

A COMMISSION REPORT

INTERGOVERNMENTAL
COOPERATION
IN
TAX ADMINISTRATION

ADVISORY COMMISSION ON
INTERGOVERNMENTAL RELATIONS
JUNE 1961

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SOME PRINCIPLES AND POSSIBILITIES

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Washington 25, D. C.

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PREFACE

The Advisory Commission on Intergovernmental Relations was established by Public Law 380, passed by the first session of the 86th Congress and approved by the President September 24, 1959. Sec. 2 of the act which sets forth the specific responsibilities of the Commission, states in part:

"Sec. 2. Because the complexity of modern life intensifies the need in a federal form of government for the fullest cooperation and coordination of activities between the levels of government, and because population growth and scientific developments portend an increasingly complex society in future years, it is essential that an appropriate agency be established to give continuing attention to intergovernmental problems.

"It is intended that the Commission, in the performance of its duties, will--

"(1) bring together representatives of the Federal, State and local governments for the consideration of common problems;

.....

"(7) recommend methods of coordinating and simplifying tax laws and administrative practices to achieve a more orderly and less competitive fiscal relationship between the levels of government and to reduce the burden of compliance for taxpayers."

Pursuant to its statutory responsibilities, the Commission from time to time singles out for study and recommendation particular problems, the amelioration of which in the Commission's view would enhance cooperation among the different levels of government and thereby improve the effectiveness of the federal system of government as established by the Constitution. One problem so identified by the Commission relates to the need for broadening the scope of administrative cooperation between Federal, State and local tax administrations.

In the following report the Commission has endeavored to set forth what it believes to be the essential facts and policy considerations bearing upon this problem and respectfully submits its conclusions and recommendations thereon to the Executive and Legislative Branches of the National Government and to the States.

This report was adopted at a meeting of the Commission held on June 15, 1961.

Frank Bane
Chairman

ACKNOWLEDGEMENTS

The Commission and its staff record their appreciation for the assistance and advice generously provided in the development of this report by Deputy Commissioner Bertrand M. Harding and his associates in the Internal Revenue Service; Charles F. Conlon, Executive Secretary, National Association of Tax Administrators; and several former State tax commissioners: James S. Currie, Assistant Treasurer, Carolina Power and Light Company; C. Emory Glander of Wright, Harlor, Morris, Arnold and Glander; H. Clyde Reeves, President, Kentucky Independent College Foundation; Joseph M. Robertson, Administrative Assistant Secretary, Department of Agriculture; and William Schan of Price Waterhouse and Company. Final responsibility for the staff work reflected herein necessarily rests with the staff.

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**INTERGOVERNMENTAL COOPERATION IN TAX ADMINISTRATION:
SOME PRINCIPLES AND POSSIBILITIES**

Administrative cooperation between Federal and State tax administrations has had Congressional and Executive endorsement in principle for more than a generation. Its application, however, has been rather limited, and has consisted mostly of the exchange of income tax information. Even within this narrow compass, it has proceeded only by fits and starts, and in most States has amounted to a one-way flow, not an exchange.

The Need for Intergovernmental Cooperation

The case for intergovernmental cooperation between tax administrations requires little demonstration.

Tax administrations at all governmental levels--Federal, State and local--are engaged in a common task: the enforcement of laws required for financing governmental services. While our governmental system is predicated on a division of jurisdictional responsibilities among governmental levels, these levels exist only to complement one another in the common goal of serving the people's needs. The legislation providing for the creation of this Commission is itself Congressional affirmation of the unity of purpose of the numerous jurisdictions which compose this Federal governmental system.

The dual tax sovereignty of the National and of the State governments, which gives rise to the overlapping of State and National taxes, not only permits but requires that the governments comprising our Federal system function in unison where and whenever the public interest so dictates. We espouse the cause of local self-determination in the interest of keeping government close to the people, but do not willingly countenance wasteful duplication of facilities and senseless inefficiency in jeopardy to State and National goals.

The Federal and State governments have a more specific interest in the quality of each other's tax administration as well. Just as taxpayers' respect for Federal tax administration has complementary benefits for State administrations, so improved State tax enforcement eases the Federal enforcement task. The

temptation to take liberties with tax laws increases with the size of the prospective "steal." Each discouragement to under-reporting Federal tax liability increases the odds against underreporting to the State, and vice versa. Tight administration at one level inevitably rubs off to the benefit of the other.

The keystone of taxation at the State and particularly the national level is self-assessment. We look in the first instance to the taxpayer to assess himself; to take the initiative in advising the tax collector of the amount of his liability; not the other way around. The system necessarily depends on a high level of public tax morality, that indefinable quality of a people which appears to thrive or wither as the bonds of trust between a people and their government at all levels thrive or wither. Strength or weakness at any one point, be it county, city, State or Nation, inevitably fortifies or undermines, as the case may be, taxpayer relationships at every other level. An assist to State tax enforcement ultimately strengthens Federal enforcement, and vice versa.

