Regional Court Influence Over Bureaucratic Policymaking: Courts, Ideological Preferences, and the Internal Revenue Service

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While there have been numerous studies demonstrating bureaucratic control of administrative and regulatory agencies, many argue that the Internal Revenue Service is an agency out of control, and one not subject to political constraints. However, some recent studies have shown that the IRS is subject to some political control in shifting policy between the often competing concerns of efficiency and fairness. We extend these studies to examine judicial control of the IRS. Examining cross sectional time series data from 1960 until 1988, we use regression with panel corrected standard errors to show that, while efficiency is always very important, the IRS shifts audits between the wealthy and the less affluent in response to the prevailing median ideology of the relevant federal court of appeals. As the median appeals court judge becomes more liberal, the IRS shifts its audits in that region in favor of equity by reducing the audits on the poor and increasing the audits of the more affluent. As the median appeals court judge becomes more conservative, the IRS shifts the audits in that region in favor of greater efficiency by increasing the audits of those in the lower economic strata. Courts provide an additional measure of control of bureaucratic behavior.

Democratic control of bureaucracies has been the subject of numerous empirical and normative examinations. Many theorists have focused on normative goals of how to control bureaucracy (e.g., Gormley 1989) while other scholars have empirically demonstrated institutional constraint of bureaucratic behavior, (e.g., Fiorina 1979) showing that this “headless fourth branch of government” is in fact subject to democratic control.

NOTE: We would like to thank John Scholz for all his advice and assistance.


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However, in contrast to these bureaucratic control studies, many citizens, journalists, elected representatives, and scholars argue that the Internal Revenue Service, arguably one of the largest and most powerful of all governmental agencies, is not subject to the same democratic pressures and constraints as other executive agencies. These scholars, journalists and officials often claim that the IRS does not carry out the policy wishes of the president and ignores congressional and court control (see, e.g., Long 1980; Burnham 1989; MacDonald 1994).

An examination of IRS audit data provides some reinforcement to this position. For a national agency addressing a national problem of collection and enforcement, there is significant variation from state to state that seems driven by the idiosyncrasies of IRS personnel. For most of the post World War II period, The IRS operated out of 60 districts within state boundaries in a larger set of 7 national regions, and currently the IRS audits out of 33 districts in 4 national regions. The states, districts, and regions all exhibit significant variance in audit rates. For example, one journalist notes that a citizen of Nevada, which has a statewide audit rate of 1.8 percent, is seven times as likely to be audited than is a citizen of Wisconsin with a statewide audit rate of 0.24 percent (MacDonald 1994: 132). A citizen of the Middle Atlantic region has a 20 percent greater probability of getting audited than a citizen of the Midwest. While some variation is to be expected because of differing local economic conditions, popular accounts seem to suggest that the variation is somehow evidence of a lack of political control of the agency.

Contrary to these assertions, we argue that the IRS operates the same as other agencies. Although the agency seeks efficiency in revenue collection, the balance between efficiency and equity is subject to the same controls by the executive, legislative, and judicial branches as other agencies. One explanation for the regional variation is the differing ideologies and policy preferences of the various federal appellate courts. In this article, we investigate the state level variation in audits of wealthy versus poor taxpayers over the 28-year period from 1960 to 1988. Specifically, we examine whether the appellate courts influence the degree to which the IRS focuses on rich versus poor.

Federal appellate courts often interact with the Internal Revenue Service in a regionally specific manner, mainly at the level of the Federal Courts of Appeals. Appeals from district courts go the appeals court from the state within which the District decision comes from, while appellate jurisdiction of Tax Court cases is premised on the residence of the taxpayer (Taylor et al. 1990). In 1997 alone, federal appeals courts handled 248 civil tax appeals by plaintiffs against the United States. In contrast, according the Supreme Court compendium, from 1953

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1 We chose state variation over regional variation because state level data has been much more stable over this period of time than regions or districts (see Scholz and Wood 1998, 1999).

2 I.R.C. § 7482.
until 1994, the United States Supreme Court handled only 131 federal tax cases with the United States as a party. Thus, the appellate courts provide an important and appropriate forum to examine and explain regional variation in IRS policy.

