PART ONE

THE UNITED STATES AND THE OTHER "FIVE": AN ANALYTIC COMPARISON

by

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CHAPTER I

AN OVERVIEW: REQUISITE ADMINISTRATIVE FRAMEWORKS

1.1 *Introduction: Why the volume was written*

Tax administrators in well developed countries rarely have either occasion or opportunity to compare experiences or exchange opinions regarding procedures and practices utilized in administering complicated tax laws. Moreover, there is little comparative literature on the subject. Even the tax institutes which are internationally oriented usually focus on substantive tax principles, not procedures and practices. Hopefully, therefore, administrators in highly developed countries will find useful this analytic comparison of practices and procedures through which six of their number resolve disputable income tax questions—administratively and judicially.

Concern for tax administrators in well developed countries, however, was not the prime motivation for this study. The initial conception grew out of the belief that administrators in countries *just now developing* would find especially useful an analytic comparison of diverse functioning models which had evolved out of long experience. Since these now developing countries differ from one another on many counts, it was imperative that there be equally wide dissimilarity among the several experienced countries selected as models. Thus, the choice of Belgium, France, West Germany, Great Britain, the Netherlands, and the United States. These countries differ in their size and population, the complexity and precision of their tax statutes, the degree their legislative bodies provide additional guidance through pre-enactment materials, the assessment system used (self- versus non-self-assessment systems), the standards of construction to which their courts traditionally conform, the theoretical status assigned by each to the doctrine of precedent, and the types of persons available to handle tax disputes—both within and without the government. Consequently, it was possible to determine whether such basic differences were relevant or irrelevant when choosing, from among the alternative functioning models, the structural arrangement and practices most appropriate for each level involved in the conflict resolution process. Also, the analytic comparison contained

in the first four chapters should enable any given country to determine the extent to which diverse parts of different wholes are adaptable to its situation.

The third purpose of this study is a byproduct of the first two. Practitioners engaged in international tax practice may gain a useful insight into the conflict resolution process followed in each of the six countries covered.

1.2 *Relationship of procedural goals to organization*

Enactment even of a semi-complex income tax statute is bound to generate substantial uncertainty and a host of disputes. Uncertainty and disputes alike need to be dealt with in a timely fashion, uniformly but efficiently and conveniently to taxpayers, through impartial determinations of high quality.

These objectives cannot be achieved through spontaneous self-generation. Nor can they be achieved in a vacuum. Achievement—if it does take place—must come through the acts or non-acts of people, operating in the first instance within some *administrative* framework. Since the aims themselves ultimately conflict with each other, the likelihood they can be achieved in proper balance is affected inevitably by the manner in which the relevant parts of the administration are organized. In other words, once an administrative organization comes into being, the die tends to be cast regarding the relative degree of emphasis each such goal actually will enjoy. Consequently, the administrator should consider *first* those diverse goals, not organizational structures. Only after balancing the goals so they fit together properly—due account being taken of the personnel available to implement them—is he in a position to consider the implementing structure. In short, the "mix" of balanced goals should fix the shape of the administrative structure, not *vice versa.*

1.3 *Sequence of this volume*

The wide range of considerations relevant to the accomplishment of that first step (reconciling the goals) and the impact the resulting mix should have on the details of *administrative* organization, procedures, and practices, are examined by Chapters II and III in the course of analytically comparing the experience of the six countries. A comparable but self-contained analytical comparison of the *judicial* machinery these countries use in resolving income tax disputes then follows in the concluding Chapter IV of this PART. Succeeding PARTS TWO through SIX then describe, on a country-by-country basis,

the five European models (Belgium, France, Germany, Great Britain, and the Netherlands). These PARTS provide the basis for the analytical comparison to U.S. experience contained in this PART. Because PART ONE weaves a description of U.S. practices and procedures into its comparative study of all six countries, only its general sequence, *not* its topic headings, conform to the common outline to which the five European authors were requested to adhere in the subsequent PARTS.

