



Sheldon S. Cohen

By Jasper L. Cummings, Jr. and Alan J.J. Swirski*

Sheldon Cohen is a director of Farr, Miller & Washington, PC, Investment Counsel, in Washington, DC. He is a certified public accountant and an attorney and served as Commissioner of the Internal Revenue Service in 1965-1969 and as Chief Counsel in 1964-1965.

Q What is your opinion of the state of voluntary compliance with the tax laws today compared with when you were Commissioner?

A Well, life is much more complex today. Although the Code is more complex and business is more complex, the Service is smaller in relation to the population and compliance has decreased. There's an old Yiddish expression which says—"he thinks he is an honest man who is not given the opportunity to steal." We try to design systems in the tax law and tax return preparation to keep honest people from becoming thieves. Thieves are thieves anyway; so we try to design a system in which people will not be tempted.

Now transplant yourself back to the early '60s. The Revenue Service was the first major system in the world to utilize a computer, and luckily it worked. People thought we could do more than we could do, and, by the time we finished, we could do most of the things we said we could do. But at the beginning when we were checking 1099 forms, we were checking one or two letters of the alphabet, but one or two letters in the alphabet was better than none. By the time we were finished, we were doing them all. Since people expected that their returns were being checked, they behaved that way.

I recently told the congressional committees that they didn't get into this compliance hole in one year and they are not going to get out of it in one

year. There is no magic elixir. We need increased enforcement, and collection, audit, and surveillance activity of various kinds. We also need increased audits to prove to people that there is a penalty if you do not comply. Audits function as a deterrent, just like a police car sitting on the shoulder of a highway slows down traffic. Knowing that a friend, business associate, or somebody you know is being looked at is a deterrent, because it makes you think "well, maybe I ought to be more punctilious about complying." We have lost all that.

Q When you were Commissioner, did you view the intensity of audits as important as the number audited?

A Both, you need broad and you need wide. You cannot do slapdash audits of major concerns because they will bury the problem where you will not see it. On the other hand, you cannot go deeply into everybody, so you have to have some system. That was what drove us to TCMP (Taxpayer Compliance Measurement Program), the first scientific audit program to try to ferret out what is really happening out there. Agents were using the criteria that they traditionally used picking returns for audit and we would run 50% no change. When we adopted TCMP, I had to go to the Appropriations Committee and tell them our compliance would not be affected but that our audit results might be because we were going to do a cross section of returns in order to establish a baseline.

We discovered that within three or four years of TCMP audits, we were down to 18% no change audits. That is a dramatic result (the last time I looked they were up around 26 to 30%).

Q You were a drafter involved with both the 1954 Code and the original regulations issued thereon. Tell us of your role in the drafting of the Code and how that process went.

A I graduated law school at the end of the summer school session (1952) so I was off kilter. Even though I was offered a scholarship, a teaching fellowship, and a job at a major law firm, I would have had to wait six months to start. Instead of waiting, I just decided to go to work for the IRS because that was where all the action was in those days. The best tax lawyers in the '50s and '60s came out of the IRS. The assistant chief counsel who interviewed me hired me on the spot and assigned me to L&R because he said I would do the best there.

The very first project I got in 1952 was to amend a section of the law that nobody had ever heard of. I took a draft to Ed Kraft (the House legislative counsel) who tore it apart; four hours later we had a new draft. He looked at me and he said "Sheldon you draft the committee report." That was the first time I understood somebody drafted the committee report. You have to understand that law schools in those days were less sophisticated than law schools today. I knew there were committee reports, but I figured the committee staff drafted them. Luckily, I had taken good notes and I went off to draft it.

The Republicans announced a major tax program when they won the election in the fall of '52. One of the major projects

*Jasper L. Cummings, Jr., Alston & Bird LLP, Washington, DC, and Raleigh, NC, and Alan J.J. Swirski, Skadden, Arps, Slate, Meagher & Flom LLP, Washington, DC.

that the Eisenhower administration had, George Humphrey being the Secretary of Treasury, was accelerated depreciation. Of all the people working at the Treasury and at the IRS at this time, I was the only CPA, so I was the only one who understood a good deal of the accounting material. There was one CPA who was later recruited by the Treasury as a short termer from some of the major accounting areas who helped me later on. So I drafted accelerated depreciation in the House and later in the Senate. The business community was unhappy with some of the rules I wrote in the House and they tried an end run around me by asking for something called sum of the year's digits depreciation in the Senate. They thought it could overlook salvage value.