Our current preoccupation with this country's responsibilities in the cause of freedom invests these considerations with particular timeliness. The present and prospective task of financing essential requirements at all levels is vast and complex and unless tax administrations at all levels function harmoniously, assisting one another in every way possible, out of a conviction that they are engaged, individually and collectively, in the service of the American people, their collective job will not be well done and resources urgently required for other governmental needs will be dissipated.

The Background

Congressional recognition of the need for intergovernmental administrative cooperation followed soon after the advent of overlapping income taxation.^{1/} The Revenue Act of 1926 contained explicit provision for giving States access to Federal tax return information. By that time fifteen States were taxing either individual or corporate income or both. Section 257 of the 1926 Act

^{1/} A summary of the provisions of the Internal Revenue Code and associated regulations governing the disclosure of tax returns and related documents to the States will be found in the Appendix.

authorized the opening of Federal tax returns to State inspection upon the Governor's request and under rules and regulations prescribed by the Secretary of the Treasury with Presidential approval.

Some enterprising State officials are reported to have contrived to gain access to Federal tax files even before the Congressional authorization. The late tax commissioner of Massachusetts, Henry F. Long, had apparently sent State men to Washington to examine Federal tax returns "as early as 1920."^{1/} However, the Executive Order implementing the 1926 legislation was not signed by President Hoover until June 9, 1931. It opened individual, joint, partnership, estate, and trust returns to any officer of an income tax State, provided that the inspection was to be solely for State income tax purposes. The regulations were subsequently broadened to permit inspection for purposes of taxes on income derived from intangible property. Four years later in 1935, the so-called Costigan amendment reaffirmed and in a restricted sense broadened this authority.

President Hoover's Executive Order and the associated regulations appear to have had their motivation in the overlapping taxation of incomes which began to assume significant proportions as a result of the Federal and State income tax increases and new State enactments generated by the Great Depression. States were moving in increasing numbers into the taxation of individual and corporation incomes already subject to Federal taxes. Within less than three years after January 1929 ten additional States embarked on income taxation. This raised problems at the State level which were not encountered by the National Government. The States could readily impose reporting requirements on taxpayers within their own borders. They were handicapped, however, with respect to non-residents and residents' income from out-of-State sources. This circumstance, coupled with the general belief that Federal tax provisions command a higher degree of taxpayer compliance than their State counterparts, led logically to the realization that the States' enforcement tasks would be facilitated by access to Federal tax information.

The interests of local governments were also involved. The Costigan amendment, as the 1935 legislation is commonly designated, appears to have been offered on the floor of the Senate

^{1/} Clara Penniman and Walter W. Heller, State Income Tax Administration, p. 217.

in response to the collective petition of the National Association of Tax Assessing Officials, the U. S. Conference of Mayors, and the American Municipal Association. They wanted access to Federal returns to assist in the administration of local personal property taxes. However, Federal tax returns have never been opened directly to local officials; only to State officials for both State and local taxes.

Since the grant of Congressional authority to give States access to Federal tax returns, administrative cooperation has passed through two phases, and is well into a third.

After the 1931 Executive Order and on through the 1940's a substantial number of income tax States availed themselves of taxpayer information available in the records of the Internal Revenue Service. From 1935 to 1940 State tax officials frequently inspected green duplicate copies of the Federal tax returns kept in file in collectors' offices in the field. Some purchased photostatic copies of Federal tax returns, which Internal Revenue supplied at set rates. Some availed themselves of the opportunity to purchase transcripts of Internal Revenue's audit adjustments. Others sent their own personnel to Washington (and after decentralization of the Service, to field offices) to microfilm Federal returns, prepare abstracts of them manually, or merely to type lists of Federal taxpayers open to the public.

Most States found these facilities productive of additional revenue, even when used intermittently or only on a one-time basis. A mere list of Federal taxpayers' names and addresses enabled the State to uncover residents who had failed to file tax returns. The Revenue Service, however, had little incentive to promote expansion of these arrangements, since they encroached on its limited resources. State personnel working in Internal Revenue's premises required office space and desk facilities. While the States paid for audit abstracts and photostatic copies of returns, their payments accrued to the General Fund of the Treasury and not to the spendable funds of the Revenue Service.