**Bureaucratic Control and the Internal Revenue Service**

The bureaucratic literature emphasizes the rational internal goal seeking nature of bureaucracy (Niskanen 1971; Wildavsky 1992; Fiorina 1979; Gormley 1989; Wilson 1989). Many have identified what Gormley (1989: 3) calls the bureaucratic pathologies—clientism, incrementalism, arbitrariness, imperialism, and parochialism. Because of these pathologies, agencies allegedly develop their own goals independent of those of the elected officials. For example, budget maximizing and continually seeking small increases of its budget becomes a primary goal of an agency's bureaucrats (Niskanen 1971; Wildavsky 1992; but see Wilson 1989).

In seeking to maximize its budget, the agency experiences goal displacement. Broad political goals of service, fairness, justice, or equity lose out to the parochial goals that agency workers develop. Thus police and prosecuting attorneys come to believe that every individual whom they arrest, or every defendant who comes to their attention, is guilty. Agencies with enforcement responsibility often have incentive to focus on legally sound but politically trivial cases in order to augment their perceived successes (Katzmann 1980). Arrests and successful guilty pleas lead to greater prestige and larger budgets. Compiling arrest and successful prosecution records becomes more important than efficiency, fairness or the administration of justice.

Many argue that the IRS follows this pattern, and often exceeds other agencies in disdain for broad political and social values. For example, David Burnham (1989) argued that the IRS was beyond control and pursued its own arbitrary agenda. Recent congressional hearings present anecdotal evidence to support Burnham. Witnesses testified of capricious and arbitrary agent behavior during both audit and post audit activity (Wiseman 1997). Earlier, Shapiro (1988) had noted that the IRS goal of maximum tax yield might subvert the broad tax policy aim of equity and fairness. Long (1980) and others (Strassels 1979; Crouch 1996; Scholz and Wood 1998, 1999) concur that the IRS has its own idiosyncratic goals, independent of justice and fairness. Burnham (1989), Long (1980) and MacDonald (1994) argue that a primary concern of the IRS is maximizing revenue. MacDonald asserts that the IRS rewards with larger budgets regions and districts that collect the most in revenue.

However, despite the assertions of an agency "out of control" studies and recent events have shown political responsiveness by the IRS. This political responsiveness marks the IRS as comparable to other agencies. Well-publicized congressional hearings focusing on IRS abuse of taxpayers have led to IRS
internal audits, firings in some district offices, and promises of reform by both the Treasury Secretary and the Director of the Internal Revenue Service (Rosenbaum 1998). In response to allegations of abuse, Congress passed legislation that members call the "Taxpayer Bill of Rights" (ibid.). Included in the new law is a switch of the burden of proof from the taxpayer to the IRS in audit disputes (Wiseman 1997; Stevenson 1997).

Recent scholarly studies buttress these political events. Scholz and Wood (1998) show that the IRS changes its corporate to individual audit ratio in response to political change. Using a multivariate analysis, the authors use several state and federal political control variables to examine the impact of partisan change and change in political control. The authors show that changes in presidential administrations and congressional committee membership lead to changes in IRS audits. President Reagan's election, for example, led to an increase in individual audits and a decrease in corporate audits.

In a later (1999) study, Scholz and Wood (1999) show that federal and state partisan composition affects audit rates, with Republicans initially seeking efficiency over tax fairness or equity, and Democrats favoring equity. The same study indicated that Democrats and Republicans exchanged positions on fairness and efficiency by 1980. Howard (2001) observes IRS responsiveness to both trial courts and litigation, in that the agency shifts its audits in response to trial court concerns about equity and concerns about litigation costs.

These studies of the IRS support previous empirical examinations of bureaucratic control by the executive and legislative branches. Many studies support either congressional dominance (Calvert, Moran, and Weingast 1987; McCubbins and Schwartz 1984; Calvert, McCubbins, and Weingast 1989) or executive control over agencies (Moe 1982, 1985; Wood and Waterman 1993, 1994). Other scholars have also studied the impact of courts on agency policy. However, much of this research involving courts and agencies usually addresses the question of compliance (Segal and Spaeth 1993; priggs 1996), or the influence of courts over national policy (Shapiro 1964; Moe 1985; Hansen, Johnson, and Unah 1995).

