Proposed amendment to Section 32

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Section 32:

Proposed amendment to Section 32 if the suspension provisions are retained:

If a tax computed and levied hereunder is not paid before six o'clock p.m. on the last day of the eleventh month after the due date of the first installment thereof, the corporate powers, rights and privileges of the delinquent taxpayer, if it be domestic bank or a domestic corporation, or if it be a foreign bank or national bank or foreign corporation its corporate powers rights and privileges so far as they pertain to intra-state business, shall be suspended and shall be incapable of being exercised for any purpose or in any manner except for the purpose of (1) performing, paying or settling its obligations, but this exception shall not include the power to pay dividends or make any distribution to stockholders in liquidation; (2) defending actions but such bank or corporation shall have not power to commence actions and actions which have been commenced by such bank or corporation and not terminated before the suspension here- in provided for becomes effective may be dismissed at the option of the defending party to such actions; (3) receiving performance of or giving a valid discharge of any obligation or claims in its favor; (4) amending the articles of incorporation to set forth a new name and the officers, directors and stockholders or members of any such corporation may take such actions in their respective capacities as may be required by law in order to amend the articles of incorporation for such purposes.

The controller shall transmit the name of each bank or corporation to the Secretary of State, who shall immediately record the same in such manner that it may be available to the public. The suspension or forfeiture herein provided for shall be come effective immediately such record is made, and the certificate of the Secretary shall be prima facie evidence of such suspension or forfeiture.
Any person who attempts or purports to exercise any of the rights, privileges or powers of any such domestic bank or domestic corporation except as hereinabove permitted, or who transacts or attempts to transact any intra-state business in the State in behalf of any such foreign bank, or nation bank, or foreign corporation shall be guilty of a misdemeanor and upon conviction thereof shall be punished by a fine of not less than two hundred fifty dollars and not exceeding one thousand dollars, or by imprisonment in the county jail not less than fifty days or more than five hundred days, or by both such fine and imprisonment. The jurisdiction of such offense shall be held to be in any county in which any part of such attempted exercise of such powers, or any part of such transaction or business occurred. Every contract made in violation of this section is hereby declared to be voidable at the instance of the other party to the contract or his assigns.

Section 35:

If Section 35 is retained the first paragraph thereof should be amended to read as follows:

Any corporation which has suffered the suspension provided for in the preceding section may be relieved therefrom upon payment of the tax and the interest and penalties for non-payment for which the suspension occurred together with all other taxes, deficiencies, interest and penalties due under this act, if the payment is made during the year in which the suspension occurred, or upon payment of all taxes, interest and penalties due under the act together with an amount equal to twice the amount of the tax interest and penalties due the state for the year in which the suspension occurred if payment is made in any year other than such year, and upon the issuance by the controller, of a certificate of revivor.
Application for such certificate on behalf of any domestic corporation which has suffered such suspension may be made by any stockholder or creditor or by a majority of the surviving trustees or directors thereof; application for such certificate may be made by any foreign corporation which has suffered such forfeiture or by any stockholder or creditor thereof.
(2) The second aspect is the large number of Board of Tax Appeals docket settled by agreement. On the average, 70 percent of the dockets of the Board of Tax Appeals are settled by agreement without ever reaching a trial. These cases, through the filing of a petition, had supposedly crossed the line dividing the administrative from the judicial stage. Nevertheless, they were disposed of administratively without judicial determination.

The large number of last minute settlements before trial—50 percent of the Board dockets settled by agreement—indicates that the taxpayer or the Commissioner or both are only too often willing to prolong a controversy by carefully leading it through division to division in the Bureau, the Commissioner at one stage pausing for a moment to issue a deficiency letter, the taxpayer pausing at another stage to file a petition to the Board, until at last the day of the trial approaches and there is no escape from taking a decisive step.

