable that the audits be completed and the appeals disposed of so that assessments may be made of any deficiencies before the statute of limitations runs against any such additional assessments. With respect to 1917 returns which were filed on March 15, 1918, the statute will run against any additional assessments thereon on March 14, 1923. The Board feels that it would be unfortunate if it should be found necessary to request waivers of the statute of limitations from any large number of taxpayers, and it would be regrettable if the proceding of summary assessment by the Commissioner of Internal Revenue had to be resorted to in numerous cases. It is recognized by the Board that in a number of instances waivers will have to be secured or summary assessments made, but it is desirable that these cases be reduced to as small a number as possible.

One important step in the procedure leading up to final assessment is the decision on appeals by taxpayers to the Committee on Appeals and Review from additional tax liability tentatively found. At the time the Board made its investigation, it appeared that approximately 60 cases were being appealed to that Committee each week. The Committee stated that it was disposing of approximately 30 cases a week. There was an accumulation of approximately 1471 appeals before the Committee. The undisposed of appeals involving 1917 returns amounted to about 713.

The Committee on Appeals and Review is composed of a chairman and nine other members. The procedure followed by the Committee is, briefly, as follows:

The members sit separately in hearing appeals. Upon arriving at a decision the member who hears the appeal makes his recommendation in writing and states the facts, and supports his decision by an opinion. This opinion he sends to every other member of the Committee and at stated intervals the Committee meets as a whole, with the exception of the chairman, and reviews all decisions of the various members on the merits of the case and form of the opinion. The decisions are affirmed, reversed or modified and submitted to the chairman of the Committee who, if he approves them, transmits them to the Commissioner, and in the ordinary course the Commissioner makes assessments in pursuance of the recommendations and opinions. This, briefly, is the procedure, although some cases may be sumitted to the Solicitor's office for an opinion.

The Board finds that the time consumed in the writing and discussion of opinions is very considerable. While these opinions may be helpful in some cases, the Board is of the opinion that they should be discontinued until the Committee on Appeals and Review has disposed of the existing accumulation of cases and is practically current with new appeals. In special cases the Commissioner may, in his discretion, require the rendition of opinions by the Committee.

The Board is further of the opinion that the work of the Committee on Appeals and Review can be greatly expedited and satisfactorily disposed of by dividing the Committee into groups of three, as hereinafter recommended.

The Board is of the opinion, however, that even with these changes in the procedure it will be necessary to increase the personnel of the Committee on Appeals and Review in order to attain satisfactory progress in disposing of the accumulated cases.

The Board therefore recommends-

1. That three additional members be appointed on the Committee on Appeals and Review at this time.

2. That the Chairman of the Committee on Appeals and Review divide the other members into groups of three; that each group hear and decide the appeals which are referred to it, except appeals which can be satisfactorily heard by one member of the group, in which case the decision of the member who hears the appeal shall be reviewed by the group to which he belongs; and that the recommendations of each group, after such review thereof by the Chairman of the Committee on Appeals and Review as may appear to him to be advisable, be transmitted to the Commissioner in due course for assessment in accordance with the recommendations.

3. That the practice of writing opinions be abolished, except in cases where the Commissioner of Internal Revenue shall specifically request an opinion.

4. The Board further recommends that the above recommendations be put into force beginning November 1, 1922.

Prior to the making of the above recommendations, the Board has taken up the substance thereof with the Commissioner of Internal Revenue and with the Chairman of the Committee on Appeals and Review, and the Board understands that they are both in sympathy with and approve of the recommendations substantially as above stated.

Respectfully submitted,

By order of the Board.

(SIGNED) Wm. S. MOORHEAD,

Chairman.

Order of Commissioner Relative to Re-opening

Closed Cases.

January 20, 1923.

Numerous complaints from various sources have reached me that taxpayers are being subjected to examinations and requests for information concerning cases in which the audits have been completed and the cases closed. Such examinations are not advisable and are clearly contrary to the spirit of the Act and the regulations of the Department. The reopening of closed cases should be the rare exception and not the rule. In the absence of evidence of fraud or gross error, cases once closed are not to be reopened.

Treasury Department
Tax Simplification Board
Washington

June 22, 1923.

RECOMMENDATION TO THE SECRETARY:

The Tax Simplification Board has conducted an investigation into the use of ownership certificates required to be attached to coupons for interest on corporate bonds when the coupons are deposited for collection. Our Board inquired into the work involved in examining and sorting these ownership certificates, the results obtained from them in collecting additional taxes, the moral effect of their use in obtaining an accurate return by the taxpayer, and the inconvenience caused taxpayers and various banks in making out and handling them. The matter was taken up with the Deputy Commissioner in Charge of the Income Tax Unit, the Chief of the Sorting Section, and other officials of the Internal Revenue Bureau. A hearing was given to representatives of a number of banks and trust companies.