The lobbyists were less effective then and did not really understand the process nearly as well as they do today. So when I drafted the sum of the year's digits method in the Senate, I just automatically put in salvage value. And I did it because it was the right thing to do and because all the theory books told me to do it, not because I was trying to do anybody in. So we got the right answer although it was not the answer the lobbyists were looking for.

In fact I remember the boss came to me at 3:00 one afternoon and said "Sheldon, the Senate Committee wants to look at sum of the year's digit method depreciation." I said "What's that?" He

said, "I don't know. That's all we have but you need a draft by 10:00 tomorrow morning." By midnight, I had read every accounting text in the library. I was the only one in the building, everybody else went home. I found a footnote in the *Accountant's Handbook* describing it. I still have the *Accountant's Handbook* at home. It described the method in example form, there was no verbalization, I had to verbalize it. So that was my night. My wife did not see much of me those few months.

Everything was less sophisticated. There were just a few of us, mostly zero to six years out of school, who drafted the entire '54 Code and the entire set of regulations. Many of the group were at L&R, and a few in the Treasury, with a few supervisors.

They recruited a few, mostly fellows, there was only one woman in the whole group, to help us with the regs and we worked in teams. There would be a three or four person group, for example, on the depreciation regs, which were the major regs. There was me, an economist from Treasury, a lawyer from the Joint Committee staff, and so on. We wrote reports to the Assistant Secretary and Chief of Staff of the Joint Committee. It was a joint project. The Joint Committee staff and the House Ways and Means and Senate staffs all worked as a group, which eliminated a lot of superficial reviews and turf wars.

I just decided to go to work for the IRS because that was where all the action was in those days. The best tax lawyers in the '50s and '60s came out of the IRS. The assistant chief counsel who interviewed me hired me on the spot and assigned me to L&R.

Q Who oversaw that group?

A The review committee consisted of Colin F. Stam, the Chief of Staff of the Joint Tax Committee, Ken Gemmill and Dan Throop Smith, who were the Treasury people, one lawyer and one economist. They would usually meet in Dan's office or Mr. Stam's. Mr. Stam was an old man by then and when we made fun of him when he would look like he had fallen asleep, he was actually wide awake. Then he would snap out of it and look right at you and ask you the questions you did not know the answer to. It was pretty clear that he was listening and understood everything you said to him. I was a 25 year old kid and he was a 65 year old man, so he seemed like 140 years old to me.

The supervisory group was very good and they were very cooperative. It was almost seamless. This was the first time the Republicans had had the Congress, both houses, for many, many years. They only held it for the two years but they struck and enacted major changes pretty effectively.

Q About lobbying, you mentioned it was less effective then than it is today. How did it occur back then?

A I was in executive sessions where the most important things in those days happened. The lobbyists were out in the hallway or in the lobby. And you would see members go out and you would see a messenger come in and hand them notes. It was a lot cleaner in the sense that there were less hands involved in it. Therefore the chances for deterioration of the system because of some particular person's problem or business's problem were much less.

The Eisenhower crowd was very effective. Dan Smith had been a professor at Harvard Business School. Ken Gemmill was a well known tax

The supervisory group was very good and they were very cooperative. It was almost seamless. This was the first time the Republicans had had the Congress, both houses, for many, many years. They only held it for the two years but they struck and enacted major changes pretty effectively.

lawyer. They were co-heads of the study at the Treasury. Interestingly enough, just before the Code was updated, a small group of three people actually rewrote the entire income tax regulations. Imagine rewriting the entire income tax regulations in less than ten months. I was the youngest one in the group and was given the dirty jobs like the administrative provisions and the indexing.

When we did the '54 Code, my roommate, Bob Winokur, did the rearranging of the substantive provisions. Before 1954 every tax had its own administrative provisions and they were all different. The assessment rules were different. All sorts of rules were different. One of the projects was to make sure they were the same, that we got them as close together as we could. I did the rearrangement of all the administrative provisions. Everybody said I had the dirty job because I had the non-substantive stuff. Of course, it turned out that my project lasted longer than his. If you draft a substantive provision, you can bet your life they are going to change it. If you draft an administrative provision, you can bet your life they are not going to change it.

Q So the regulations issued under the 1954 Code were largely a rearrangement of regulations that had just been written under the 1939 Code?

A Yes. The last set of regs under the old Code was reg 118 and was updated and issued sometime in 1953. Then the 1954 Code was adopted August 16,

1954. I was told to get the regs on depreciation out by October and I had a notice of rulemaking dated early in October.

When they were actually adopted in '55 they were largely a cleaned up version of the 1953 regulations, put all in the same style. We set up the subsection numbering system that still exists. I still remember a lot of the administrative stuff not because I am very smart but because I am the only person who ever looked at it. Nobody ever looks at that until you get a case and you say "Okay, how do you assess a tax? How does it really work?" So it has helped me in a few cases every once in a while. Bob Winokur did all the income tax rearrangement and I did all the administrative provisions.