**REGIONAL COURT INFLUENCE OVER BUREAUCRATIC POLICYMAKING**

Few studies have examined the impact of regional courts on regional agency policymaking, and there has been little empirical examination of the possibility of politically relevant regional variation in agency behavior, despite the fact that there is clear evidence of regional variation at many agencies. The most stringent test of regional homogeneity—that aside from noncontroversial "implementation" factors, the IRS will establish the same policy in every region—is likely to fail. Anecdotal accounts suggest that regional variation is both significant and rooted in political factors at the IRS. Federal courts may induce regional variation
in agency policy because court interaction with the bureaucracy primarily occurs in regionally distinct arenas—the Federal Courts of Appeals.

How does an appellate court establish a range of permissible agency policy outcomes? One way to model the appellate court decision making process is to recognize that judges typically hear cases in randomly assigned three-judge panels. The random assignment of three judges may be thought of as a permutation problem. To consider the situation generically, imagine that there are $k$ judges serving on an appellate court. There are $(k/3)$ distinct three-member panels, and it turns out that the median judge on the appellate court is more likely than any other judge to be the median judge on any particular panel. For example, consider Figure 1's illustration of a small appellate court of five judges, $J_{1,5}$, whose ideological preferences are arrayed on a liberal-conservative scale.

As Table 1 indicates, there are ten distinct three-member panels possible among this hypothetical collection of five appellate court members. In three such panels, the median judge is $J_2$. In three panels, the median judge is $J_4$. In four panels, the median judge is $J_3$. The bounds of acceptable policy for the appellate court might be thought of as the interval between $J_2$ and $J_4$. In this hypothetical appellate court, no three-member panel will vote to uphold a policy outside of that range. The IRS might infer that such bounds for policy indicate the permissible range in that appellate court.

However, if each possible panel has equal probability of assignment (1/10th, in this example), then a specific panel may choose to overturn an agency policy, even if the agency establishes the policy within the broad bounds of potential panel medians. For example, if the IRS establishes a policy at $J_2$, but unluckily draws a panel composed of $J_3$, $J_4$, $J_5$, the IRS policy is vulnerable to a judicial remand, or reversal. A rational IRS official ought to set policy based on a calculation of the lottery among all possible panels. That is, the IRS ought to randomize its policy choice among $J_2$, $J_3$, and $J_4$, with probabilities (.3, .4, .3), respectively, because the probabilities of drawing $J_2$, $J_3$, and $J_4$ as the median judge are (.3, .4, .3), respectively.

Of course, one cannot observe randomizing behavior—one can only observe the specific choice the IRS settles on in that circuit. It is easily shown that the median judge on the circuit is the most likely to be the median judge on any particular panel, so variation in the ideology of the median judge on the appellate court ought to be related to variation in the regional agency policy, subject to the provision that such responsiveness ought to decline as the variance in judicial ideology grows. The wider the range of possible policy targets for the agency, the less the central target will be constraining on IRS policy choice.

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3 Because of the heavy and growing workload of the courts of appeals in the post-WWII era, en banc hearings constitute only a negligible number of administrative appeals. Excluding the Federal Circuit, the Courts of Appeals employ three judge panels in over 99 percent of all administrative hearings (Schuck and Elliott 1991).
Hypotheses, Data, and Methods

Congress micro manages the IRS to a greater extent than regulatory agencies, which have been the vehicle for prior examinations. Nevertheless, the agency possesses considerable discretion in its enforcement actions. No single discretionary action at the IRS generates more or more intense constituent complaints than the dreaded audit. The agency uses a number of secret formulas\(^4\) to select taxpayers for audit, and adjustments in those formulas differentially affect different taxpayer income classes. That is, the degree to which audits focus on upper or lower income taxpayers is politically relevant to competing concerns of equity and efficiency.

Primary Hypotheses

Given that we are looking for regional court control over this audit ratio, we derive the following two primary hypotheses:

\(H_1:\) As the ideology of the Appellate Court median moves in a liberal direction, the IRS will shift a state's low-income/high-income audit ratio toward higher income audits.

