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CONVERSION OF CERTAIN OPERATIONS OF THE INTERNAL REVENUE SERVICE TO ADP

PAUL A. SCHUSTER*

INTRODUCTION

I certainly appreciate the invitation received from your President to meet with you and speak to you this afternoon, as members of the Bar and Meeting of the Wyoming State Bar. You, as members of the Bar and members of the Judiciary, and we, in the Internal Revenue Service, have many things in common. I am sure that all of us are very interested in the fair and equitable administration of the law. Many of you, in varying degrees, are directly concerned with the administration of our Federal Tax Laws. You assist your client in the preparation of Federal tax returns and in many instances represent them through the appeals procedure provided by the law. In serving in this capacity as taxpayer representatives in the various steps of the appeals procedure, you are actively participating in the counter balance which is so necessary to assure a continuing strong and realistic interpretation and administration of our Federal taxes.

At times the role of the attorney in his pursuit of justice and the discharge of his duties as he sees them, is not a popular one. Also, we, who have chosen a career in the Internal Revenue Service, realize that our work is not always of a popular nature. What we must do at times in the administration of tax laws is certainly not pleasant from a personal viewpoint, but from a conscientious and official viewpoint there is often no alternative but to use full enforcement or collection measures. This line of thought brings to mind some of the very sage words expressed by the Honorable Ewing T. Kerr, United States District Judge for the District of Wyoming, when he gave me the oath of office at the time of my induction as your District Director of Internal Revenue. After briefly tracing the history of taxes throughout civilization, and explaining their importance in a free government for the benefit of many Internal Revenue Service employees present, members of the Court, and others, the Judge stated, and I quote:

I certainly have a lot of respect for those who have dedicated their lives to this particular field. It isn't the most popular profession. It is somewhat like being a judge. This is not a popular job. Yet, someone must perform these duties.

I can't recall anyone in any community having been singled out for outstanding services simply because he had collected more taxes than his predecessors or his competitors. We don't operate that way. And yet I want to re-emphasize that we couldn't exist without the performance of the duties which you people are rendering.

His Honor then effectively outlined the relationship between the Courts and the Internal Revenue Service in the interpretation and administration

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of the tax laws and concluded this portion of his words with the statement:

Both Departments are important and indispensable in the operation of the Federal Government.

I frequently recall those words and hope that I shall always be guided by them. Although they are cause for pride, they are, at the same time, sobering, and cause for humility.

In many of our internal operations we, in the Internal Revenue Service, frequently must rely on legal counsel, and I am happy to state that competent counsel is always available to us in the offices of our Regional Counsel and our United States District Attorney. We, in the Service, have come to realize the importance of the role of the attorney within and without the government.

Your President has asked that I talk to you today in the conversion of certain operations of the Internal Revenue Service to ADP (Automatic Data Processing). I am certainly happy to do that, as we want to acquaint as many taxpayers and practitioners as possible with the basic information concerning our conversion. I also wish to show you a brief, professional film entitled, "Push Buttons and Taxes," which very effectively depicts much of the basic concepts in our ADP conversion and system. In addition to the discussion of ADP, I would also like to speak briefly to you on two other matters; one is the liaison between your organization and our District office, and the second is one of our more vexing administration problems at the present time.

LIAISON BETWEEN WYOMING STATE BAR AND INTERNAL REVENUE SERVICE

In regard to the liaison between the Wyoming State Bar and our Internal Revenue District, I wish first of all to welcome each and every one of you, as individuals or as a group, to visit our headquarters' and field offices to discuss items of mutual interest with our representatives. On a more formal level, I encourage your officers to meet with us once or twice a year and in this regard, I intend to stay in touch with them for the purpose of working out arrangements for such meetings. Such meetings would afford us an opportunity to find out more about your problems in your dealings with the Internal Revenue Service. I am confident that if we are informed of these problems we can satisfactorily resolve them. We would also like the opportunity to acquaint you better with our operations at the District, Regional, and National levels. And, whether we are attorneys or Internal Revenue Service employees, one thing is certainly of mutual interest to all of us as U. S. citizens; the desire to have fair and equitable tax laws which are fairly and equitably administered. We would greatly appreciate your bringing to our attention any indications of inequities or abuses, as we can do something about this through proper channels. It is quite possible that in your practice of the Federal Tax Laws you encounter either specific problems or informa-

tion of a general nature, which, if brought to the attention of our National Office, could result in the initiation of better tax legislation. Therefore, I do encourage your officers or representatives selected by your group, to meet with us to discuss matters of mutual interest for the purpose of strengthening our liaison and our over-all tax administration in this District.