The ultimate choices which a country must make in establishing administrative machinery to deal with disputable tax questions are no more difficult than those involved in setting up judicial machinery. As between the two, however, there is far greater variation at the administrative level in the relevant functions to be performed. Thus this level, viewed *en toto*, tends to become substantially more complex than the other. Because of this peculiar complexity at the administrative level, this introductory chapter is designed (i) to put briefly in overall perspective the main outlines of the administrative structure, described in Chapters II and III, which were evolved from the previously mentioned goals, and (ii) to identify at least the primary problems of practice and procedure with which each of the major components of that structure, and those two chapters, must grapple.[1] This overview is accomplished by focusing separately on the three central themes upon which the relevant parts of the administrative structure should be organized.

1.4 *First central theme: A centralized interpretative program*

Whatever the inherent conflict otherwise existing between the previously described goals, not one can be effectively implemented in the absence of the first organizational requirement: specifically, a tax administration's National Office should establish at that same top level an active interpretative program for the benefit of lower echelons. A few specialists concentrated there can produce interpretations of a high quality which otherwise thousands of less qualified field officials would need individually to work out for themselves with consequent prejudice both to uniformity and overall efficiency.

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[1] Readers interested in detailed treatment of any of the matters specifically referred to in this Chapter should consult the table of contents.

The first problem is whether these interpretative directives should be made accessible to taxpayers through publication. True, such a policy would create many administrative problems. Illustrative—but only illustrative—are questions pertaining to reliability, the right to make retroactive changes or indeed prospective changes, to say nothing of inherent difficulties associated with the requisite painstaking draftsmanship. But on the affirmative side, publication will contribute to uniformity even in so-called non-self-assessment countries. Further, it will help assure proper application of these directives by the field forces. Only through publication can this process receive assistance from an adversary—a taxpayer. For only then will he have a firm basis on which to question the way in which a given local official applies a directive to his own situation. Finally, publication will minimize uncertainty. Because these interpretations are centrally evolved, at the least they should have the stature of reliable advance warnings regarding the contours of an administration's litigation policy.

Of course, all interpretative difficulties can never be anticipated as of that point in time immediately following enactment of a new statute. Consequently, for the National Office to sustain its control over interpretative policy to the previously cited ends, it must promulgate, in addition to an initial set of interpretative instructions or regulations, *ad hoc* rulings as new questions arise. Many of the difficulties this policy would create are similar to those associated with publication of any initial set of directives. Distinctive here, however, is the problem of providing the "ivory tower" at the National Office with an effective early warning system, capable of alerting it in a timely fashion to the really significant newly emerging practical issues. The most effective device of this type actually depends on catering directly to taxpayer self-interest. The National Office can guarantee receipt of such warning if it establishes the practice of ruling *in advance* on the *proposed* transactions of individual taxpayers. While this practice also produces many administrative headaches to which detailed procedures must be responsive, it simultaneously satisfies a further significant and worthwhile aim: dispelling uncertainties for which the tax system itself is otherwise responsible.

Not one of the European countries covered here fosters major programs involving every one of these different types of interpretative efforts. Britain does the least,[2] though actually

[2] See Chap. XVII *infra*.

it has the most complex statute of the Five. Normally, on enactment of a new statute, it does not publish an initial set of interpretative regulations, thereafter does not rule on proposed transactions, and as new issues emerge typically does not publish rulings thereon. However, by foresaking goals which, when viewed in long-run perspective, seem basic to wise tax administration, Britain has avoided the raft of difficulties experienced by the United States, the country which does the most in this area, and which maintains every one of the foregoing types of interpretative programs. For purposes of this overall view, only the two prime difficulties the United States has encountered need be mentioned.

The first involves certain inherent conflicts. Previously it was said that, given the doubts and volume of disputes stemming from a complex tax statute, the consequent goals (to deal with these doubts in a uniform, timely, efficient, impartial, and sophisticated manner) actually *united* to support establishment of a centrally administered interpretative program. Within such a program, however, are certain inherent and difficult-to-resolve conflicts. For example, in trying to promulgate an *initial* set of interpretative instructions, it is not easy to strike the right balance between timeliness, completeness, technical accuracy, understandability, and efficiency (in the sense of avoiding undue expenditure of talented manpower). As is indicated in Chapter II *infra*, however, adoption of certain procedures and practices will tend at least to provide a reasonable degree of assurance that each competing aim will enjoy the stress appropriate to it.