As a result of its investigation the Board came to the conclusion that it would be unfair and inadvisable to make any change in the practice of requiring ownership certificates to be attached to coupons for interest detached from bonds containing so-called tax-free covenant clauses requiring the debtor corporation to pay the normal tax on the income represented by the coupons up to two per cent of the normal Federal income tax, largely for the reason that, if ownership certificates were not required in such cases, the debtor corporation would be required to pay the tax even though the taxpayer might not be subject to any tax by reason of his income being exempt from tax, the covenant of the corporation being merely to pay the tax in the event that the bondholder were required to pay the same.

In respect of ownership certificates required to be attached to coupons representing interest on bonds not containing a tax-free covenant clause, our Board has come to the conclusion that little additional tax is secured by their use; certainly not sufficient additional tax to justify the expense, labor and delay incident to the sorting and use of such certificates. The moral effect of their use is largely problematical, but our Board could not find that the wisdom of requiring information with regard to these comparatively small items was indicated in view of the fact that information at the source is not required in respect of many other and larger payments of sums which would constitute income to the payee. It was found that the discontinuance of the ownership certificates of theclass to which we refer would result in a very substantial decrease in the amount of work now being done by the Sorting Section, and in the work of that Section on other returns of information from the source of payment becoming more nearly current than it now is. We also found that the burden placed upon and inconvenience caused taxpayers and banks and trust companies would be very greatly alleviated and lessened if this class of ownership certificates were abolished. The recommendation which we are about to make has the approval of the officials of the Income Tax Unit with whom we have conferred.

The Tax Simplification Board therefore respectfully recommends-

1. That ownership certificates be required only from(a) owners of bonds containing so-called tax-free covenant clauses whereby the debtor corporation agrees to pay the normal tax up to two percent assessed against the owners of such bonds in respect of the interest thereon; and (b) owners of bonds which do not contain such clauses when such owners are non-resident alien individuals, fiduciaries, partnerships, or corporations.

2. That the foregoing recommendation be put into force as soon as practicable.

Respectfully submitted,
By order of the Board.

Wm. S. Moorhead
Chairman.

Form 1040A
U. S. INTERNAL REVENUE

FILE RETURN WITH THE COLLECTOR OF INTERNAL REVENUE FOR YOUR DISTRICT ON OR BEFORE MARCH 15, 1924

INDIVIDUAL INCOME TAX RETURN

FOR NET INCOMES OF NOT MORE THAN $5,000

DERIVED CHIEFLY FROM SALARIES AND WAGES

For Calendar Year 1923

PRINT NAME AND ADDRESS PLAINLY BELOW

(Name)

(Street and number, or rural route)

(Post office) (County) (State)

Do not write in this space

SERIAL NUMBER

AMOUNT PAID

$

(Cashier's Stamp)

CASH CHECK M. O.

Examined by

OCCUPATION

QUESTIONS

1. Are you a citizen or resident of the United States?
2. Is this a joint return of husband and wife?
3. If not, is a separate return being filed by your husband or wife?
4. Were you married and living with husband or wife on the last day of your taxable year?
5. If not, were you on the last day of your taxable year supporting one or more persons closely related to you and living in your household?
6. How many dependent persons (other than husband or wife) under 18 years of age or incapable of self-support because mentally or physically defective were receiving their chief support from you on the last day of your taxable year?
7. State amount of dividends received from domestic corporations

INCOME

1. Salaries, Wages, Commissions, etc.
(State name and address of person from whom received.)

$

2. Interest on Bank Deposits, Notes, Mortgages, and Corporation Bonds

3. Other Income (except dividends from domestic corporations and interest on obligations of the United States).
(State nature of income)

(a)

(b)

4. TOTAL INCOME IN ITEMS 1 TO 3 $

DEDUCTIONS

5. Taxes Paid $

6. Contributions (Explain on reverse side)

7. Other Deductions Authorized by Law (Explain on reverse side)

8. TOTAL DEDUCTIONS IN ITEMS 5 TO 7 $

COMPUTATION OF TAX

9. Net Income (Item 4 minus Item 8) $

10. Less Personal Exemption and Credit for Dependents

11. Balance taxable at 4% (Item 9 minus Item 10) $

12. TOTAL INCOME TAX (4% of Item 11) $

AFFIDAVIT

I swear (or affirm) that this return has been examined by me, and, to the best of my knowledge and belief, is a true and complete return for the taxable year as stated, pursuant to the Revenue Act of 1921 and Regulations issued under authority thereof.

(If return is made by agent, the reason therefor must be stated on this line)

(Address of agent)

(Signature of taxpayer or agent)

Sworn to and subscribed before me this ..... day of ....., 1924.

(Signature of officer administering oath) (Title)

NOTE.—If you are engaged in a profession or business, including farming, use Form 1040.

2—24 GOVERNMENT PRINTING OFFICE

INSTRUCTIONS

Liability for Filing Return

An income tax return must be filed by every citizen of the United States whether residing at home or abroad, and every person residing in the United States, though not a citizen thereof, having a net income for the calendar year 1923 of (*a*) $1,000 or over, if single or if married and not living with husband or wife, or (*b*) $2,000 or over, if married and living with husband or wife, or (*c*) a gross income of $5,000 or over.

Items Exempt from Tax

(*a*) Proceeds of life insurance policies paid upon the death of the insured.