In addition to these meeting, I also encourage your organization to participate with us in tax seminars, particularly prior to the start of each Federal income tax filing period. These seminars have already been discussed with officers of the Wyoming Society of C.P.A.'s and the officers of the Wyoming Society of Public Accountants. Both organizations are very receptive to such seminars and have indicated an interest in joint sponsorship of such seminars. I don't know whether it will be possible for us this year to arrange for joint attendance or joint sponsorship by your organization, the C.P.A.'s and P.A.'s. However, from our viewpoint such an arrangement would certainly be fine. If a joint sponsorship on the part of all three organizations cannot be arranged this year, we still hope that sponsorship other than by the Internal Revenue Service can be arranged, that the seminars will become a reality, and that all three of the organizations will attend the seminars in large numbers. I am sure you can appreciate that our manpower does not permit us to participate in separate series of seminars for each organization. Such an arrangement would become too time-consuming, even though we would like to participate to that extent. It should be understood, of course, that the seminars would be well-planned and cover timely items including the most recent changes in tax law, revenue procedures, and other matters of current, mutual interest.

INTEGRITY

In the area of liaison, and also in the area of administration problems, I would like to take a minute or two to discuss the very important subject of integrity. On many an occasion, our Commissioner Mr. Caplin, has stressed the importance of integrity at the three levels of: 1) the taxpayer; 2) the tax practitioner; and 3) the Internal Revenue Service employees. Certainly we in the field, charged with the responsibility of effectively administering the tax laws, concur wholeheartedly in our Commissioner's views on the subject of integrity. We, in the Service, share equally in the responsibility and I am confident that here is a continual consciousness on the part of our employees of the importance of integrity in their day-to-day official and personal lives. Integrity covers a wide variety of items in so far as our Service employees are concerned. To mention but a few, it involves the full day's work; the obligation for continued self-improvement to do a better job; the need for professionalism in all aspects of the job, and the need for courteous, fair, impartial treatment in all tax cases.

In the area of integrity we ask you to help us. We ask you to encourage complete integrity among your clients. And we ask you to do

this by helping us in the education of our taxpayers concerning their obligations for correctly reporting and timely paying the various Federal taxes for which they are liable. Taxpayer education is receiving our continual attention and emphasis.

Actually, we are encouraged by the evident increasing consciousness on the part of religious, civic, business and professional groups to the need for integrity in relation to Federal tax administration. For example:

- 1) A recent article in General Electric News stressed the obligation of citizens to pay all Federal income taxes without trying to hide anything from the government.
- 2) A message on the moral obligation of filing complete and accurate returns was arranged by the Catholic Bishop of Wilmington, the Rabbis of Wilmington, the Jewish Federation of Delaware and the Protestant Council of Churches.
- 3) The United States Judge at Little Rock issued a statement expressing indignation at the prevalence of failure to file cases brought to his attention and stated his intention to seriously consider jail sentences in such cases.
- 4) After a nurse was convicted for failure to file, a representative of Professional Nurses Association contacted one of our Revenue offices and asked that a Revenue employee attend one of their meetings and speak on record keeping and filing requirements.
- 5) There have been several instances where tax practitioners have written memorandums to their clients advising them of the need to keep full and accurate records on travel and entertainment expenses, or report, interest and dividend income, etc.
- 6) Conscientious taxpayers are paying visits to our Revenue Office to advise that they have been very favorably impressed with articles which they have read and which were initiated either by our National Office or our Local District office.

