Report to The Congress on

Scope and Use of Taxpayer Confidentiality and Disclosure Provisions

Volume I: Study of General Provisions

Office of Tax Policy
Department of the Treasury
October 2000

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

OCT 0 2 2000

The Honorable Bill Archer
Chairman
Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

Section 3802 of the IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206 (July 22, 1998), requires the Treasury Department to conduct a study of the scope and use of provisions regarding taxpayer confidentiality. Enclosed is Volume I of our report of that study.

As directed by Congress, the study examines (1) the present protections for taxpayer privacy, (2) any need for third parties to use tax return information, (3) whether greater levels of voluntary compliance may be achieved by allowing the public to know who is legally required to file tax returns, but does not file tax returns, (4) the interrelationship of the taxpayer confidentiality provisions in the Internal Revenue Code of 1986 ("Code") with provisions in other Federal law, including section 552 of title 5, United States Code (commonly known as "the Freedom of Information Act"), and (5) the impact on taxpayer privacy of the sharing of income tax return information for purposes of enforcement of state and local tax laws other than income tax laws. The sixth item Congress directed us to examine, whether the public interest would be served by greater disclosure of information relating to tax-exempt organizations described in section 501 of the Code, will be addressed in Volume II of our report, which will be published separately.

I am sending a similar letter to Mr. Rangel.

Sincerely,

Jonathan Talisman
Acting Assistant Secretary (Tax Policy)

Enclosure

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

OCT 0 2 2000

The Honorable William V. Roth
Chairman
Committee on Finance
United States Senate
Washington, DC 20510

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I am sending a similar letter to Senator Moynihan.

Sincerely,

Jonathan Talisman
Acting Assistant Secretary (Tax Policy)

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Part One – Introduction, Background, and Executive Summary

I. Introduction

Section 3802 of the Internal Revenue Service Restructuring and Reform Act of 1998 ("RRA 1998")[1] requires the Secretary of the Treasury and the Joint Committee on Taxation (the "JCT") to conduct separate studies of the scope and use of provisions regarding taxpayer confidentiality and to report the findings of such study, together with any recommendations deemed appropriate to Congress. The staff of the Joint Committee on Taxation (the "JCT staff") published its report on January 28, 2000.[2]

Treasury is publishing its study in two volumes. Volume I contains recommendations relating to general confidentiality and disclosure issues. Volume II, which will be published separately, will contain recommendations relating to disclosure issues with respect to tax-exempt organizations.

Volume I of the study is divided into three parts. Part One contains this introduction, background information relating to the Congressional mandate for the study and Treasury's solicitation of comments in connection with the study, and an executive summary including Treasury's specific recommendations. Part Two contains a history and overview of the relevant laws addressed by the study including sections 6103 and 6110 of the Internal Revenue Code (the "Code"),[3] the Freedom of Information Act (the "FOIA"), and the Privacy Act. Part Three discusses various issues arising under these laws and makes recommendations related thereto. Some of these recommendations respond to disclosure provisions included in H.R. 4163 – the Taxpayer Bill of Rights 2000 ("TBOR 2000") – and/or to specific recommendations made by the JCT staff in the JCT Study.[4] Volume I of the study also includes the following appendices: a copy of Treasury's solicitation for comment published in connection with the study (Appendix

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[1] Public Law 105-206, signed by the President on July 22, 1998 (H.R. 2676). For legislative history, see H.R. Rep. No. 105-599 (Conference Report), S. Rep. No. 105-174 (Senate Committee on Finance), and H.R. Rep. No. 105-364, Part 1 (House Committee on Ways and Means).

[2] The JCT staff published its report in three volumes. *See* Joint Committee on Taxation, *Study of Present-Law Taxpayer Confidentiality and Disclosure Provisions as Required by Section 3802 of the Internal Revenue Service Restructuring And Reform Act of 1998, Volume I: Study of General Disclosure Provisions* (JCS-1-00), January 28, 2000; Joint Committee on Taxation, *Study of Present-Law Taxpayer Confidentiality and Disclosure Provisions as Required by Section 3802 of the Internal Revenue Service Restructuring And Reform Act of 1998, Volume II: Study of Disclosure Provisions Relating to Tax-Exempt Organizations* (JCS-1-00), January 28, 2000; Joint Committee on Taxation, *Study of Present-Law Taxpayer Confidentiality and Disclosure Provisions as Required by Section 3802 of the Internal Revenue Service Restructuring And Reform Act of 1998, Volume III: Public Comments and General Accounting Office Reports* (JCS-1-00), January 28, 2000. All references to the JCT Study herein are to Volume I unless otherwise indicated.