In 1949 an effort was made to cope with the expanding interest of the States in obtaining information from Federal returns and also to provide for a return flow of information from the States to the Revenue Service. A conference of Federal, State and local representatives sponsored by the Secretary of the Treasury developed a plan for coordinated use of State and Federal auditing resources. This, the second phase of administrative cooperation, contemplated that State and Federal administrations would coordinate their audit plans and share in each other's audit results. This would permit more effective deployment of income tax audit resources at both

levels, avoid duplication of effort, and safeguard taxpayers against a repeat audit ordeal. After the Treasury conference, the Internal Revenue Service concluded cooperative income tax audit agreements with five States (Colorado, Kentucky, Montana, North Carolina and Wisconsin). They were intended to serve as pilot projects before extension to other States. Although this arrangement was enthusiastically endorsed by the participating States, the Revenue Service did not find the results encouraging. The States had only limited income tax audit programs and with one conspicuous exception had little audit information to share with the Federal Service. Consequently, the exchange program gained no additional support within the Internal Revenue Service during the pilot project stage.

In 1957, some two years after the "Kestnbaum" Commission had endorsed administrative cooperation as a tool for intergovernmental tax coordination, the program was given a new direction and a new lease on life. At the instance of the Governor of Minnesota, an effort in this direction elicited the active support of the President's Deputy Assistant for Intergovernmental Relations, a White House staff office created in 1956 on the recommendation of the "Kestnbaum" Commission.

Under this, the third phase, "agreements on the coordination of tax administration" have now been negotiated with four new States (California, Kansas, Minnesota and Utah) and four of the original agreements (Kentucky, Montana, North Carolina and Wisconsin) have been renegotiated. A half dozen additional agreements, moreover, are in varying stages of negotiation.

The significant feature of the current agreements is that unlike the pilot projects, they do not rely solely on State income tax audit information for the quid pro quo. They recognize instead that, while the situation varies from State to State for most information items, most States have some information in their administrative files potentially useful to the Internal Revenue Service, such as names and addresses of workers covered under State employment security programs, which is a ready source for locating delinquent Federal income tax taxpayers; State motor vehicle registration lists to facilitate the enforcement of the Federal use tax on trucks; or licensing and sales information useful for the administration of the Federal motor fuel, transportation, or retail excise taxes. A check list of types of State information compiled mostly from current exchange agreements illustrates the range of possibilities:

Abstracts of State income tax audits of individuals and corporations.

Lists of employers making returns of amounts withheld from employees or employers who are liable under unemployment compensation laws.

Lists of individuals, partnerships and corporations who engage in specific types of businesses (such as all jewelry stores, all grocery stores, etc.) or who are members of certain professional groups (such as dentists, etc.); i.e. occupational group listings.

Lists of newly formed incorporated businesses, and amount of capital stock fees; lists of corporate dissolutions or withdrawals.

Abstracts of audit adjustments on State inheritance (and gift) tax returns.

Lists of inheritance tax returns for decedents whose gross estates (for State inheritance tax purposes) exceed \$60,000.

Copies of real estate appraisals made for inheritance tax purposes.

Copies of valuation appraisals made of closely held stocks owned by estates.

Copies of inventories of decedents' lock boxes.

Lists of highway department condemnation awards, or other condemnation awards made by the State.

Lists of recipients of rebates or refunds of motor fuels and special fuels taxes, especially farmers.

Lists of registered trucks, tractors, trailers and buses whose gross (or loaded) weight exceeds 26,000 pounds, or whose unloaded weight exceeds 13,000 pounds.

Lists of licensed distributors and licensed suppliers of motor fuels and special fuels.

Lists of auto registrations for collection and lien activities.

Information respecting business insolvencies under State laws.

Sales tax audit information which may be helpful in examination of taxpayers' income or excise tax returns.

Lists of large State tax refunds, including gasoline tax refunds.

Photostatic copies of State or local property tax returns (intangible property tax in particular) where necessary to aid in audit or intelligence activity.

Information from State welfare department relative to dependence claims, and relief status of individuals claimed as dependents.

Information from State regulatory agencies concerning new stock issues; mergers and consolidations of service institutions, such as banks, insurance companies, etc.

The broadened scope of the information exchange program to embrace other potentially useful State data has increased substantially its life expectancy, if only for the reason that it can provide a better balance between the benefits it bestows on the parties to the exchange.

Benefits from the Exchange Program

In fiscal year 1960 an Internal Revenue Service tally showed an aggregate of \$10.6 million additional annual Federal revenue directly attributable to information supplied by State governments. The Service estimated that it would have required an expenditure in excess of \$250,000 to develop this information for itself; and that the annual cost of furnishing Federal information to the States was less than \$50,000.

Incomplete information on additional State income tax revenues directly traceable to information obtained from the Federal Revenue Service suggests that its annual magnitude is at least of the order of \$10 million, probably larger.