As Professor Traynor states:

"It is a serious commentary on the existing system that many of the important cases can be delayed year after year by the taxpayer, and at times by the Government, and then settled within a few days by shrewd negotiation with one eye on the adversary, and the other on the Board member who will hear the case if the trading breaks down." The Board keeps functioning, however, only because of such administrative settlements. The average number of cases closed by decision of the Board after hearing is a little over 20 percent. Consequently, unless 80 percent of the 5,000 petitions filed annually with the Board are settled by the Technical Staff and the Appeals Division, the Board machinery would break down.
(3) The collectibility of deficiencies is seriously affected by the delayed disposition of cases before the Board. It must be remembered that aside from the hit-and-miss method of jeopardy assessments, while a case is pending before the Board the Government has no security that the tax finally determined will actually be paid. As a consequence, for the fiscal year 1937, over 11 percent of the total amount assessed as a result of Board decisions after trial was found to be uncollectible.

(4) The number of petitions to the Board involving small amounts is a serious commentary on the existing situation. Of the 8,424 dockets pending at the end of the 1938 fiscal year in the Board and the courts that review its decisions, 15 percent involved deficiencies of less than $500; 36 percent involved deficiencies of less than $1,000; 40 percent involved deficiencies of less than $2,000; 57 percent involved deficiencies of less than $5,000. The relatively small amounts involved in these cases make it imperative, in the interests of economy with respect to both taxpayer and the Government, that a simpler procedure be devised for their disposition.

So much for the highlights of the existing picture. We may now briefly consider the fundamental defects in the administrative and judicial procedure which have brought about these results.

Elaborate machinery for administrative review of controversies.

You are all familiar with the present elaborate machinery for the administrative review of tax controversies—examination by a field agent, review of his report by the field office, conference in the field office, review by auditors in Washington, conferences with the Conference Division, notice of deficiency, conference with the Technical Staff, conference with the Technical Staff and the Appeals Division of the Chief
Counsel’s Office. To some extent, the program of decentralization will simplify this machinery. It is clear, however, that in the past these multiple considerations made for confusion and delay. Revenue officers are reluctant to take the responsibility for final decisions. Taxpayers have learned the advantages of a vigorous contest at each stage. It should be observed that the conferences in the Income Tax Unit concede, on the average, 50 percent of the deficiencies recommended by the audit divisions, that the Technical Staff and the Appeals Division concede between 65 and 70 percent of the deficiencies asserted in the 90-day letters, that the Board of Tax Appeals, after hearing the unsettled cases on their merits, reduces the asserted deficiencies by 75 percent. Under these circumstances, taxpayers have much to gain and little to lose by contesting claimed deficiencies.

Inability of Commissioner to obtain necessary factual information.

This high percentage of abandoned deficiencies—nearly 70 percent in amount—suggests a deeper evil. Obviously the Commissioner not only stands to gain little by asserting unsupported deficiencies but also runs the risk of losing the taxpayers' respect and cooperation. The difficulty lies in obtaining the facts. Fundamentally, the income tax procedure is based upon the principle of self-assessment. Yet experience has clearly demonstrated the need for an audit of the returns by the Commissioner. Not possessing the facts, he must proceed initially by individual investigation. As such an investigation on a broad front, involving thousands of taxpayers, is bound to be unsatisfactory, the
Commissioner finds himself in a dilemma—he can proceed so cautiously as to forego additional assessments which might well have been collected or he can assert claims which might prove to have no foundation in fact. The first choice would afford to many taxpayers an inequitable escape from a tax liability justly due, thereby throwing an unfair burden on other taxpayers. The second choice forces the Commissioner to undertake litigation that is expensive and lengthy.

As a result of this early breakdown of the principle of self-assessment, the time and money of the taxpayer, the Commissioner and the Board are all being spent as a result of the effort of the Commissioner to obtain facts which the taxpayer could and should readily provide. It would seem but a corollary of the principle of self-assessment that the taxpayer should immediately disclose the facts and circumstances upon which he based his return when it is called into question. Yet the present procedure, by assuming that the duty of self-assessment is ended when a return is filed, and by substituting thereafter investigation by the Commissioner or cross-examination before the Board, makes impossible a fair and expeditious determination of tax liabilities.