TRUST FUND TAXES

Now I would like to turn to that vexing problem in tax administration which I mentioned earlier. Although by far the majority of our taxpayers are honest, have tremendous integrity and continually express their voluntary compliance and willing participation in our self-assessment system, there are still some who do not meet their obligations through ignorance or an outright disregard of the laws. These failures are particularly noticeable in our Trust Fund Tax areas. When I mention Trust Fund Taxes, I am referring particularly to those taxes which an employer withholds from an employee for Social Security Tax and for Federal Withheld Tax, and which together with the employer's share of the Social Security Tax are to be reported quarterly on Form 941. The law provides

that if the taxes withheld from the employee, plus the taxes owing by the taxpayer, exceed \$100 per month, the taxpayer is to purchase on a monthly basis a so-called Depository Receipt in the amount of the Trust Fund Taxes for which he is liable each month. The taxpayer can purchase the Depository Receipt by sending the tax money directly to the Federal Reserve Bank or to a qualified local depository bank. The validated depository receipt he receives from the Federal Reserve Bank should be attached as a credit to the taxpayer's Form 941. Across the country compliance with the timely purchase of depository receipts and the timely reporting and payment of Trust Fund Taxes is not what it should be. The record of our taxpayers in the Cheyenne District, percentage wise, is not too favorable. We are still receiving delinquent returns and unpaid returns, and there are a number of instances where taxpayers fail to purchase depository receipts as required by the law. There are still taxpayers who withhold the taxes from their employees but who then divert those taxes to their own personal or business use. This gives them the advantage of competing unfairly with their fellow businessmen who report and pay their taxes timely. Such taxpayers also cost all of us many tax dollars which could be spent much more beneficially than in the searching out of delinquent returns and the collection of delinquent accounts. Did you ever stop to think that once an employer has withheld tax from an employee we must give that employee credit for the amount withheld on his individual income tax return and often refund the money to him even though we didn't receive it to begin with because the employer did not report and pay it over to the government? In view of this over-all condition, we have given the matter particular attention. Our primary concern has been to educate the taxpayers concerning their obligation in the Trust Fund Tax area. New employers and business men are contacted as promptly as possible and furnished with detailed information concerning the type of taxes for which they are liable, the forms to be used in reporting them, and the manner in which the taxes are to be computed, reported, and paid.

In addition to taxpayer education we have also accelerated our entire collection process in the Trust Fund Tax area. Now when a taxpayer files a delinquent Trust Fund Tax return, or an underpaid tax return, he is promptly contacted either by telephone or in person, is advised of his obligations and requested to pay the taxes in full.

Public Law 85-321 was passed to strengthen the enforcement arms of the Internal Revenue Service in this area. The reason for Congress passing the law was the increased number of employers and collection agents who failed to meet their obligations. The purpose of the law is to provide a tool for the Internal Revenue Service in obtaining greater compliance. In flagrant cases the statutory provisions of the law, under Section 7512 of the Code, require the taxpayer, after proper notification by the District Director, to establish a special Trust Fund account and

deposit the taxes required to be withheld and collected on the second banking day after the tax is withheld or collected. Section 7215 of the Code applies certain criminal sanctions providing for maximum penalties of a \$5000 fine and a one-year imprisonment for taxpayers who do not comply with the provisions of Section 7512 of the Code. In this particular instance, proof of willfulness is not required. Failure to make the timely deposits following receipt of a notification alone is sufficient to incur the criminal sanctions. It is our intention to continue to give this entire area of tax administration our very concentrated attention with a view of educating all of our businessmen and employers who are liable for Trust Fund Taxes, to continue to accelerate our entire collection process, and to continue with a firm collection policy. In this area also, we solicit your complete cooperation in aiding us to obtain the compliance necessary.

I certainly want to also express our sincere appreciation to the thousands of businessmen and employers who comply fully with the law and to the many practitioners who so ably assist them.