[3] All section references are to the Internal Revenue Code of 1986 unless otherwise indicated.

[4] A number of the JCT staff's recommendations were incorporated into TBOR 2000, which was passed by the U.S. House of Representatives on April 11, 2000.

A), an IRS memorandum describing the criteria Treasury believes are relevant to determining whether to permit a disclosure of returns or return information for non-tax purposes (Appendix B), and a list of tax agreements between the IRS and U.S. possessions, tax information exchange agreements, and multilateral conventions (Appendix C).

II. Background

A. Congressional Mandate

Section 3802 of RRA 1998 requires the Secretary of the Treasury and the JCT to conduct separate studies of the scope and use of provisions regarding taxpayer confidentiality and to report the findings thereof along with any recommendations deemed appropriate. Specifically, the study is to examine:

1) the present protections for taxpayer privacy;
2) any need for third parties to use tax return information;
3) whether greater levels of voluntary compliance may be achieved by allowing the public to know who is legally required to file tax returns, but does not file tax returns;
4) the interrelationship of the taxpayer confidentiality provisions in the Internal Revenue Code of 1986 with provisions in other Federal law, including section 552 of title 5, United States Code (commonly known as "the Freedom of Information Act");
5) the impact on taxpayer privacy of the sharing of income tax return information for purposes of enforcement of state and local tax laws other than income tax laws, including the impact on the taxpayer privacy intended to be protected at the Federal, state, and local levels under Public Law 105-35, the Taxpayer Browsing Protection Act of 1997; and
6) whether the public interest would be served by greater disclosure of information relating to tax-exempt organizations described in section 501 of the Internal Revenue Code of 1986.

The legislative history of both the House bill and the Senate amendment indicates that "a study of the confidentiality provisions will be useful in assisting the Committee in determining whether improvements can be made to these provisions."[5] Findings by the National Commission for Restructuring the IRS also appear to have provided an impetus for these studies:

> The Commission heard concerns regarding the scope and use of the provisions regarding taxpayer confidentiality. In light of the complexity of the issue and the need to balance a host of conflicting interests, including taxpayer privacy, the need for third parties to use tax return information, and the ability to achieve greater levels of voluntary compliance by allowing the public to know who does not file tax returns, Congress should study these rules.[6]

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[5] *See* H.R. Rep. No. 105-364, 105th Cong., 1st Sess., at 82; S. Rep. No. 105-174, 105th Cong., 1st Sess., at 115.

[6] Report of the National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS*, at 48 (June 25, 1997).

B. Solicitation of Comments

Because of the wide range of interests affected by the laws relating to confidentiality of taxpayer information, Treasury sought the input of taxpayers, employees of the IRS who administer these laws, and third parties, including Federal and state agencies, who use or desire to use taxpayer information in their programs.

To conduct its study, Treasury first formed a task force comprised primarily of IRS employees (and including one representative from the Department of Justice), to assist in the identification and development of issues relevant to this study. In October of 1999, Treasury published a solicitation for comments in the Federal Register.[7] In response to this solicitation, Treasury received a number of comments from taxpayers, taxpayer representatives, interested organizations, and Federal and state agencies. These comments are available for inspection and copying upon request. Treasury also met with interested parties and individuals.

III. Executive Summary

This study responds to the Congressional mandate of section 3802 of the Internal Revenue Service Restructuring and Reform Act of 1998 ("RRA 1998") to study the scope and use of provisions regarding taxpayer confidentiality. The study first provides a history and overview of the laws regarding taxpayer confidentiality and then makes recommendations related thereto. Some of these recommendations respond to provisions included in TBOR 2000 and/or the JCT Study.

A. History and Overview of Relevant Laws

1. Section 6103

Except for a few periods in our history, tax information generally has not been available to the public – its disclosure has been restricted. Prior to 1977, tax information was considered a "public record," but was only open to inspection under Treasury regulations approved by the President or under presidential order. Under this scheme, the rules regarding disclosure were essentially left to the Executive branch.

By the mid-1970's, there was increased Congressional and public concern about the widespread use of tax information by government agencies for purposes unrelated to tax administration. This concern culminated with a total revision of section 6103 in the Tax Reform Act of 1976. There, Congress eliminated Executive discretion regarding what information could be disclosed to which Federal and state agencies and established a new statutory scheme under which tax information was confidential and not subject to disclosure except to the extent explicitly provided by the Code. Although there have been many amendments to the law since that time, the basic statutory scheme established in 1976 remains in place today.