(*b*) Amounts received by insured as return of premiums paid for life insurance, endowment, or annuity contracts.

(*c*) Gifts (not made as a consideration for services), and money and property acquired under a will or by inheritance.

(*d*) Interest upon (*a*) obligations of a State, Territory, or a political subdivision thereof, or the District of Columbia; (*b*) Federal Farm Loan bonds; and (*c*) all obligations of the United States and its possessions as to normal tax. Interest on Liberty Bonds owned in excess of $55,000 is subject to surtax but should not be reported on this form.

(*e*) Amounts received as accident or health insurance on account of personal injuries or sickness, plus damages received on account of such injuries or sickness.

(*f*) Amounts received under the War Risk Insurance and Vocational Rehabilitation Acts, and pensions from the United States for services in the military or naval forces in time of war.

(*g*) Dividends or interest, not exceeding $300, from domestic building and loan associations, operated exclusively for the purpose of making loans to members.

(*h*) Rental value of dwelling and appurtenances thereof furnished a minister of the gospel as part of his compensation.

(*i*) Compensation paid by a State or political subdivision thereof to its officers or employees.

Personal Exemption and Credits

A single person, or a married person not living with husband or wife on the last day of the taxable year, may claim a personal exemption of $1,000. The head of a family, or a married person living with husband or wife on the last day of the taxable year, may claim an exemption of $2,500. If husband and wife file separate returns, the personal exemption may be taken by either or divided between them. In addition to the personal exemption, a credit of $400 may be claimed for each person (other than husband or wife) under eighteen years of age, or incapable of self-support because mentally or physically defective, who was receiving his or her chief support from you on the last day of your taxable year.

The "head of a family" is a person who actually supports one or more persons living in his or her household, who are closely related by blood, marriage, or adoption.

General Information

Affidavit.—The oath will be administered without charge by any collector, deputy collector, or internal revenue agent.

Returns.—File the return with the Collector of Internal Revenue for the district in which you reside on or before March 15, 1924.

Tax.—The tax may be paid at time of filing the return, or in four equal installments payable quarterly.

Penalties.—The following penalties are imposed by the statute: For making fraudulent return, not to exceed $10,000 or one year's imprisonment, or both, and in addition 50 per cent of tax evaded; for failure to make return on time, not more than $1,000, and in addition 25 per cent of the total tax; and for failure to pay tax when due, or understatement of tax through negligence, etc., 5 per cent of tax due, plus interest at 1 per cent per month during the period it remains unpaid.

Income

Salaries.—Enter on line 1 all salaries, wages, or other compensation received from outside sources by (*a*) yourself, (*b*) your husband or wife if a joint return is filed, and (*c*) each dependent minor child having a net income of less than $1,000 per annum.

Interest.—Enter on line 2 all interest received or credited to your account during the year on bank deposits, notes, mortgages, and corporation bonds. Interest on bonds is considered income when due and payable.

Other income.—Enter on line 3 all other taxable income, including dividends on stock of foreign corporations.

Deductions

Taxes.—Enter on line 5 all personal taxes and taxes on property paid during the year. Do not include Federal income taxes.

Contributions.—Enter on line 6 any contributions or gifts made during the year to any corporation or fund organized and operated exclusively for religious, charitable, or educational purposes. The amount claimed shall not exceed 15 per cent of the net income computed without benefit of this deduction.

List below names of organizations and amounts contributed to each.

Other deductions.—Enter on line 7 any other deduction authorized by law, including interest paid on personal indebtedness.

Any deduction claimed should be explained below.

EXPLANATION OF DEDUCTIONS CLAIMED ON LINES 6 AND 7

ITEMS	AMOUNT

Order Putting Into Effect Changes in Organization

To effect a closer supervision of the audit, to insure greater production, to speed up and secure closer coordination of the work, and to reduce to a minimum the physical transfer of cases, the following changes in the organization of the Income Tax Unit of the Bureau, effective at the close of business, September 8, were announced today;

The Special Audit Division, and the Consolidated Returns Subdivision, are abolished as such, and a consolidated Returns Audit Division is established, consisting of the sections of the present Consolidated Returns Subdivision and the Amortization and Review Sections.

The Special Assignment Section is abolished.

The Special Adjustment and Special Assessment Sections are transferred to the office of the Deputy Commissioner.

The Natural Resources Division is abolished as such, and an Engineering Division and a natural Resources Audit Division established. The Engineering Division will consist of the five valuation sections. The Natural Resources Audit Division will consist of audit sections F, G, H and Review.

The Administration Division and the Records Subdivision are abolished as such, and a Records Division and a Service Division established. The Records Division will consist of the sections of the present Records Subdivision and the Provingand Sorting Sections. The Service Division will consist of the Stenographic and Building, Equipment and Supply Sections.

The orders and Codes Section is abolished as such, and its work and personnel transferred to the office of the Assistant Deputy Commissioner.

The clerical forces under the supervision of the Heads of the present Natural Resources and Administration Divisions will be assigned according to duties performed between the four new divisions into which they have been divided.

The Office of the Supervisor of Claims is abolished.

The changes in organization involve no reduction in personnel.