CONVERSION OF IRS ACTIVITIES TO ADP—AUTOMATIC DATA PROCESSING

In turning to the subject of the conversion of our Service activities to ADP, it should be kept in mind that it also relates to operating problems within the Service; particularly that of an ever-growing work load which no longer can be handled manually and with present mechanical equipment. As a matter of background, I would like to furnish you with the following statistics, which shows the tremendous growth in the number of Federal taxpayers and the attendant work for the Internal Revenue Service, as well as the increased work estimated over the next few years. These statistics are as follows:

Returns Filed – Nationally

1930	1961	1970 (Estimated)	1980 (Estimated)
5 million	9.5 million	110 million	135 million

Total Revenue Receipts – Nationally

5 billion	\$95.3 billion	(100 billion and over –Estimated)
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Cheyenne District – Revenue Receipts and Growth in Population

	Receipts	Population
F/Y 1930	\$405,800	225,656 – 1930
1950	\$37 million, 426 thousand	290,529 – 1950
1960	\$87 million, 127 thousand	327,531 – 1960
1961	\$90 million, 703 thousand	
1962	\$95 million, 136 thousand	

Although the revenue receipts have increased substantially in the Cheyenne District, I am again reminded of the sage words of Judge Kerr, which I mentioned earlier in my speech, to the effect that no one is singled out for having collected more taxes than his predecessor. As a matter of information, the total national revenue of \$95.3 billions of

dollars, which represents actual money in the bank, was placed there at the Internal Revenue Service cost of operation of only one-half of one cent for each dollar deposited.

In addition to the increase in returns filed and total revenue receipts, you will also be interested in knowing that during the past year the Internal Revenue Service received a total of about 350 million income information documents and a total of about 500 million of all types of returns and documents. The necessity of the Internal Revenue Service to turn to the use of high speed electronic equipment is quite apparent.

ORGANIZATION

Now, just how will the conversion to ADP affect the over-all organization of the Internal Revenue Service? It is anticipated that we will still continue to operate our 62 District offices, such as the District office with which you are acquainted at Cheyenne. In addition, we will continue to have our nine Regional Offices, to which will be attached, but not necessarily located in the same city, a Regional Service Center. For example, although our Regional Commissioner's Office is located in Omaha, Nebraska, for the Omaha Region, our Regional Service Center is located in Kansas City, Missouri. Of course we will still continue to have our National Office in Washington, D. C., and a new operation was initiated only last fall and it is known as our National Computer Center, located in Williamsburg, West Virginia.

How Will ADP Work?

Next you will be interested in knowing how the ADP system will work. Under ADP, returns and remittances will still be received in the District offices. The remittances will be detached from the returns and deposited as they are now by each of the District offices. The returns will be perfected in part in the District office and shipped promptly to the Regional Service Center. At the Regional Service Center key punch operators will prepare punch cards to record specific information from each return. The information entered in the punch cards will be transcribed to high-speed electronic transaction tapes. These transaction tapes will be forwarded promptly to the National Computer Center in Williamsburg, West Virginia. At the National Computer Center two master files will be maintained and these master files will include approximately 75 million accounts. One of the master files will be the Business Master File and each account in the Business Master File will be identified by the taxpayer's employer identification number. The second master file will be the Individual Master File and each account in that file will be identified by the individual taxpayer's Social Security account number. Actually, the master file is the heart of the system and it is intended that it will contain an account for each taxpayer in the United States. The information on the transaction tapes prepared at the Service Center will be transcribed to the master file and according to present plans, it is estimated that the entire

master file can be updated once every forty hours. In other words, if it were necessary to post some transaction, such as a payment, an abatement, an assessment, or other type adjustment to each taxpayer's account in the master file, it would be possible to make such postings once every week through the use of our high speed electronic equipment in our National Computer Center.

After the postings to the master file have been completed, output tapes are prepared at the National Computer Center and the output tapes are sent to the respective Service Centers throughout the country. On the basis of the output tapes the Service Center will prepare Notices of Taxes Due, advise taxpayers of adjustments, etc. However, all of the follow-up action to the information forwarded to the taxpayers by the Service Center will be handled by the District offices. In other words, the taxpayers and the tax practitioners will still not see any substantial difference in their present relationships with the District office as all of their contacts will still be with it, such as in the nature of correspondence, personal contacts, payment of taxes, etc.

Through the system and particularly the use of our master file in the National Computer Center, it is hoped that we will be able to check delinquencies more promptly, to detect duplicate refunds, to have a record of all taxes for which each taxpayer is liable, and a current, running account of each taxpayer throughout the country. In the Omaha Region we will start processing the business returns under the new system effective January 1, 1964, and the individual income tax returns on January 1, 1965.