There are four basic parts to this statutory scheme:

1) The general rule that makes tax returns and tax return information confidential except as expressly authorized in the Code.

2) The exceptions to the general rule detailing permissible disclosures. Disclosures for purposes other than tax administration are more limited than disclosures for purposes of tax

[7] 64 F.R. 54960 (Oct. 8, 1999). A copy of this notice is attached as Appendix A.

administration. This is consistent with the policy underlying section 6103, which is that the need for a particular item of tax information must be balanced against the taxpayer's reasonable expectation of privacy in information provided to the IRS as well as the effect on continued compliance with our voluntary system of self-assessment.

3) Technical, administrative, and physical safeguard provisions to prevent the recipients of tax information from using or disclosing the information in an unauthorized manner, and accounting, recordkeeping and reporting requirements that detail what disclosures are made for what purposes to assist in Congressional oversight.

4) Criminal penalties, including a felony for the willful unauthorized disclosure of tax information, a misdemeanor for the unauthorized inspection of tax information, and a civil cause of action for the taxpayer whose information has been inspected or disclosed in a manner not authorized by section 6103.

2. Section 6110

Section 6110 was added to the Code by the Tax Reform Act of 1976, largely in response to litigation that had arisen regarding the IRS's refusal to disclose, pursuant to the Freedom of Information Act ("FOIA"), private letter rulings and technical advice memoranda. Section 6110 opens to public inspection, with certain identifying and other information deleted, written determinations and certain types of background materials relating to those written determinations.

3. The Freedom of Information Act

Enacted in 1966, the FOIA generally provides that any person has a right, enforceable in court, of access to Federal agency records, except to the extent that such records (or portions thereof) are protected from disclosure by one of nine exemptions or three special law enforcement record exclusions.

The purpose of the FOIA is the disclosure of information that "sheds light" on an agency's performance of its statutory duties. The statute was enacted based upon the fundamental principle that an informed citizenry is essential to the democratic process and that the more the American people know about their government the better they will be governed.

The FOIA divides the information that must be disclosed by Federal agencies into three categories: information that must be published in the *Federal Register*, information that must be made available for public inspection and copying, and information that is subject to disclosure upon request.

4. The Privacy Act

The Privacy Act of 1974, enacted in the aftermath of Watergate, was intended to regulate the collection, maintenance, and disclosure of information about individuals by government agencies. The Privacy Act prohibits the disclosure by agencies of information about individuals without the consent of the individual involved unless the disclosures are within one or more statutory exceptions. The Privacy Act, like the FOIA, contains a provision permitting an individual a right of access to information about himself or herself contained in an agency's system of records. The Privacy Act also contains provisions: (1) requiring an agency to publish its systems of records in the Federal Register; (2) permitting an individual the right to amend

records concerning himself or herself that are erroneous; and (3) requiring accountings of records concerning an individual that are disclosed.

B. Treasury's Recommendations Relating to the Confidentiality of Returns and Return Information

1. The Relationship of Confidentiality to Voluntary Compliance

a) Publicity of Nonfilers

- Treasury strongly recommends against publishing the names of nonfilers or delinquent taxpayers. The benefits to be derived from such a program are speculative at best and do not warrant taking the risk of inaccuracies or other adverse consequences that may undermine taxpayer confidence in the tax system.

b) Disclosure of Taxpayer Identity Information Related to Accepted Offers-in Compromise

- Section 6103(k)(1) should be repealed and such information made available to the appropriate Congressional tax-writing committees. Alternatively, accepted offers-in-compromise should be publicized without taxpayer-identifying information.

c) Public Record Data/Publicity of Criminal Tax Cases

- Information reflected in returns and return information properly made a part of the public record should not be protected by section 6103. IRS should be authorized to issue press releases supplementing certain details in the public record regarding criminal tax cases to ensure that criminal tax enforcement is effectively publicized.

2. Interaction of Section 6103 with Other Statutes

- It should be clarified that section 6103 preempts any law outside of Title 26 that would otherwise authorize the disclosure of returns or return information, unless such other law explicitly overrides section 6103.

- Section 6103 should be amended to explicitly indicate that section 6103 is an exemption 3 statute under the FOIA and that the FOIA is not one of the laws preempted by section 6103. Section 6103 should also be amended to expressly permit disclosure of tax information to the taxpayer, the taxpayer's representative, or the taxpayer's designee, pursuant to a FOIA request. Finally, in the case of FOIA litigation involving a member of the public who is not authorized by section 6103 to receive returns and return information, the court should be expressly permitted to make an in camera inspection to determine whether a document either consists of or contains return information. IRS should also have explicit authority to disclose such information to the Justice Department in connection with such cases.