\(H_2:\) As the ideological variance on the Appellate Court increases, the IRS responsiveness to the appellate court median will decline.

Data

Relying on a dataset of IRS audits, we designed a model suitable for testing the impact of appellate court ideology on IRS policy choice in a context that allows for regional variation. The panel dataset we constructed features one observation for each state for each year between 1960 and 1988 (n = 1450). Data on the IRS, including audit rates, comes from a database compiled by John

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\(^4\) The best known is the DIF, or Discriminate Income Function.
Scholz and B. Dan Wood. The data are available by state, district office, and region. Following the approach used by Scholz and Wood (1998, 1999), we examine state variation for this study.

We derive our dependent variable by dividing the audits per state per year of the highest income class (≥ $100,000.00 income per year) by the total number of audits per state per year of the lowest class income class of taxpayers (£ $25,000.00 income per year). This ratio increases when the IRS shifts audit attention away from low income taxpayers, towards high income taxpayers. That is, the measure correlates with modern political and economic liberalism and conservatism.

We also use a ratio to define efficiency and use it as a control variable. Here we divide the percentage of low income audits with no change by the percentage of high income audits with no change. As the rate increases it becomes less efficient to audit poor people, and more efficient to audit the wealthy. Efficiency serves as an important variable because we assume the IRS will decrease audits of one income class and increase audits of another income because it is more efficient in terms of time and resources to audit one income class more than another. This change in audits would be unrelated to the change driven by the appellate courts.

We use three different income measures and one economic measure as control variables. We look at farm income, manufacturing income, and service income in each state per year. We reason that these are three measures indicating varying degrees of state wealth, not captured in a single per capita income or gross domestic product measure. States with large manufacturing capacity and income usually have higher income, with farm states having the lowest income and service-based economies falling in the middle. Therefore one should expect greater low-income audits in states with greater farm-based economies, and greater high-income audits in states with more manufacturing income. Service

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5 These audit classes have remained constant over the entire period of our study.
6 We realize this does not measure actual cash return, and that audits of the rich might yield more than audits of the poor. However, given limited time and personnel resources, we assume the IRS will not want to waste these resources on unproductive audits. A greater percentage of audits that actually produce more revenue is a valid measure of productivity and efficiency, and one to which congressional oversight committees, as well as the public, will favorably respond.
economies should experience increased audits of the rich, but not as much as in manufacturing states. We also use a gross measure of aggregate state employment as another control variable. As employment goes up, a greater number of low-income citizens start earning income, and thus the IRS should increase the number of audits of low income individuals.

To test whether the ideological variation among courts of appeals helps to explain the audit behavior of the IRS in different regions, we rely on Humphries and Songer (1999)\(^7\) measures of economic liberalism for each appeals court judge. For each court of appeals for each year, we examine the collection of judges serving to identify the median court of appeals judge ideology. If the national policymaking conditions are adequate to explain IRS choices, then variation among states will be unrelated to appellate court ideology. On the other hand, it is plausible that the IRS will deviate from their ideal policy outcome in the direction of the appellate court judge median, to avoid being overturned via judicial review.

We also create an interaction variable using these ideology scores and their standard deviation. We reason that the greater the standard deviation, the greater the ideological distance among the possible panels. A wider range of judicial ideology spreads the lottery choice for the IRS over a wider range of policies and may give the IRS greater maneuverability. The coefficient for the interaction between ideological variation and ideological median should be in the opposite direction from the coefficient for median ideology, pulling the overall effect of the median judge towards zero for high variance on the court.

We list the mean and standard deviation for each variable in Table 2. The IRS audits a greater number of poor taxpayers than wealthy taxpayers. This reflects, among other things, the greater number of less affluent individuals. There is notable variance among the states.

Admittedly, there is a potential problem with using these Humphries-Songer economic liberalism scores (or any other similar measure) and judicial votes in cases involving the IRS. To date, the literature has not shown that ideological voting, and voting for or against the Internal Revenue Service, is concordant. In fact, there is a well-known counter example. The very liberal Justice William O. Douglas was an opponent of the IRS, usually voting against the government in tax cases. Conversely, conservative judges might support the IRS because it represents support for the government.