Original jurisdiction in income, estate and gift tax cases.

Turning our attention to the judicial procedure, we may first consider the forums having original jurisdiction in income, estate and gift tax cases. When the Board of Tax Appeals was established, jurisdiction over refund suits was retained by the Federal District Courts and the Court of Claims. While perhaps wise at the time, today such retention has become an anachronism. Taxpayers have resorted to the Board in
such large measure that the vast majority of income tax controversies are now passed upon by the Board. As there is no essential difference between the issues in a proceeding contesting a deficiency and the issues in a refund suit, where the item in dispute is the same, there is no rational basis for having the one heard by the Board and the other by the Federal courts. The retention of jurisdiction in the Federal District Courts and the Court of Claims has made it impossible to obtain uniformity in tax cases. Instead of being a tribunal to whom both taxpayers and the Commissioner can look for authoritative guidance, the Board is merely one of 67 tax tribunals of original jurisdiction. Moreover, the present system of recovery by suit for refund consists of a hodge-podge of suits against collectors in the District Courts, suits against the United States in the District Courts, suits against the United States in the Court of Claims and proceedings against the Commissioner in the Board of Tax Appeals. Certainly the suit against the collector—described by the Supreme Court as "an anomalous relic of by-gone modes of thought"—has no present justification.

Appellate review in income, estate, and gift tax cases.

An even more striking defect in judicial procedure is presented by the method of appellate review of Board decisions. The normal judicial procedure distributes original jurisdiction among many courts and confines appellate review to a smaller number of courts, with final review in one court. The Board of Tax Appeals procedure is practically upside down. Original jurisdiction is confined to one court and appellate review is distributed among eleven courts. The work of the Board is seriously
handicapped by this system of review. Subject to eleven masters con-
stantly quarreling among themselves, the Board is left without authori-
tative guidance.

The method by which the Supreme Court selects cases for review
adds further confusion. While finality is impossible until the Supreme
Court considers the issue, that Court will rarely grant certiorari in
the absence of a conflict among the Circuit Courts of Appeals. But a
decision of one Circuit Court of Appeals and a denial of certiorari by
the Supreme Court together do not settle an issue. If the taxpayer is
the defeated party, other taxpayers in other circuits are still free
to litigate the same question. If the Commissioner is the defeated
party, he cannot abide by the decision but must litigate in other cir-
cuits in the hope of developing the prerequisite conflict. The present
system of appellate review is thus an open invitation to litigation and
tax law differs from circuit to circuit until the Supreme Court decides
the issue.

It is these defects in administrative and judicial procedure which
the so-called "Traynor Plan" is designed to remedy. The remedies sug-
gested have two fundamental objectives:

(1) With respect to the administrative procedure, to bring about
an objective analysis of controversies in the administrative stage, there-
by increasing the number of cases settled in that stage and stopping
the flood of petitions to a Board which cannot possibly handle them.

(2) With respect to the system of judicial review, to establish
a simplified structure which will insure certainty and uniformity in
tax decisions.
The administrative procedure suggested by Professor Traynor is as follows:

**Preliminary conferences.**

The present preliminary conferences in the office of the local revenue agent would be continued but their efficiency would be strengthened and their importance clearly emphasized. The conferences representing the Commissioner should be such as to insure the taxpayer of a responsible consideration of his case. The great bulk of tax controversies must continue to be disposed of in these conferences and the subsequent administrative procedure should be designed to encourage both taxpayer and the Commissioner to reach a solution of the controversy in this stage.

**Protest procedure.**

If the controversy is not disposed of in the preliminary conference, the Commissioner would notify the taxpayer of the proposed deficiency and of his opportunity to file a protest containing a complete statement of the transactions involved. The protest, in writing and under oath, would contain (a) the grounds of protest; (b) the relevant facts; (c) a list of relevant documents; (d) a list of persons having knowledge of the facts, together with a brief statement of their connection with the transaction. Failure to file the protest would result in immediate assessment of the deficiency, as in the case today of a failure to file a petition to the Board. This protest would be considered in a conference in the field, at which every effort would be made to settle the matter, or failing such settlement, to eliminate all factual issues. The conferences representing the Commissioner would be the most capable tax technicians in the Bureau.
Findings of fact by Commissioner.