- Sections 6103 and 7431 should be amended to explicitly state that they preempt the Privacy Act with respect to the disclosure of returns and return information and the remedy for unauthorized disclosures.

3. Disclosures Related to Tax Administration

a) Disclosures to Officers or Employees of the Department of the Treasury

(1) Inspection of Taxpayer Representatives' Returns

- Treasury supports section 204 of TBOR 2000, which would amend section 6103(h) to provide that the return of a representative of a taxpayer whose return is under examination by an officer or employee of the Department of the Treasury cannot be inspected or disclosed to such officer or employee solely on the basis of the representative's representation of the taxpayer unless the officer or employee's supervisor approves such inspection or disclosure on another basis.

b) Disclosures of Third-Party Tax Data in Judicial or Administrative Proceedings

- The notice and redaction procedures of section 205 of TBOR 2000 should not be enacted. Rather, it should be clarified that the item test does not apply to a similarly situated, but completely unrelated, taxpayer. Specifically, the item test should be clarified to indicate that the treatment of the item must be directly related to the resolution of an issue in the proceeding due to the operation of the Code or some relationship between the parties. Alternatively, if it is determined that third-party tax disclosures should be allowed in judicial proceedings involving disparate treatment issues, disclosure should be predicated on a prima facie showing of disparate treatment. In addition, third parties in judicial proceedings involving disparate treatment issues should be notified by the IRS and given a statutory right of intervention. Treasury would not recommend codifying the standard regarding how much third party information can be disclosed proposed by section 205 in order to ensure the necessary flexibility for purposes of meeting the rules of evidence.

c) Investigative Disclosures

- IRS Criminal Investigation special agents should be permitted (but not required) to identify themselves, their organizational affiliation, and the criminal nature of their investigation when contacting third parties in person or in writing. Treasury recommends that this clarification be made to section 6103(k)(6) and/or to section 7608(a).

d) Miscellaneous Tax Administration Disclosures

(1) Disclosures of Levies on Government Employee Wages

- Section 6103 should be amended to clarify that persons otherwise included in 6103(a) (such as Federal employees) who receive tax information under section 6103(k)(6) (dealing with investigative disclosures) are not subject to the redisclosure restrictions of section 6103 for such information.

(2) Disclosures by TIGTA and Safeguarding

- Section 6103(k)(6), relating to disclosures for tax investigative purposes, should be amended to clarify that it includes disclosures by the Treasury Inspector General for Tax Administration ("TIGTA"). In addition, the Inspector General Act should be amended to remove the accounting and safeguarding requirements for information disclosed to the TIGTA under section 6103(h)(1).

(3) Disclosures in Connection With Levies on FMS Payments

- Section 6103(k)(8) should be amended to expressly permit: (1) testing, (2) disclosures to the Federal Reserve Board, (3) pre-levy disclosure to SSA, (4) disclosure to salary paying agencies to calculate the amount to be levied, and (5) levy of and disclosure to non-Treasury disbursing offices for purposes of carrying out section 6331(h).

(4) TIN Matching

- Section 6103(k) should be amended to permit taxpayer identification number verification by persons required to provide such information to the IRS. This verification should be limited to whether or not the information provided by the payor matches IRS records.

(5) Disclosures to Organizations Regulating Tax Practitioners

- Section 6103(k) should be amended to permit the IRS to disclose return information contained in suspensions and disbarments imposed by administrative law judges to professional organizations regulating tax practitioners such as state bar associations and accountancy boards.

(6) Treasury Personnel and Claimant Representative Matters

- The disclosure authority currently found in section 6103(l)(4) should be transferred to section 6103(h), as such personnel and integrity matters are inherently connected to the administration of the internal revenue laws. Such authority should be broadened to authorize disclosures to and use by the Justice Department in defending personnel and integrity matters

arising from tax administration. This expansion should also authorize disclosures in connection with personnel and integrity matters arising out of conduct by Justice Department employees whose duties include administering and enforcing the tax laws. In addition, this provision should be clarified to encompass all administrative and judicial proceedings the outcome of which may affect the personnel rights of an employee.

e) Disclosure to States

(1) Joint Filing Programs

- The disclosure permitted by section 6103(d)(5) for the STAWRS program and described in section 976 of the Taxpayer Relief Act of 1997 should be extended permanently to all joint filing programs with state tax agencies and should be expanded to permit the disclosure of all common data elements in addition to taxpayer identity and signatures. Subsections (a)(2) (redisclosure limitations) and (p)(4) (safeguards) of section 6103 and the criminal penalties of sections 7213 and 7213A should not apply to disclosures or inspections made pursuant to section 6103(d)(5).