However, we present evidence that there is a relationship between the measure we use and judicial votes for and against the IRS in the manner we have characterized. To demonstrate this association, we use Songer's United States Court

\(^7\) There are many variations of measuring appellate court ideology; we chose the Humphries Songer measure because it is a slightly more precise version of the generally accepted Tate Handberg (1991) measure.
TABLE 2. DESCRIPTIVE STATISTICS

<table>
<thead>
<tr>
<th>Variable</th>
<th>Mean</th>
<th>Standard Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit Ratio</td>
<td>34.20</td>
<td>82.28</td>
</tr>
<tr>
<td>Farm Income</td>
<td>1538.62</td>
<td>1613.63</td>
</tr>
<tr>
<td>Manufacturing Income</td>
<td>12058.99</td>
<td>13980.82</td>
</tr>
<tr>
<td>Service Income</td>
<td>7313.41</td>
<td>9481.84</td>
</tr>
<tr>
<td>Employment</td>
<td>1596.33</td>
<td>1795.16</td>
</tr>
<tr>
<td>Efficiency</td>
<td>11.00</td>
<td>1.96</td>
</tr>
<tr>
<td>Appellate Ideology</td>
<td>-0.021</td>
<td>0.099</td>
</tr>
<tr>
<td>Ideology St. dev.</td>
<td>0.20</td>
<td>0.047</td>
</tr>
</tbody>
</table>

of Appeals Database to examine the voting record of the individual appellate court judges who voted on civil cases involving the IRS during the period of our study. Using the coding from the database, we derive mean levels of support for the IRS for each appellate court judge. We then compared these levels of support for the IRS to the Humphries-Songer economic liberalism measures.

Given the expense of filing suits, and then bringing appeals in the federal circuit, we assume that wealthy individuals and organizations bring a far greater percentage of appeals challenging the IRS. Based on our hypotheses, we expect the mean level of support for the IRS to be higher the more liberal the judge and lower the more conservative the judge, because most of the appellate challenges to the IRS come from wealthy individuals.

We calculated the Pearson correlation between the Humphries-Songer economic liberalism scores and the mean support for the IRS for 219 judges for whom we can observe both factors. The correlation is .218 and significantly different from zero at the .001 level, indicating a positive association between higher economic liberalism scores and support for the IRS. Conversely, the more conservative the judge, as measured by the Humphries-Songer economic liberalism scores, the more likely the judge supports the individual against the IRS. Thus, we believe that there is a significant relationship between the measures of economic liberalism we employ in our study and individual voting by judges in IRS cases.

Methodology

The data used for this study is cross-sectional time-series data, or panel data. The presence of this data makes the use of Ordinary Least Squares (OLS)

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8 In fact, average verdict awards in post-audit assessment litigation in both the Tax Courts and in the Federal District Courts against the IRS from 1981 to 1988 were in excess of $300,000.00 (Howard 2001).
problematic since one cannot assume that all the errors will be uncomplicated or "spherical" (Beck and Katz 1995: 636; Green 1997). There is the potential for auto/serial correlation and heteroscedasticity.

States are of different sizes. Therefore the effect of wealth and unemployment, for example, may differ from state to state. To control for the different effect of state size, we use a percentage basis for any relevant state measure. In addition, the use of a ratio as the dependent variable also reduces the risk of heteroscedasticity due to variation in state size. We use a fixed effect model to control for any additional variation. Since audit rates have declined over time, the use of a ratio also reduces the risk of other methodological problems associated with studies over time such as non-stationarity (Scholz and Wood 1998).

Finally, there is the risk of serial or spatial correlation (Anselin 1988). Audit decisions in any one state in a region undoubtedly influence audit decisions in another state. To control for serial correlation, we used Stata 6.0 Feasible Generalized Least Squares with the Beck and Katz panel correction for standard errors. The results are reported as regression coefficients.