As one matter of particular interest to you, it is also contemplated that as our ADP activities continue we will be able to tie them in through cooperative agreements with many if not all of the states throughout the country. It is quite apparent that with such tie-in between the Federal District offices and the respective states throughout the country, the over-all administration of Federal and State taxes will be greatly strengthened.

Identification Numbers

In our ADP system the importance of the taxpayer's identification number cannot be over-stressed. If the master file in the National Computer Center is the heart of the system, then the numbers are certainly the nerve center of the system. Let me repeat that we are dealing here in two types of numbers: the employer identification number which is used in identifying the account of each business taxpayer in the Business Master File, and the taxpayer's Social Security account number which will identify the individual taxpayer's account in the Individual Master File. You will recall that last October 5, 1961, Congress passed the Public Law 87-397, which established the use of identifying numbers for tax purposes. Subsequently, the Service encouraged all taxpayer who had identifying numbers to show them on their 1961 Form 1040 and their

1962 Form 1040ES. Our Service Centers now in existence have prepared lists of the names of the taxpayers who did not show identifying numbers on their 1961 Form 1040 or 1962 Form 1040ES and have furnished these lists to the Social Security Administration. At the present time the Administration is in the process of forwarding applications for numbers to those taxpayers. I sincerely urge you to assist the Administration and us in helping the taxpayers to correctly prepare these application forms. In fact, some of the forms are not being prepared correctly and it is necessary for the Social Security Administration to direct further inquiries to the taxpayers for the purpose of obtaining additional information to enable the Administration to ascertain whether a new number is to be issued or the taxpayer already has a number. In each instance where you are approached by a taxpayer for assistance in preparing the forms or furnishing the Administration with requested information, please help the taxpayers in every possible in furnishing the correct and full information to the Administration.

Payers and Payees

One more item in regard to numbers, and that deals with payers and payees. At the present time, in 1962, if they so desire payers may ask payees to furnish them with identification numbers if the payers have such numbers. When we mention payers, we are referring to those who pay wages, salaries, dividends, interest, royalties, etc. Payers should not in any way encourage payees who do not have numbers to apply for numbers during calendar year 1962. However, during 1963, all payees must obtain identification numbers and they must furnish them to the payers, as the payers are obligated to show the identification number on all income information documents prepared after October 1, 1963. In view of all these requirements, I again earnestly solicit your assistance in asking all taxpayers who have Social Security numbers to show them on their 1962 returns and to encourage them to obtain numbers during 1963 if they do not have them to put on their 1962 returns.

Preparation of Tax Returns

When in just a minute you see the movie "Push Buttons and Taxes" you will also see the importance of the accurate and complete preparation of all Federal tax returns in the future. Where in the past the Internal Revenue Service did not insist that the taxpayer or the practitioner fill in each item on the return, it will now be necessary to do so. We, therefore, ask that particular care be taken in the preparation of corporation returns, Forms 1120, from now on, and also in the preparation of Forms 1040, 1040A, and all others of Federal returns. In other words, even though some of these returns will not be entered into the system until a later date, serious consideration should be given now to the full and accurate completion of all Federal returns so that when the time comes for their introduction into the system, their full and correct preparation

will be a matter of routine. Again, your cooperation in this entire area of preparing correct and accurate returns is sincerely solicited.

And now, before showing you the very interesting movie of "Push Buttons and Taxes," let me conclude by summarizing as follows: I again want to express my sincere appreciation for the invitation to be with you here today and I again encourage continuing strong liaison between your organization and our District Office through periodic meetings and annual seminars. I seriously solicit your assistance in our over-all Federal tax administration by helping us to strengthen integrity at the three levels of the taxpayer, the practitioner, and the Internal Revenue Service; particular attention is needed at the present time in the Trust Fund Tax area and I urge you to learn and to encourage all of your clients to learn as much as they possibly can about our Automatic Data Processing System. Through it we will have a more efficient and effective administration of our Federal taxes than has ever been known.