Another inherent conflict exists between that part of a program designed to neutralize uncertainty in individual cases—through a *private* ruling on a taxpayer's proposed transaction—and that part designed to achieve uniformity through *publication* of rulings. As to the former, *speed* is essential, for consummation of any given taxpayer's proposed transaction cannot be long postponed. Equally indispensable in the case of published rulings, however, is the exact opposite—*painstaking care* or absolute technical accuracy—for published rulings fix the nationwide stance of the government, not just the tax consequences of an isolated taxpayer's proposed transaction. Here again the difficulty lies in devising procedures and practices which at least tend to assure that each goal (speed v. quality) will receive that degree of stress appropriate to the purpose to be served.

The second major problem is to *sustain* on a continuing basis the requisite emphasis on each aspect of such a multi-sided interpretative program. Interpretative directives long delayed guarantee an interim marked by uncertainty, lack of uniformity, inefficient use of field forces, or all three. Maintaining an interpretative program at an adequate level, however, can be prejudiced all too easily by a competing pressure on administrators. For example, a national office official, responsible for manning the typically under-staffed assessment function's "firing line," is concerned with putting out *today's* brush fires. Moreover, he knows that this kind of productivity is measurable day by day and man by man. That official would be under tremendous pressure *not* to allocate on an adequate sustaining basis the talented manpower—i.e., the "think time"—required to develop interpretations which will be wholly useless until completed. Also prejudicial is the fact that even then their exact net utility, however large, can not be recorded in terms of a precise monetarily expressed plus on his productivity charts. One possible remedial step—which simultaneously will further the goal of impartiality—is to assign responsibility for the interpretative function to senior officials who work outside the enforcement function—as in France[3] and the United States. Chapter II indicates other arrangements and procedures which likewise can contribute to the first of these two ends.

1.5 *Second central theme: Decentralization of the enforcement function*

A second structural requirement involves a high decentralization of the enforcement function itself, with local administrative offices resolving the bulk of all actual disputes. These two activities—enforcement and dispute-resolution—are certain to engage a large number of personnel, which decentralization will spread widely across the nation. In consequence, this arrangement would make unachievable the goal of uniformity if not complemented by the previously described centrally administered interpretative program.

Even then, the first and most serious problem is to maintain—among such a large and decentralized staff—a sufficiently high level of competence to do the work properly.[4] However,

[3] See Chap. IX *infra*.

[4] The character, and its relevance, of non-governmental tax practitioners is considered in Chap. IV, §4.9 *infra*.

the overriding imperatives of efficiency and taxpayer convenience lead to an inescapable conclusion. Decentralization is so essential that the administration itself simply must assume the added burden of providing, through in-service training, the requisite professional understanding to otherwise educated persons. Even among the six highly developed countries covered here, the educational systems do not produce the particular type of specialists needed. Moreover, persons most suited to the task all too often—though with variations from country to country—are not available for government employment at this level in anything like a sufficient number. In consequence, each of the Six, having decentralized its enforcement function among offices numbering from 100 in the Netherlands to 1700 in France,[5] has instituted some type of in-service training program.

Of the Six, Belgium does the least.[6] Most inspectors in its local offices came into the system at a lower level, on the basis of an examination taken after completing secondary education. Their subsequent professional development, insofar as government bears the cost, involves little more than a planned program of on-the-job training. They must carry out on their own time the contemplated study of tax law, regulations, etc.

The most extensive government sponsored training programs among the European countries are carried on by France[7] and the Netherlands.[8] After passing a general qualifying examination, applicants for the job of inspector or assessor are subsidized during the period required to complete work on a law degree. In France, the applicant previously must have started work on this degree. His two-year training program at the National School for Taxes is arranged so that he can complete the degree requirements. The Netherlands' subsidy covers all university work leading to a Master's Degree in tax law and theory. Both countries require that the subsidy be returned should the applicant fail to stay with the government for a certain number of years. Both also provide substantial in-service classroom courses for the employee-rank

[5] See §1.4 in Chaps. V, IX, XIII, XVII, and XXI *infra*. The U.S., while maintaining only 58 district offices, subdivides them into approximately 800 posts of duty.