(2) Safeguarding Issues with Respect to States' Use of Federal Tax Data

- Treasury supports section 207 of TBOR 2000 insofar as it requires States to certify compliance of their tax administration contractors with section 6103(p)(4) safeguards. If adopted, this provision should be initiated in pilot form and include a sunset date. In addition, section 6103(p)(4) should be amended to explicitly include disclosures to contractors pursuant to section 6103(n).

4. Disclosures Not Related to Tax Administration

a) Nontax Criminal Cases

(1) Imminent Threat of Death or Physical Injury

- The disclosure permitted by section 6103(i)(3)(B)(i) in cases of imminent death or physical injury should be extended to local law enforcement agencies and local suicide prevention authorities and should not be subject to the safeguards of section 6103(p)(4). Similarly, Federal or state law enforcement agencies should be permitted to disclose such information directly to such local law enforcement agencies and local suicide prevention authorities. Civil penalties should apply to disclosures of such information for other purposes.

(2) Civil Forfeiture

- Section 6103(i)(1) should be amended to permit the Justice Department to obtain an ex parte order permitting disclosures in preparation for proceedings pertaining to civil forfeitures.

(3) Form 8300 Disclosures

- Pursuant to the Administration's anti-crime legislation, the administration of Form 8300 (Report of Cash Payments Over $10,000 Received in a Trade or Business), currently under section 6050I of Title 26, should be transferred to Title 31.

b) Use of Tax Information for Federal Benefit and Loan Programs

- Additional exceptions to the confidentiality of taxpayer information under section 6103 should be granted in rare circumstances and only where the agency can demonstrate, using established criteria, a need for the information that clearly outweighs taxpayer privacy interests and concerns about the effects on voluntary tax compliance.

c) Obtaining Returns and Return Information Pursuant to the Taxpayer's Consent

- Where a specific statutory authorization for a large-scale governmental progammatic disclosure does not exist, agencies generally should be permitted to solicit taxpayers' consent to disclosure for such purposes only upon a demonstration (e.g., through a statistical test match or through a small-scale pilot), applying established criteria, of a need for the information that clearly outweighs taxpayer privacy interests and concerns about the effects on voluntary tax compliance. Section 6103 should be amended to provide that the safeguard requirements of section 6103(p)(4) apply to such governmental disclosure programs to the same extent as to disclosures pursuant to specific statutory exceptions.
- Large-scale non-governmental third-party consent disclosures should be permitted only upon approval by the IRS, based on established criteria, on a programmatic basis. Such consents should specify the minimum amount of information necessary to achieve the intended purpose of the disclosure.
- Section 6103(c) should be amended to provide that returns or return information disclosed pursuant to the taxpayer's consent may be disclosed or used by such persons only for purposes of, and to the extent necessary in, accomplishing the purpose of the disclosure. In addition, appropriate civil damages and criminal penalties for wrongful disclosure and inspection should be extended to apply to persons who receive returns or return information pursuant to the taxpayer's consent and use the information in a manner inconsistent with the consent.

- Section 6103(g)(2) should be amended to codify existing practice with respect to tax checks, combining the notice provided by consent with statutory access (including by a President-elect) to the information necessary to effectively and efficiently conduct tax checks.
- Section 6103(l)(3) should be amended as necessary to achieve its intended purpose (for example, by permitting disclosures to contractors), and the practice of using consents for this purpose should be discontinued. Taxpayers should, however, receive notice of such potential disclosures.
- IRS should have the ability to enter into joint efforts with state licensing programs, on a case by case basis, where it determines that there is a nexus between the license and the tax information sought and that there are likely to be tax compliance benefits.
- IRS should have the flexibility to accept consents for such purposes as disaster relief.

d) Child Support Enforcement

- Section 6103(l)(6) should be amended, or committee language should be drafted, to clarify which entities and individuals are entitled to receive return information for which specific purposes, and whether such information may be redisclosed for limited purposes necessary for establishment and enforcement of child support orders.
- Section 6103(l)(6)(A)(i) should be amended, after consultation with the Office of Child Support Enforcement ("OCSE"), to eliminate of information not currently used by OCSE or for which there is no anticipated need.
- Section 6103(l)(6)(A)(ii), if retained in its present form, should be amended to permit the disclosure of employer identification numbers with other Form 1099 information and should be expanded to include limited information regarding mortgage interest paid.
- A technical amendment to section 6103(l)(8) should be made to permit SSA to make disclosures to OCSE.