We cite these statistics with reluctance, for they grossly understate the revenue and less tangible benefits flowing from these exchange programs. The revenues directly attributable to information supplied by States and vice versa are clearly secondary to the revenue consequences of the general improvement in taxpayer reporting practices encouraged by the exchange program. The

announcement value of a State's accessibility to Federal tax returns is very real. It improves voluntary compliance with State tax laws. The collection statistics cited, moreover, pertain to the year for which the information was obtained, whereas the effect on taxpayers' reporting habits is more lasting. A non-filer who has been called to the mat is less likely to default the next year. Under a self-assessment system the margin between success and failure can be quite narrow. Steady if slow improvement in the quality of voluntary taxpayer reporting is essential to its survival.

Obstacles to Administrative Cooperation

In the light of the compelling arguments for reciprocity between Federal and State tax administrations postulated earlier, the performance after 30 years of effort leaves much to be desired.

While tax administrators at all levels share a common concern for good tax enforcement and frequently develop cooperative working relations with their colleagues in neighboring and overlapping jurisdictions, institutional barriers appear to stand in their way. The political leadership in their respective jurisdictions is typically preoccupied with day-to-day problems and with the immediate needs of its own constituencies, and is not likely to go to great pains in behalf of inter-jurisdictional comity. More immediately pressing problems tend to relegate endorsement of abstract principles to ceremonial occasions. The creation of the office of staff Assistant for Intergovernmental Relations to the President, the Sub-Committees on Intergovernmental Relations by the House Committee on Government Operations, the special committees to consider intergovernmental problems at the State level, and indeed, the establishment of this Commission itself testify to an overt recognition of this situation and hold some promise of a remedy.

In some States statutory authority for the exchange of information is limited. Most jurisdictions are limited also in using audit evidence provided by another level of government and more particularly in using appropriated funds to do the work of another level of government. Federal agencies, for example, required special enabling legislation before they could withhold State income taxes from their employees, to reciprocate a service State and local governments have been rendering the National Government since the introduction of the withholding of Federal taxes from wages and salaries. Federal legislation is currently pending to permit Federal agencies to withhold local income from their employees. An immediate irritation is the priority of liens for collections now accorded the Federal Government which

practically prevents State officials from calling a tax case to the attention of Internal Revenue if there is any doubt that the taxpayer's resources would be adequate to meet both Federal and State claims.

Another barrier is the unequal quality of State tax enforcement particularly in the income tax area. State tax administrations are typically thinly staffed. In those States which use both income taxes and consumer taxes, the return per dollar of enforcement effort is likely to be greater from consumer than from income taxes. In consequence, income tax enforcement tends to be neglected even in relative terms.

The compulsion every tax administrator feels to demonstrate the highest possible revenue return per dollar appropriated for his activity is strong also at the Federal level. The Internal Revenue Service is under persistent pressure to deploy its limited enforcement resources with a view to maximizing collections. It is reluctant to devote even a small part of its facilities to compile information for States because the information it receives in exchange is likely to be less productive than the leads it already has in its possession but is unable to pursue for lack of personnel.

Because the States' taxes differ in important detail from Federal taxes and from one another's, as do their tax records, the potential usefulness of State data for Internal Revenue Service's purposes is not readily apparent. It has to be ascertained separately, State-by-State. State tax administrators are not sufficiently familiar with Internal Revenue requirements to know what data in their possession would be particularly useful for Federal tax enforcement. Internal Revenue, in turn, is unfamiliar with the contents of the States' files and cannot take the time to probe them. The situation requires an organized effort, a State-by-State examination by technicians familiar with the needs of the one and the resources of the other.

The Next Steps

The programs for the exchange of tax information between governments have clearly proven themselves to be practicable. Their value as tools of intergovernmental coordination has never been questioned. Their expansion both geographically and in content, is timely. The words of the declared purpose of the Congress in creating this Commission apply: "...the complexity of modern life intensifies the need in a federal form of government for the fullest cooperation and coordination of activities

between the levels of government..." We would only add that the fiscal requirements associated with our international responsibilities add urgency to that need.

We find that several courses of action are required to move the program forward.

Statutory Authority. First, there is a degree of uncertainty, at least in some States, about the authority of tax officials to share tax information with other jurisdictions. This uncertainty should be removed.

Recommendation No. 1. The Commission recommends to the Council of State Governments that it direct its appropriate Committees (a) to survey the adequacy of legislative authority in the States to exchange tax and related information with other State administrations and with the Internal Revenue Service and (b) to draft the additional suggested draft legislation deemed necessary to permit the exchange of information, under appropriate safeguards, with other State tax administrations and with the Internal Revenue Service.