If the controversy is not settled in the conference on the protest, the Commissioner would issue his final notice of deficiency. This notice would contain specific findings of fact on the matters involved, so that the taxpayer will have definite advice of the case against him. At the same time, the Commissioner will thus be compelled to evaluate the facts objectively.

Scope of Board Review.

After receipt of such notice of deficiency and findings of fact, the taxpayer, if he desired, would file his petition with the Board of Tax Appeals. The consideration of the case in the Board would be subject to the following limitations:

(1) The taxpayer in his proof before the Board would be limited to the grounds, documents and facts outlined in his protest.

(2) The Commissioner would be limited to the issues and facts contained in the findings of fact. He could no longer present a claim before the Board for an additional deficiency.

(3) The taxpayer, as at present, would have the burden of proving that the findings of fact were erroneous.

(4) To insure the collectibility of any deficiency found by the Board, it may be desirable to require the taxpayer to post a bond or other security at the time of filing his petition with the Board. On the basis of recent figures, by reason of the proposed changes in administrative procedure this requirement would affect only 15 percent of the taxpayers now filing petitions with the Board. Moreover, pro-
vision would be made to permit the Board in its discretion to waive such requirement when it seemed clear that the Government would incur no loss as a consequence.

In short, the requirement of a protest would force disclosure of the facts either in the protest itself or in the preliminary conference preceding it, in view of the taxpayer's knowledge that the facts would have to be disclosed later in any event. The findings of fact would force the Commissioner to make a realistic appraisal of his case in the administrative stage. The limitations on proof before the Board would serve to insure the efficacy of both protest and findings of fact. The present decentralization of the Technical Staff and Appeals Division insures a competent force in the field to consider the protests and to prepare the findings of fact.

It has been said, with particular reference to the findings of fact, that this procedure gives complete control to the Commissioner, that the facts would be determined entirely by the Treasury, that the Board would be no check upon the findings of the Commissioner. This view of the proposal is completely erroneous. It is definitely not suggested by Professor Traynor that the findings of fact be considered final if supported by evidence. It is not intended to introduce into the tax field the system of administrative finality that exists with respect to the Interstate Commerce Commission, the Federal Trade Commission, and so on. The Commissioner's findings of fact, as far as the taxpayer is concerned, would be no different in their finality than the present notice of deficiency. Their whole purpose is to serve as a check on the Commissioner, for he and not the tax-
payer is limited before the Board to these findings of fact. The taxpayer is limited in his proof to the matters in the protest—a document prepared by him—and not to the findings of fact. Subject to the limitations in the proof that may be adduced, the Board would continue as it does now to weigh the evidence and to reach its own conclusion.

We may now consider the suggested method of judicial review.

**Original jurisdiction in tax cases.**

The refund jurisdiction of the District Courts and the Court of Claims would be transferred to the Board of Tax Appeals, so that the Board would have complete original jurisdiction in income, estate and gift taxes. The number of refund cases is comparatively few—245 were decided in the last fiscal year—and as the suggested administrative procedure contemplates a reduction in the number of petitions to less than 1,000, the Board could easily handle these additional cases. This transfer would go far to reduce the present load of uniformity in tax decisions. It would also serve to eliminate the present confusion caused by suits against the collector and suits against the United States, as all proceedings would be against one person, the Commissioner, and before one tribunal, the Board of Tax Appeals.

**Decentralization of the Board of Tax Appeals.**

In order that the Board of Tax Appeals may exercise its increased jurisdiction more effectively, it would be decentralized into five divisions. Such decentralization of the Board is really made imperative by the current decentralization of the Bureau. Already, over 90 percent
of the Board's cases are heard outside of Washington. However, the
Bureau and the tax bar will probably urge that the frequency of circuit
hearings should be increased and this can only be accomplished by a de-
centralized Board. Furthermore, needed reforms in the procedure of the
Board, similar to those accomplished for the District Courts by the new
Rules of Civil Procedure, can only be provided by a decentralized Board,
since these reforms are dependent upon expeditious and elastic handling
of preliminary motions and other procedural matters. Finally, such de-
centralization would make possible the expeditious trial of petitions
filed with the Board and thereby serve to encourage settlement of con-
troversies in the administrative stage.