e) Disclosures to Contractors

- Disclosures to contractors and agents of a Federal, state, or local agency should be permitted when the agency both has demonstrated a compelling need for contractors to have access to the requested information and is able to demonstrate oversight of its contractors and certify compliance of those contractors with the safeguards of section 6103(p)(4). Such disclosure/certification programs should be initiated on a pilot basis. Certification would not be necessary for contractors receiving only fact-of-discrepancy information.

f) Other Benefit Programs

(1) Entities Permitted to Receive Return Information

- Section 6103(l)(7) should be amended to permit Tribes, charitable, religious, or private organizations operating Federally recognized TANF programs to receive tax information for TANF purposes.

(2) Overlap Between (l)(6) and (l)(7) Disclosures

- Section 6103 should be amended to permit sharing of return information within a state agency that receives such information in connection with two or more programs under section 6103(l)(6) and/or section 6103(l)(7) with respect to the same individual, subject to Treasury's recommendation with respect to contractors. Similarly, consideration should be given to amending section 6103 to permit inter-agency data-sharing in similar circumstances.

(3) Disclosures to Veterans Affairs

- Provided the Department of Veterans Affairs demonstrates (1) continued need for the information disclosed pursuant to section 6103(l)(7)(D)(viii) and (2) continued compliance with the safeguards of section 6103(p)(4), section 6103(l)(7)(D)(viii) should be extended beyond its current expiration of September 30, 2003.

e) Student Financial Aid Programs Administered by the Department of Education

- If the test match currently underway between the IRS and the Department of Education supports a business case for income verification by the Department of Education, section 6103 should be amended to permit disclosure of necessary items of information for income verification in connection with student financial aid eligibility determinations as contemplated by the Higher Education Act. Consistent with Treasury's recommendations regarding contractors generally, if adopted, this provision should permit access by contractors, subject to the limitations described above.

- The erroneous reference to section 6103(l)(13) in section 484(q)(2) of the Higher Education Act should be removed.

- Congress should amend section 6103(l)(13) to provide access to the items of information the Department of Education needs and to permit the use of contractors, subject to the limitations described above. This provision, as amended, should be extended beyond its current expiration of September 30, 2003.

f) **Statistical Use – Disclosures to Census Bureau, Etc.**

(1) **Expanding the Number of Covered Agencies**

- The disclosure authority of section 6103(j) should be expanded to additional specified statistical agencies, and such agencies should be permitted, upon prior Treasury approval, to share IRS data with each other.

(2) **Disclosures to the Federal Trade Commission**

- Section 6103(j)(2), regarding disclosures to the Federal Trade Commission ("FTC") for statistical purposes, should be repealed, because the FTC no longer needs the information.

5. FOIA and Disclosure Issues With Respect to IRS Documents

a) **Agency Working Law – FOIA and Section 6110**

- Section 202 of TBOR 2000, which would place an affirmative obligation on the IRS to disclose all "Official Advice" under section 6110 should not be enacted, because it requires the disclosure of documents that are neither final nor authoritative and are protected by the deliberative process privilege and thus will create confusion as to the law.

b) **Closing Agreements, Taxpayer-Specific Competent Authority Agreements, etc.**

- Section 6103(b)(2)(C) and section 6110(b)(1) should be amended to clarify that closing agreements, taxpayer-specific competent authority agreements (see below), and any other negotiated agreement between the IRS and taxpayers or the IRS and another party concerning a taxpayer (and any background information related to such agreement) constitute confidential return information in their entirety and do not constitute written determinations subject to disclosure under section 6110.

c) **Pre-filing Agreements**

- Section 6103(b)(2)(C) and section 6110(b)(1) should be amended to clarify that pre-filing agreements (and any background information related to such agreements) constitute confidential return information in their entirety and do not constitute written determinations subject to disclosure under section 6110. In the initial years of the program, IRS should be authorized to issue a report describing the number of pre-filing agreements executed and the types of issues resolved therein.

d) Information Exchanged Under Bilateral Tax Conventions and Competent Authority Agreements

- It should be clarified that any information expressly protected under a non-disclosure provision of a tax treaty (including any agreement listed in Appendix C) is protected from public disclosure pursuant to FOIA exemption 3 and/or section 6110(c)(3). This could be accomplished through a Title 26 statutory provision specifically affording confidentiality to information expressly protected from disclosure by a tax treaty. This provision, among other things, would assure confidentiality of both taxpayer-specific and non-taxpayer specific competent authority agreements. In addition, as recommended above, section 6103(b)(2)(C) and section 6110(b)(1) should be amended to clarify that any taxpayer-specific competent authority agreement and any background information related to such agreement constitutes return information in its entirety and does not constitute a written determination subject to disclosure under section 6110.