Preparation of an Inventory. The lack of enthusiasm of the Internal Revenue Service to a one-way flow of information to the States, albeit authorized by Congress, is understandable. Indeed, a quid pro quo probably serves the long run public interest for it encourages the States to reciprocate. As already noted, State and local governments possess a variety of information potentially useful in Federal tax administration. It should be made available for that purpose. The States have no incentive to organize it and place it at the disposal of the Revenue Service voluntarily; certainly not if the assistance of the Federal tax administration is theirs for the taking.

We welcome the increasing emphasis in the Federal-State exchange agreements on other than State income tax audit information. States should be free to deploy their limited enforcement resources in the tax areas they find most productive, as for example, consumption taxation. Indeed, if the trend to pattern State income tax provisions after the Internal Revenue Code continues, it might ultimately become timely to consider the joint administration of Federal and State income taxes.

The Revenue Service has declared itself ready to negotiate agreements with States wanting them. It leaves the initiative to the States, however. More States would take that initiative if the potential value of exchange of information programs were better

understood, and more particularly, if the States possessed an inventory of the bodies of information in their own possession which the Revenue Service would want to receive in exchange. The preparation of such inventories, however, requires intimate familiarity with Internal Revenue procedures and practices.

The Commission finds that there is need for an organized effort to review, on a State-by-State basis, the bodies of information obtained in the course of the administration of State and local governments, from the viewpoint of their potential usefulness to Federal tax administration. It is prepared to devote its staff facilities, if reinforced with technical assistance by State and local governments and the Internal Revenue Service, to prepare this inventory.

Recommendation No. 2. Accordingly, this Commission recommends that the Council of State Governments through the National Association of Tax Administrators and the U. S. Treasury Department through the Internal Revenue Service each designate one or more technicians to an ad hoc committee on which local governments and the Commission's staff would also be represented, such committee to undertake a State-by-State analysis of bodies of information available in State and local governmental records potentially useful for the administration of Federal taxes.

Training of Personnel. One of the barriers to cooperation among tax administrators--and, indeed, to the adequacy of State and local tax revenues and equal treatment of taxpayers--is the uneven quality of State enforcement. Admittedly, this is due in the first instance to inadequate appropriations. In part, however, it is attributable to the fact that most States find it impracticable to individually conduct training programs for their personnel. Staffs are typically too small for an organized training program on a continuing basis. In practice, therefore, State tax enforcement personnel is restricted to learning on the job.

Over the years the Internal Revenue Service has developed an integrated training program which begins at the district and regional level with basic courses and progresses through intermediate and advanced specialized work, some at the National headquarters. Several States have expressed an interest in arrangements to enable their enforcement officers to participate in Internal Revenue training courses. Many States could benefit from such an arrangement. The proposition however has not advanced beyond the suggestion stage. It would probably require Congressional approval since the use of appropriated funds is

involved, although the States might properly be billed for an allocated share of the additional costs. To place the proposal before Departmental officials and the appropriate Congressional committees, the Internal Revenue Service would require specific information on the extent of State interest, the probable number of enrollees, the kind of training required, the ability of State personnel to meet qualification requirements for admission to training, etc.,--in short, a concrete proposal.

We have considered an alternative approach, namely, the development of a training program specifically for State and local personnel under the auspices of such an organization as the National Association of Tax Administrators. This would entail some duplication and may not be practicable for it would probably limit training to one location beyond the ready reach of most State administrations. The Internal Revenue Service's program, on the other hand, is largely decentralized in places within relatively easy access for State employees.

Recommendation No. 3. The Commission therefore recommends that the Council of State Governments through the National Association of Tax Administrators, assume leadership in preparing a concrete proposal on the part of interested States for the admission of State and local tax enforcement personnel to Internal Revenue Service's training programs, for the consideration of Treasury Department officials and the Congress.

Special Projects. Periodically, State and local governments have need for information available by special processing from the records of the Internal Revenue Service. The Internal Revenue Service is deterred from complying with requests for such information even on a reimbursement basis, because the payments accrue to the General Fund of the Treasury Department. The Revenue Service has no authority to use them directly to pay for the cost of the work or to replace the appropriated funds which may have been expended in performing it. Congress has granted such authority to some Federal agencies, notably the Bureau of the Census. A grant of similar authority to the Internal Revenue Service would serve the cause of intergovernmental cooperation between tax administrations. A legislative proposal to this effect is being readied by the Administration for submission to the Congress.

Recommendation No. 4. The Commission recommends to the Congress that it give favorable consideration to legislation authorizing the Internal Revenue Service to perform statistical and related services for the States on a reimbursement basis,

such payments to accrue to the credit of its own appropriation account.

More Remote Steps

In the preceding discussion we were concerned with ways and means by which governments can assist one another in the enforcement of their tax laws. We had assumed that the jurisdiction that imposes the tax will continue to administer it. This, however, is not a necessary limitation on intergovernmental cooperation. It is perhaps a point to recall that just 100 years ago, under the Act of August 5, 1861, all the States except Delaware elected to collect their apportioned share of a \$20 million direct Federal tax levy, which under the Constitution had been apportioned on the basis of population.