The heroes are the supervisors, Eddie Kahn, Herb Allen, I could name a half a dozen supervisors who had been around—but most of us were green as grass.

Q You served under President Johnson. What was the level of his interest and involvement in tax matters?

A Immense. He would call me all the time. The very first year of his presidency, President Kennedy came to the IRS building when they had their annual meeting of field supervisors, the district directors, and the regional commissioners. I was chief counsel when Johnson took over and I asked him if he would like to come to the building. He said "no, why don't you come here." So Commissioner Caplin and I loaded our entire top staff on buses and we went to the White

House for coffee and cake. The president gave everybody a pep talk, and the next year we did it again, and the third year I arranged for the vice president to come to the IRS building and give them a pep talk and I got a call from the president.

The president called me and said "don't you love me anymore?" I said, "What did I do now?" He knew what we were doing. And I said "I thought we'd imposed enough on your time." He said "No, I like to do it." I said, "Fine, I'll bring them over," and we loaded everybody on the bus and went over there.

He enjoyed talking with line people. Early in his career he had been part of the National Youth Administration under President Roosevelt and he knew what it was like to be a subordinate and not see the boss. He gave them a wonderful speech about doing a good job, that we have a fair tax system, and that we have to make it better. He exhorted them to jack up the administration and their work level and so on, and it was terrific. My wife took all of their wives over for tea with Mrs. Johnson. It was very good for morale to know that the boss is interested in your program. We did it every year for the whole five years.

Q Now, you have advocated some reform of the taxation, or nontaxation, of exempt organizations. What changes do you see as needed?

A A number of years ago Jack Nolan and I went to a conference at Ditchley. Ditchley is a conference center at Oxford, England where they invite

I always thought that running the IRS was like running a large spaghetti factory. The problem is, you have got to taste the spaghetti every once in a while. You need to have enough technical competence to be able to taste it to see whether the product is good. If you get a non-technician before a congressional committee and they ask him the most simple elementary technical question and he flounders, it does not look good.

15-20 Americans and 15-20 Brits to talk about a problem that is common to both systems but treated differently in both systems. When Jack and I came back we made a proposal regarding the way charitable organizations are handled. We testified before the Ways and Means Committee and wrote about it.

The British have a charity commission and the charity commission is designed to encourage charities and to write the rules and regulations about charities. The rules are written by the charity commission but are enforced by the tax authorities as if they were revenue law. We thought that would be good for the United States because the IRS has this two headed role—the commissioner in charge of that function is both an encourager of charity and an enforcer of the rules of charity and that has always been a problem. It has been administered pretty well recently, but you still have this idea that we need more and better rules and we need stricter enforcement. Enforcement has been pretty meager. If you look at a few thousand of the millions of exempt organizations, you are only looking at a small fraction. And there are so many strange things going on, we see them in our newspapers all the time.

Jack and I thought that it would be a good idea to separate the encouragement from the enforcement roles. We never got much traction on the idea. It comes up every once in a while, John Gardner was flirting with it when he

set up some of his Independent Sector ideas. He wanted that to be encouraging, but that is a private group. There are a variety of ways to do it, not just one way. I'm not going to say that our idea has got to rule. It is just I think that there is a festering problem here.

It is not going to go away, either, and nobody wants to face it. It is the devil I know for the devil I don't know. The charities stay with the status quo. They know the system, they have dealt with the system, they feel they can work with the system, and they would rather keep the present system. The IRS does not look for any additional work because anytime you change something it takes more work to put it in to effect. So, we stay where we are and then we complain about the system.

Q What do you think of the shift of Commissioners from CPA or tax lawyer model to business model?

A We had that for a long time. Eisenhower appointed several non-tax people. T. Coleman Andrews and Russell Harrington were both non-tax CPAs. I used to write speeches for Mr. Andrews and the staff would give me hell because he would say something that was completely wrong and I would show them the draft. The draft was right. He freelanced. He did not know enough tax to know when he was going off the reservation. He had a good sense of busi-

ness as did Mr. Harrington, but they were not tax people.

I always thought that running the IRS was like running a large spaghetti factory. The problem is, you have got to taste the spaghetti every once in a while. You need to have enough technical competence to be able to taste it to see whether the product is good. If you get a non-technician before a congressional committee and they ask him the most simple elementary technical question and he flounders, it does not look good. No one knows everything in the darn Code. And, as the Code grows, it gets harder and harder. However, it does help to have a working knowledge of the way the system works. I know, for example, the way an appeal system works, I don't have to go out and get briefed on that.