We test our hypotheses using our panel design based the following equation:

\[ Y_i (Audit\ ratio) = a + b_1 \text{ (court median ideology)} + b_2 \text{ (Court ideology median-variance interaction)} + b_3 \text{ (Service income)} + b_4 \text{ (manufacturing income)} + b_5 \text{ (Farm income)} + b_6 \text{ (employment)} + b_7 \text{ (local government)} + b_8 \text{ (efficiency)} + e. \]

**RESULTS**

The results, presented in Table 3, coincide with our prediction. Our court variable, ideology, was statistically and substantively significant (109.56, p < .001) in the expected direction. Given that larger positive Songer-Humphries scores indicate a more liberal court, a one-unit change in the liberal direction for

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\[ ^9 \text{We then tested for heteroscedasticity. There are no hard and fast rules for detecting heteroscedasticity, on some rules of thumb. We performed basic tests on the equations in the model, including graphing the estimated squared residuals (ui,) against the estimated Y_i, and against several of the explanatory variables. We also performed White's general heteroscedasticity test on the reduced form and final equations (see Greene 1997: 550). The chi square values obtained were all below the critical chi square value at the .05 level of significance.}\]

\[ ^10 \text{We also tested for autocorrelation. Since the Durbin-Watson test is not a valid test in the presence of a lagged dependent variable (Greene 1997: 596), we used modification of the Bruesch-Godfrey test suggested by Greene, which showed no evidence of autocorrelation.}\]

\[ ^11 \text{Our results are robust even with the inclusion of other political controls, such as the party of the President and the partisan balance in Congress. In this alternative and unnecessarily complicated model, the coefficient for the Court ideology is 111.05 (S.E. 23.26) and the coefficient for the interaction term is 138.87 (S.E. 80.81).}\]
### Table 3
**Regional Court Influence: IRS Audit Ratio and Ideology**

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient (Standard Error in parenthesis)</th>
<th>Average Effect of Standard Deviation Change on Shift of Actual Audits*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Court ideology</td>
<td>109.56*** (26.23)</td>
<td>1685</td>
</tr>
<tr>
<td>Court ideology Interaction</td>
<td>-1390.88*** (117.14)</td>
<td>1663</td>
</tr>
<tr>
<td>Efficiency</td>
<td>7.99*** (1.69)</td>
<td>1632</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>0.0002** (0.00001)</td>
<td>1180</td>
</tr>
<tr>
<td>Farm production</td>
<td>0.003*** (0.001)</td>
<td>1307</td>
</tr>
<tr>
<td>Service production</td>
<td>-0.0007*** (0.0001)</td>
<td>4361</td>
</tr>
<tr>
<td>Employment</td>
<td>-0.001 (0.0006)</td>
<td>1545</td>
</tr>
<tr>
<td>Constant</td>
<td>22.80</td>
<td></td>
</tr>
</tbody>
</table>

N = 1450  
Chi² = 186.91** 
Log Likelihood = -3744.36

*Average effect represents the change in the dependent variable resulting from a one standard deviation change in each independent variable. We calculate the effect on the actual number of audits shifted between the income classes in the average state.  
** = p < .01 (two tailed)  
*** = p < .001 (two tailed)

The court median decreases audits on the poor by about three percent. In an average state this translates into 500 fewer audits of those in the lowest income class. A standard deviation positive shift (.099) results in a shift of over 1,600 audits. To demonstrate the impact of all the variables, in the second column in Table 3 we calculate the effect on our dependent variable of a positive one standard deviation change of each independent variable. Specifically we show the effect on the actual number of audits shifted because of a one standard deviation change.

To illustrate by way of specific example, the liberalism of the median judge on the 10th Circuit Court of Appeals increased by .04 between 1968 and 1969. There was also a corresponding decrease in audits of the lowest income class in several states comprising that appellate court, including a decrease in audits of that class in Colorado by about .17, from 20,882 audits to 17,231 audits.
However, a large ideological variance on the court can completely erase the audit rate shift (−1390.88, p < .001). A one-unit increase in the spread of ideologies on a circuit can reduce the responsiveness of the IRS by almost one-third, rendering ineffective any increase or decrease in the median ideology. For example, between 1971 and 1972 the median judge’s liberalism score for the second circuit went down about .02, but the variance of the ideology also increased by .03.12 The effect was to eliminate any change in the audit ratio in that circuit. Although the coefficient is large, the variance of this interaction term is smaller than the ideology coefficient.