6. Unauthorized Disclosures

a) Reports to Congress

- Treasury supports section 209(b) of TBOR 2000, which would require IRS to include information regarding unauthorized disclosures in its annual disclosure report to Congress.

b) Notification of Taxpayers

- Section 209(a) of TBOR 2000, regarding administrative determinations of browsing, should not be adopted, but, rather, section 7431 should be amended to provide that taxpayers shall be notified at the earlier of indictment or whenever the IRS proposes an administrative determination as to disciplinary or adverse action against an employee arising from the employee's unauthorized inspection or disclosure of a taxpayer's return or return information.

c) Burden of Proof

- Section 7431 should be amended to clarify that the burden of proving that an employee's unauthorized disclosure of tax information was a result of a good faith, but erroneous, interpretation of section 6103 rests with the Government. In addition, section 7431 should be amended to provide that the good faith defense also applies to factual mistakes.

d) Exhaustion of Administrative Remedies

- Section 7431 should be amended to require exhaustion of administrative remedies prior to awarding damages under that section and to provide that any claims payable under this authority are payable out of the U.S. Judgment Fund.

7. Miscellaneous Recommendations

a) Disclosure to Former Spouse Upon Oral Request

- Treasury supports section 203 of TBOR 2000, which would permit disclosures to former spouses with respect to a joint return upon oral request, but consideration should be given to phasing out the TIGTA reporting requirement.

b) Disclosure of Taxpayer Identity for Refund Purposes

- Treasury supports section 210 of TBOR 2000, which would permit use of the Internet to locate individuals entitled to refunds.

c) Refund Offset Disclosures

- Treasury does not agree with the JCT staff's recommendation to repeal section 6103(m)(2), which relates to disclosures for purposes of the refund offset program.

Part Two – History and Overview of Relevant Laws

I. Introduction

This section provides a history and overview of the laws addressed by this study, including section 6103, section 6110, the FOIA, and the Privacy Act.

II. Section 6103

A. Introduction

Except for a few periods in our history, tax information generally has not been available to the public – its disclosure has been restricted. Congress has used two basic approaches in determining whether, and under what circumstances, tax information could be disclosed. Under the first approach, taken prior to 1977, tax information was considered a "public record," but was only open to inspection under Treasury regulations approved by the President or under presidential order. Under this approach, the rules regarding disclosure were essentially left to the Executive branch.

By the mid-1970's, there was increased Congressional and public concern about the widespread use of tax information by government agencies for purposes unrelated to tax administration. This concern culminated with a total revision of section 6103 in the Tax Reform Act of 1976. There, Congress eliminated Executive discretion regarding what information could be disclosed to which Federal and state agencies. Under this second approach, Congress established a new statutory scheme in which tax information was confidential and not subject to disclosure except to the extent explicitly provided by the Code. Although there have been many amendments to the law since that time, the basic statutory scheme established in 1976 remains in place today.

B. Summary of Events Leading to the 1976 Tax Reform Act Rules on Tax Information Confidentiality [8]

The history of tax information confidentiality may be traced to the Civil War Income Tax Act of 1862,[9] when tax information was posted on courthouse doors and sometimes published in newspapers to promote taxpayer surveillance of neighbors. For the next 70 years, there was

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[8] Much of this discussion is taken from *Report on Administrative Procedures of the Internal Revenue Service to the Administrative Conference of the United States*, S. Document 266, 94th Cong., 2d Sess. 821-1135 (October 1975). *See also* Zaritsky, Legis*lative History of Tax Return Confidentiality: Section 6103 of the Internal Revenue Code of 1954 and Its Predecessors*, U.S. Congressional Research Service, Library of Congress, D.C.: 74-211A (1974); Janssen, *Income Tax Snooping Through History*, Wall Street Journal, May 6, 1970, at 18; and Rogovin, *Privacy and Income Tax Returns*, The Washington Post, October 13, 1974, at C4.

[9] Act of July 1, 1862, ch. 119, 12 Stat. 432, 437. Ambiguities in that provision regarding public inspection led Congress, in 1864, to explicitly permit public inspection of the assessment list:

> [I]t shall be the duty of the assessor … to submit the proceedings of the assessors … and the annual lists taken and returned as aforesaid, to the inspection of any and all persons who may apply for that purpose.