My own view is that it is basically a management job, with about 100 to 105 thousand people, you know you have got to move people around. I left the revenue service as a grade 12 in 1956 and came back as chief counsel six and a half years later. Although I was young, only six or seven years out of the IRS, I knew enough people in the Service that I could rely on, they were really first rate technicians. The first thing I did was to interview each of them separately and ask them who are the good people, who are the people I ought to recruit to the leadership positions here. And interestingly enough, at least two-thirds of them said Lester

Uretz, who ended up being deputy chief counsel and then later chief counsel. I had never met the man before. So the most important thing is still people. The operation of the Revenue Service, or any government agency, is people. It is recruiting good people, keeping good people, motivating good people, and finding the right mix of people, the right kinds of talent. You can sit back and float at that point.

Q When you were Chief Counsel and then Commissioner, what privacy norms or rules covered the Service's retention of information?

A There was a 6103, I mean 6103 was not nearly as broad as it ended up being in '76 and beyond. But there were confidentiality rules. I do not want my tax return spread all over the Washington Post, even a list of the charities that I give to. We each reveal private information to the Revenue Service because it is required. If it is made public, it can be used for blackmail, it can be used for kidnapping, there are a whole variety of problems—you can't think of them all.

We had situations where gamblers were reporting honest tax returns while violating every gambling law in the state. If their returns were revealed, they would stop reporting. If you prosecute one, then it is over. So you have to make your choice. We had a tax system that included lots of illegal income reported. Most people did not know that, but we knew it. If you reveal it then there will be pressure to reveal it and then you will lose the revenue and become a police agency. The purpose of this system is not law enforcement. The purpose of this system is financing the government.

Q Why do you oppose private collectors for tax debts?

A Because if there is anything that is governmental it is defense and

taxation. You cannot turn over to the private collector the discretion as to whether a penalty applies or does not apply. Every time there is a question they will throw the question back to you. All you have done is double the administrative work for no purpose. I asked Mr. Rossotti and his staff when they first proposed the idea—if they could use the same money on collections officers instead of outsourcing it, would they ultimately collect more or the same. And the answer is we would collect more. We would be more efficient, we would have less questions, we would not have to review back and forth. Then the answer is go get more money. This last congress seemed to be more ready to appropriate money to pay to a stranger than to pay their own employees. The Revenue Service has been an efficient organization, one of the best in the country, it is one of the best in the world. Then, entrust them and let them go do their job—and give them the funds to do it right.

Q You presided over substantial modernization of IRS systems. Why does it seem to be so hard for the IRS to move its systems into the next generation?

A I was lucky. We had a terrific career staff. We recruited most of our staff out of the military or defense agencies. Interestingly enough, I remember one of the computer people was a supply person. He had been the inventory supply person for the Navy. Keeping track of taxpayers is like keeping track of parts for Navy ships. And the only people who ran large computers were the military at that time. We were the first non-military governmental function to have them. So we recruited the good people, we used a good system, we used the best equipment, no cheap stuff. We did not cut any corners.

I remember the first year we put in the computers, the staff recommended we go cold turkey, that is computers,

no paper. And I said, no, no, no. I am not going to be the Commissioner on whose watch the system fails. So we did it both ways that first year and the computers worked fine. So the next year we switched off. But we used the very best IBM equipment. IBM was proud and wanted the system to work, so they put their best people on it. When we had a problem, everybody in the organization showed up to fix it. And there was nobody more surprised, or pleased, to see it work than me.

For example, when I was chief counsel, I did the first computer search for a reg. They sent me a reg in which the phrase "disposed of" was used in a rather strange way so I wanted to see every time it appeared in the Code. At that point, we did not have a copy of the Code on a computer so we had to get it from one of the universities. The computer took 20 minutes or a half an hour and found 120 occurrences. The two lawyers in L&R who were assigned the project took two days and found 70 or 80 occurrences. That was the very first time that we ever used the computer for research.

The computer made us much more efficient and it was remarkable what it did. We were able to pick up frauds, we were able to pick up a variety of things that the human being would have missed, although the human eye is still pretty good. I remember once a computer technician catching a person in Detroit who had filed several fraudulent returns. First, she noticed a perfect return, that is the return had every voucher attached to it. Now that is rare. But the next day she saw another one just like it. It was a little suspicious to see another perfect return. She asked her supervisor if she could go back and look at the one the day before. They brought it back and it was identical down to the receipts, that is the receipts to the charities were exactly the same receipts, attached to both returns. And we caught a fraud within a few days. ■