Existing State-local relationships provide precedent for the imposition of a tax by one level and its enforcement by another. A number of States, for example, collect retail sales taxes for their political subdivisions. We perceive no overwhelming objection in principle to a similar extension of administrative cooperation between Federal and State governments. It is not unlikely that there are some tax enforcement activities which the States could perform effectively for the Federal Government and some that the Federal Government could perform effectively for the States. These possibilities have not gone unnoticed. Some years ago passing consideration was given to the possibility of delegating to the States responsibility for administering refunds under Federal motor fuel taxes. This year, in connection with the President's recommendation for increasing the Federal use tax on trucks, some consideration was given to the possibility of delegating some part of the enforcement of this tax to States.

Other possibilities are worthy of exploration. We cite only a few:

The Federal Government taxes retail sales of furs, jewelry, luggage and toilet preparations. In two-thirds of the States, these sales are subject to general retail sales taxes.

States are tending increasingly to pattern the structure of their income taxes on the Internal Revenue Code. The practice ranges from the adoption of Federal definitions for individual tax variables to the practice in Alaska where the State tax is fixed as a specified percentage (now 16 percent) of Federal tax liability. In these situations the State tax could possibly be collected together with the Federal tax.

Local jurisdictions charged with responsibility for recording deeds could assist materially in the enforcement of the Federal documentary stamp tax on deeds of conveyance.

Another possibility is the collection of State cigarette taxes at the manufacturing level, where the Federal cigarette tax is collected.

We cite these examples only to illustrate the range of possibilities. We recognize that there may be serious obstacles in the path of each. They, nonetheless, merit exploration in detail. Experience in other federalisms, notably Canada and Australia, and under our own system at the State-local level provide adequate justification for exploring these possibilities in depth. As we stated at the outset, in a federal form of government all levels of government exist to complement one another in the common goal of serving the people. We are, therefore, directing our staff to proceed with studies in this direction and solicit the cooperation of Federal, State and local officials and of tax scholars in this effort.

The coordination and simplification of tax administrative practices among governmental jurisdictions is one of the Commission's statutory responsibilities on a continuing basis. We shall have occasion to return to this subject area from time to time as our understanding of these problems progresses.

* * * * *

APPENDIX

Code provisions and regulations governing disclosure of returns and related documents to States

Generally, returns^{1/} of taxes are now open to inspection either (1) on order of the President under section 6103(a) of the Code, or, (2) without such an order, under rules and regulations prescribed by the Secretary of the Treasury under other provisions of law, including section 6103(b).

Executive Order 10906 and Treasury Decision 6543, dated January 17, 1961, I.R.B. 1961-12, 18, 19 open and regulate inspection of returns under section 6103(a).

Treasury Decision 6546, December 2, 1960, I.R.B. 1961-12, 29 opens returns under numerous other sections of the Code, including section 6103(b).

By way of introduction, it is observed that inspection by States is authorized in both Treasury decisions. For example, the entire class of unemployment tax returns is available to State inspection if such inspection is for the purpose of administering the State's unemployment law. Sec. 301.6103(a)-1(d)(2), Treasury Decision 6543. If, however, the State desires to inspect an unemployment tax return of a corporation for purposes other than the administration of its unemployment taxes, as provided in the preceding sentence, the application for inspection must state the name of the corporation and the reason why access is desired and otherwise comply with section 301.6103(b)-1(a) of Treasury Decision 6546.

In addition to furnishing access to returns pursuant to Treasury decisions, the Commissioner also has authority, within his discretion, to furnish access to certain excise tax returns the disclosure of which is not governed by specific provisions of the Internal Revenue Code.

Income Taxes

The general authority of the States to examine the entire class of income tax returns is found in section 6103(b) of the Code and section 301.6103(b)-1 of Treasury Decision 6546, in which the requirements respecting the governor's request for access are fully set out.

The history of the State's authority to inspect income tax returns is summarized as follows:

^{1/} As used herein, the term "return" is used as generally including information returns, schedules, lists, and other written statements filed with the Internal Revenue Service which are designed to be supplemental to or to become a part of the return, and, in the discretion of the Commissioner, other records or reports containing information included or required by statute to be included in the return. See secs. 301.6103(a)-1(a)(3), 301.6103(b)-1(d), 301.6103(c)-1(d).

Section II(G)(d) of the Tariff Act of 1913, section 14(b) of the Revenue Act of 1916, and sections 257 of the Revenue Act of 1918 and of 1921 provided "That the proper officers of any State imposing an income tax may, upon the request of the governor thereof, have access to the returns" of any corporation, or to an abstract thereof showing the name and income of the corporation, at such times and in such manner as the Secretary may prescribe.