Briefly, the decentralization would be accomplished by dividing
the nation into five districts, and from a center in each district a
Board Division of three members would travel to various cities in its
district to hold hearings. Hearings could be held by a single member,
but the decision would be made by the three members. Each Division would
in effect be a separate Board having exclusive jurisdiction within its
own district.

Single Court of Tax Appeals.

The proposed decentralization of the Board would not be possible
under the present system of appellate review. Decentralization will un-
doubtedly result in some conflicts among the Divisions of the Board, but
these conflicts would not be harmful if they could be resolved easily
and expeditiously. As decentralization of the Bureau and the Board would
broaden the jurisdictional base and permit tax cases to be fully con-
sidered and heard locally, centralisation of appellate review in a single court is both practicable and necessary. Consequently, the present appellate jurisdiction of the Circuit Courts of Appeals in income, estate and gift taxes would be transferred to a Court of Tax Appeals established in Washington. Appeals to this Court from the Divisions of the Board would be a matter of right, while appeals from this Court to the Supreme Court would be by certiorari. The Court of Tax Appeals would exercise administrative supervision over the Divisions of the Board and would prescribe the rules governing their procedure. This concentration of appellate review of Board decisions in a single court would remedy most of the difficulties inherent in the present system. Once this court had decided an issue and certiorari were denied, the issue would be settled for the entire country and the Commissioner and all taxpayers would necessarily acquiesce.

It has been stated that this proposal means the virtual abolition of the Board of Tax Appeals, and that the plan was designed to this end. I would like to point out that Professor Traynor in his article expressly stated that abolition of the Board would not solve the present difficulties. Moreover, I think that the mere statement of his proposal supports the conclusion that far from abolishing the Board, it on the contrary would strengthen the Board and for the first time since its creation permit it to function effectively.

How the Court of Tax Appeals may be established is a matter of detail. Perhaps a new court could be created. If that is not thought desirable, the jurisdiction of the present Court of Appeals for the District of Columbia could be enlarged and this court in effect made
the Court of Tax Appeals. Similarly, the Court of Claims could be constituted the Court of Tax Appeals. Figures have been presented by Professor Traynor indicating that either of these courts, with the addition of one or two new members, could easily handle the increase in jurisdiction. Or, if the United States Court of Administration provided for in the Logan Bill were established such court would in effect constitute the Court of Tax Appeals as respects the tax cases within its jurisdiction. I might also add that Professor Traynor in his article considers the contention that the present system of appellate review by the Circuit Courts of Appeals is desirable in view of the belief that tax cases today generally involve issues turning on local substantive law. He points out, however, that a survey of the decided cases for the fiscal years 1936 and 1937 indicated that only 9 percent of the cases involved such issues. The whole structure of appellate review should not be designed just to accommodate these cases. Moreover, a decentralized Board could adequately dispose of such questions.

This, in brief, is the Traynor Plan. Its sole purpose is to provide an administrative and judicial procedure for income, estate and gift taxes that will effectively and expeditiously determine controversies between the taxpayer and the Commissioner, and at the same time will operate with fairness to each party. The word "plan" may be misleading, for it connotes an inflexible program, whereas the proposal is subject to whatever change is necessary to accomplish this purpose. The proposal was formulated only after critical and objective appraisal of the present procedure. Criticism of the proposal should
be made on the same objective plane, for without such objectivity it will be impossible to achieve a procedure that is equitable to Commissioner and taxpayer alike. It is to be hoped that this group, possessing as it does a special and intimate acquaintance with the problems to be solved, will bring its knowledge and training to bear on these problems to the end that we may finally obtain an improved tax administration.