[6] See Chap. V, §1.5 *infra*. But *cf*. Great Britain, Chap. XVII, §1.5 *infra*.

[7] See Chap. IX, §1.5 *infra*.

[8] See Chap. XXI, §1.5 *infra*.

immediately below inspector or assessor. As to these, Germany does likewise, with the classroom course there extending over nine months.[9] Its assessors, however, typically are employed only after they have graduated from a university, usually with a law degree. These men then have three months of specialized training at the Federal Finance College, interspersed with on-the-job training.

The United States differs from the three European countries just mentioned. Its chief reservoir for the revenue agent class is made up of college graduates who majored in accounting.[10] However, during their first two years of employment, in addition to carefully supervised on-the-job training, these recruits attend in-service regional schools for almost five months,[11] and there the emphasis is on tax law.

The second major problem at the local office level involves the inherent conflict between its dispute-resolution function—requiring as it does an image of impartiality—and the local office's competing revenue-producing responsibility. Once again adoption of compensating procedures peculiar to that level becomes essential, but from the foregoing conflict and other considerations emerges a third organizational theme.

1.6 *Third central theme: Centralization of final administrative hearings at an intermediate level*

To reduce the magnitude of the last mentioned conflict, it is important to isolate from the local office the highest administrative official with whom a taxpayer may discuss a disputed proposed assessment. Taxpayer convenience, however, bars assignment of this function to the National Office. Thus, the need for an intermediate layer, which incidentally will permit the concentration of particularly able men to fulfill a most demanding task. Of the countries covered here, three (Belgium, France, and the United States) do put the apex of the administrative conflict resolution process in just such an office.

A yet further hard choice emerges in trying to assure administrative impartiality. The aim is avoidance of unnecessary

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[9] See Chap. XIII, § 1.5 *infra*.

[10] Estate and gift tax examiners, on the other hand, are law school graduates.

[11] Additional classroom courses are provided those who spend a substantial part of their time examining special types of returns—such as those filed by insurance companies or exempt organizations.

litigation, with simultaneous protection of the government's interest. But this leaves unresolved two perplexing questions: What litigation is unnecessary and, prior to litigation, what interest does the government have in a disputed question?

As to the first question, the tax system gains nothing, apart from protecting the government's interest in an individual dispute, from litigating cases which neither are essential to the central office's litigation policy nor are capable of clarifying the law to any really significant degree. The answer to the second question, however, ultimately means that, to obtain a bilateral agreement in many controversies, the intermediate office must be empowered to exercise true "settlement" or compromise authority, geared to a realistic appraisal of the litigation hazards each side faces. Not to be empowered to make mutual concessions in response to the litigation hazards deprives the intermediate office of the chance to be truly impartial and to obtain a bilateral agreement in disputes where the taxpayer has some reasonable chance to prevail in litigation. In short, the government's interest in a controversy not otherwise worth litigating is worth nothing more than the value of its relative *chance* to prevail should that dispute actually be litigated. Comparably, the taxpayer's competing chance represents his interest in that same controversy. And at the administrative level, i.e., absent actual litigation, justice cannot be impartial unless the total amount in issue is divided on the basis of those chances or interests. To permit such settlements, as is done in France,[12] the Netherlands,[13] and the United States,[14] will generate certain major problems considered fully in Chapter III *infra.* Some are peculiar to this level; yet others pertain to the local office level. Both can be dealt with, however, by appropriate instructions and procedures. Conversely, not to empower an intermediate office to reach such settlements is bound to result in an excessive amount of time-consuming expensive litigation.[15]

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[12] See Chap. XI, §§ 3.2a and 3.4b *infra.*
[13] See Chap. XXIII, §§ 3.2a and 3.4a *infra.*
[14] U.S. Treas. Reg. § 601.106(f), Rule II.
[15] See Chap. IV *infra.*