The provision requiring the imposition by the State of an income tax as a condition to inspection of Federal income tax returns of corporations precluded inspection by States imposing excise taxes on corporations. It was not included in subsequent acts.

Sections 257(a), Revenue Act of 1924 and 257(c), Revenue Act of 1926, provided that "The proper officers of any State may, upon the request of the governor thereof, have access to the returns of any corporation, or to an abstract thereof showing the name and income of the corporation at such times and in such manner as the Secretary may prescribe." Sections 55 of the Revenue Act of 1928 and of 1932 made section 257 of the Revenue Act of 1926 applicable to income tax returns filed under such Acts. Although this provision of law gave the Treasury Department no control of the use made by the States of material obtained from corporation returns, regulations required that the governor state why access was desired. See Article 1092 of Regulations 45, relating to the Income Tax under the Revenue Act of 1918, Article 1093 of Regulations 65, relating to the income tax under the Revenue Act of 1924, Article 423 of Regulations 74 and 77 relating to the income tax under the Revenue Acts of 1928 and 1932.

Section 55 of the Revenue Act of 1934 continued prior law respecting State inspection of corporate returns. This section, however, was subsequently amended by the Act of April 19, 1935 (74th Congress, First Session), providing for State inspection in the administration of State or local law, and the substance of which has been substantially unchanged with respect to income tax returns ever since. It was incorporated as section 55(b)(1) and (2) of the Revenue Act of 1938, section 55(b)(2) of the 1939 Code, and as section 6103(b)(2) of the 1954 Code.

Estate and Gift Taxes

Inspection of estate and gift tax returns by the States is now authorized by section 6103(a) of the Code and section 301.6103(a)-1(d) of Treasury Decision 6543, providing that returns and notices in

respect of the estate tax and returns in respect of the gift tax may be made generally available for inspection by any properly authorized official, body, or commission, lawfully charged with the administration of any tax law of the State for the purpose of such administration, provided a like cooperation is given by the State to the Commissioner and his representatives with respect to the inspection of returns of estate, inheritance, legacy, succession, gift, or other tax law of the State, for use in the administration of the Federal tax laws.

Historically, returns of these taxes were first opened to inspection by persons having a "material interest," under the authority given the Commissioner to prescribe rules and regulations with the approval of the Secretary. See Article 86 of Estate Tax Regulations 37 (1919 ed.) and Article 33 of Gift Tax Regulations 67 under the Revenue Act of 1924. An officer of a State requiring information for his official use presumably had a material interest.

Returns of these taxes were first opened specifically to inspection by States by section 55 of the Revenue Act of 1932, as amended by section 218(h) of the National Industrial Recovery Act, providing for inspection of all returns made under the 1932 Act and certain related documents to such an extent as shall be authorized by rules and regulations promulgated by the President. This provision was thereafter carried in section 55 of the Revenue Acts of 1934, 1936, and 1938. Treasury Decision 4797, dated March 25, 1938 (1938-1 C.B. 361), Treasury Decision 4798, dated March 25, 1938 (1938-1, C.B. 367) and Treasury Decision 4873, dated November 12, 1938 (C.B. 1938-2, 261) opened such returns to inspection, for official use in connection with an estate, inheritance, legacy, succession, gift, or other tax of the State, on an individual basis, by States extending a like service to the Commissioner. Treasury Decision 4929, August 28, 1939 (C.B. 1939-2, 91) was amended to include a provision similar to the one in Treasury Decision 6543, relating to general inspection of these returns.

Federal Unemployment Tax Act Returns

Inspection by States of Federal Unemployment Tax Act returns of corporations filed under Chapter 23 of the 1954 Code, on an individual basis, is now provided by section 6103(b)(1) as made applicable by section 6106 of the 1954 Code and is regulated by section 301.6103(b)-1(a).

General inspection of these returns by States for the administration of the State's unemployment tax law is opened by Executive Order 10906 and regulated by section 301.6103(a)-1(d)(2), pursuant to section 6103(a), as made applicable by section 6106 of the 1954 Code. These returns may be opened for general inspection by an officer of any State having a law properly certified to the Secretary of the Treasury by the Social Security Board upon written application signed by the Governor designating the officer to make the inspection and showing that it is solely for the purpose of administering the State law.

These returns were first made subject, by section 905 of the Social Security Act of 1934, to the same rules as to inspection as income returns under the Revenue Act of 1926, and were later opened to inspection by section 1604(c) of the 1939 Code. For prior rules see Article 10 of Treasury Decisions 4797 and 4873 and section 4630.7 of Treasury Decision 4929.