Thus, as expected, the IRS altered the audit ratio in response to the policy preferences of the median appellate court judge. As the median ideology moved in a liberal direction, a greater percentage of wealthy taxpayers were audited. As the median ideology moved in a conservative direction, the IRS targeted more low-income returns for audit. However, the IRS took advantage of variance in judicial ideology. As the variance increases, the audit ratio becomes less and less sensitive to the median ideology of the reviewing court.

The income, employment, and efficiency control variables also came out in the expected direction. A one-unit increase in the efficiency (7.99, p < .001) of auditing the highest class leads to an increase of over 75 percent in the audit ratio. As it becomes more efficient to audit the least well off, the IRS increases audits on that class of taxpayers. As expected, an increase in farm income leads to an increase in audits of the lowest class (.003, p < .001), while an increase in service based income leads to an increase in audits of the wealthiest (−.0007, p < .001). Overall, employment is negatively related to the audit ratio, as expected, but he effect is neither substantively nor statistically significant.

**Discussion and Conclusion**

As we stated in our introduction, many scholars, journalists, and citizens view the IRS as having wide discretion and a virtual lack of political control. The IRS is deemed “out of control” because its decisions are technically complex and often insulated from political calculations. This leads to an information asymmetry between bureaucrats and the political powers seeking to oversee their decisions.

In addition, the IRS is seen as being beyond control because a significant portion of the burden it imposes on taxpayers comes simply by virtue of exercising its investigation function. Political oversight is oriented around case disposition but one of the policy choices for the agency is the decision to investigate person A versus person B. In the hands of policy-motivated bureaucrats, this choice can have its intended consequence, regardless of the ultimate disposition

12 The increase in conservatism and the increased variance no doubt reflect the appointment power of President Nixon.
of the case, so this unique capability for the IRS makes oversight less easily exer-
cised by political principals.

Others, however, have shown that partisan political change has an impact on
IRS audit behavior (Scholz and Wood 1998, 1999). This article expands the
scope of the inquiry to consider oversight exercised by the federal court system
in the form of judicial review at the federal appellate level. Our results suggest
that change in the ideological balance on the bench can influence IRS audit
behavior in regard to equity and efficiency. Certainly, the IRS prizes collection
efficiency as demonstrated by our efficiency variable and our other economic
control variables. However, collection efficiency is not the sole basis for the allo-
cation of audits between the rich and poor. Independent of efficiency concerns,
the IRS shifts its scrutiny away from the upper economic strata and towards less
affluent taxpayers when and where conservatives dominate the reviewing appel-
late court bench, and in the opposite direction when liberals dominate the
reviewing appellate bench. Thus, even if it less expensive to audit the poor
because they do not have the resources or access to tax lawyers, the IRS will shift
audits away from the poor in response to a liberal appellate bench. The greater
the ideological variance on the relevant appellate court, the less the IRS shifts its
audit scrutiny in concordance with shifts in the ideological balance on the
reviewing appellate court bench.

At the trial court level, the district or tax court judge primarily acts as an
arbiter of factual disputes. With facts usually not in dispute, the appellate court
reviews agency actions to ensure that they are consistent with the congressional
intent. However, in terms of the politically charged measure of IRS audit behav-
ior we investigated, practically no legislative intent has been expressed. Instead,
the evidence in this manuscript demonstrates that the IRS adjusts its audit behav-
ior to each appellate court's ideological preferences. The most plausible explana-
tion of our findings is that the IRS shifts its audit attention away from the review-
ing court's preferred class, because the IRS is motivated to win as many cases as
possible.

Courts then provide an additional control on agency behavior. Many fear the
IRS because it is thought to be an "agency out of control." Yet, the IRS appears to
respond to electoral partisan changes as well as the ideological composition of
courts. Courts appear to shift the efficiency—equity balance. If this is true for an
"agency out of control," one could argue that other agencies are similarly subject
to court control. If so, then perhaps fears of unfettered bureaucracies undermin-
ing democratic governance are unfounded.

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