Excise Tax Returns

These returns are generally divided into two classes:

(1) Those open to inspection on order of the President under section 6103(a) of the 1954 Code, and

(2) Those open to inspection in the Commissioner's discretion pursuant to 26 C.F.R., section 601.702(d) of the Statement of Procedural Rules.

Excise tax returns of the first class, made with respect to the following taxes, under section 6103(a) are opened by Executive Order 10906 and section 301.6103(a)-1(c) of Treasury Decision 6543.

Transfers to avoid income tax (Code Chapter 5^{1/})

Manufacturers' Excise Taxes (Code Chapter 32)

Communications, transportation, and safe deposit boxes (Subchapters B, C, and D of Code Chapter 33)

Coconut and palm oil (Subchapter B of Code Chapter 37)

1/Although returns respecting these taxes are included in the 1954 Code under Subtitle A, dealing with income taxes, Treasury Decision 6543 includes such returns in the classification of returns of excise taxes, subject to disclosure only on Executive order.

Transfers to avoid income taxes were first taxed by the Revenue Act of 1932 and returns were presumably subject to the rules respecting disclosures of income tax returns to States. Section 301.6103(a)-1(d) of Treasury Decision 6543, in part, limits inspection of returns respecting transfers to avoid income taxes to any properly authorized official, body, or commission lawfully charged with the administration of any tax law of a State, for the purpose of such administration. It would seem, therefore, that there may be some doubt as to a State's authority to make inspections for the benefit of local State administration.

The other tax returns mentioned above were formerly open to inspection by section 55 of the Revenue Act of 1932, as amended by section 218(h) of the National Industrial Recovery Act, and thereafter by sections 55(a) of the Revenue Act of 1934 and of the 1939 Code. Their inspection was authorized with the issuance of Treasury Decision 5138, approved April 20, 1942 (C.B. 1942-1, 99).

Excise tax returns of the second class not opened to inspection by specific provisions of the law were generally regarded as excluded from inspection, until enactment of the Administrative Procedure Act of June 11, 1946, section 3(a) of which required every governmental agency to publish rules describing the established places at which, and methods whereby, the public may secure information or make submissions or requests. Pursuant to rules adopted under that act and now appearing in Title 26 Code of Federal Regulations as section 601.702(d) of the Statement of Procedural Rules, information in connection with matters of official record in which the procedure or inspection is not otherwise set out in the procedural rules may be obtained, in the Commissioner's discretion, upon meeting the requirements set forth in the section. Officers of States or local subdivisions qualify for inspection of these returns under the Procedural Rules just as do other applicants. Thus, there is no requirement that the request be made by the governor, for example.

Returns open under the Statement of Procedural Rules would be, for example, those respecting:

Retailers' excise taxes (Code Chapter 31)

Admissions and Dues (Subchapter A of Code Chapter 33) and

Wagering (Code Chapter 35)

Use of Highway Motor Vehicles (Subchapter D of Code Chapter 36), and
Special fuels (Subchapter E of Code Chapter 31)

Returns respecting several types of taxes are subject to State inspection by virtue of special provisions of law. For example:

(1) Returns of gasoline and lubricating oils taxes are, by section 4102 of the 1954 Code, open to inspection by such officers of any State or political subdivision thereof as shall be charged with the enforcement or collection of any tax on gasoline or lubricating oils. Section 48.4102-1(b) of Treasury Decision 6433, December 17, 1959 provides, among other things that requests for inspection of returns and related documents respecting these taxes shall be made by any officer of a State or political subdivision thereof who is charged with the enforcement or collection of any tax on gasoline or lubricating oil and shall be addressed to the District Director having custody of the records which it is desired to inspect.

For similar provisions see section 3412(e) of the 1939 Code and Regulations 44, section 314.62(d).

(2) Under section 4773 of the 1954 Code, respecting narcotic drugs and marihuana, the Secretary or his delegate is authorized to furnish certified copies of documents, including returns, filed in the internal revenue district, to officials of any State or of any organized municipality charged with enforcement of certain laws or ordinances respecting marihuana or narcotic drugs. The regulations under section 2556 (narcotics) are contained in Narcotics Regulations 5 (26 C.F.R. 151.201); and under section 2595 (marihuana), in Narcotics Regulations 1 (26 C.F.R. 152.81).

In addition to the types of information set out above, section 6107 of the 1954 Code provides that a certified copy of a list of persons paying special (or occupational taxes) in the principal office in each internal revenue district shall be furnished, upon request, any prosecuting officer of any State, county, or municipality. The various regulations dealing with the occupations subject to special taxes do not, however, necessarily contain specific regulations as to the furnishing of the required information to prosecuting officers, relying upon the statutory provision, instead.

See 26 C.F.R., Part 601 relating to other limited classes of information which may be furnished applicants, including States.