Act of June 30, 1864, 13 Stat. 218, 228.

debate in Congress as to the effect of public disclosure on the tax system and on societal interests in general.

1. 1866 to 1913

In 1866, Congress debated prohibiting publication of assessment lists in the newspapers, but the proposal failed, principally because many Congressmen believed that publication of the assessed tax would assist in preventing tax fraud.

In 1870, the Commissioner prohibited newspaper publication of the annual list of assessments, but the list itself remained available for public inspection.[10] The Revenue Act of 1870 confirmed this directive.[11] Two years later, in part because of problems stemming from publicity of tax returns, the income tax law was allowed to expire. When the income tax was reinstated by the Revenue Act of 1894, Congress affirmatively prohibited both the printing and the publishing in any manner of any income tax return unless otherwise provided by law, and provided criminal sanctions for unlawful disclosure.[12] In 1895, the Supreme Court declared the income tax unconstitutional in *Pollock v. Farmers' Loan & Trust Co*.[13] After this decision, according to one commentator, the cause of confidentiality received its ultimate victory, the burning of all tax returns.[14]

It was not until the enactment of the Payne-Aldrich Tariff Act of 1909,[15] which imposed a special excise tax on corporations, that the question of tax return publicity was raised anew. Paragraph six of section 38 of that Act seemed to provide that corporate returns were fully public, but paragraph seven imposed a penalty for the disclosure of any information obtained by a U.S. employee in the discharge of his duties.[16] The legislative history does little to illuminate

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[10] Treasury Decision (April 5, 1870), in Internal Revenue Record and Customs Journal, vol. XI, No. 15, whole No. 275 (April 9, 1870).

[11] Act of July 14, 1870, 16 Stat. 256, 259.

[12] Income Tax Act of August 15, 1894, ch. 349, 28 Stat. 509, 557-58.

[13] 157 U.S. 429 (1895).

[14] Janssen, *supra* note 8, at 18, col. 4.

[15] Act of August 5, 1909, 36 Stat. 11,116-117.

[16] Section 38 of the legislation read as follows:

> Sixth. When the assessment shall be made, as provided in this section, the returns, together with any corrections thereof which may have been made by the commissioner, shall be filed in the office of the Commissioner of Internal Revenue and *shall constitute public records and be open to inspection as such*.
>
> Seventh. It shall be unlawful for any collector, deputy collector, agent, clerk, or other officer or employee of the United States to divulge or make known in any manner whatever not provided by law to any person any information obtained by him in the discharge of his official duty, or to divulge or make known in any manner not provided by law any document received, evidence taken, or report made under this section except upon the special direction of the President; and any offense against the foregoing provision shall be a misdemeanor and be

these apparently conflicting provisions. Because, however, the Payne-Aldrich legislation did not provide any funds for the examination of returns filed pursuant to the Act, it became necessary, in 1910, to appropriate them. During the debate on the Appropriations Act of 1910, considerable light was shed upon the Congressional intention behind the 1909 legislation.

The prevailing opinion seems to have been that paragraph six of the 1909 legislation was intended to make corporate tax returns "public records" which were open to public inspection.[17] It was believed by many that public inspection of corporate tax returns would be of great assistance in the supervision and control of corporate entities (as there was considerable fear of the power of corporations at that time).

The contrary view, held by a minority, acknowledged that the 1909 legislation made tax returns public documents. However, paragraph seven of the law made it a criminal offense for any government officer or employee to release material contained in these public documents without special instruction from the President. If the public access granted by paragraph six had been entirely unfettered, paragraph seven would not have imposed criminal sanctions for divulging information without the President's consent. This illogical result was taken to mean that tax returns had not been opened to indiscriminate public inspection but only to persons having a proper interest in the returns.[18]

While there was disagreement over what was intended by the 1909 legislation, it was universally conceded that it altogether failed to open corporate returns to the public. Some blame this result on inadequate draftsmanship. Others thought the failure lay in lack of an appropriation to provide clerks to do the publicizing. At any rate, a majority did conclude that another approach was necessary. Thus, the 1910 Appropriations Act amended the disclosure provision.

The 1910 legislation, which appropriated funds for the necessary classifying, indexing, and processing of corporate returns, also stated:[19]

> [A]ny and all such returns shall be open to inspection only upon the order of the President under rules and regulations to be prescribed by the Secretary of the Treasury and approved by the President.

The debate surrounding the 1910 Act plainly indicates that Congress intended by the quoted provision to back away from the fully "public" treatment of corporate returns. Some Congressmen argued for full publicity, as opposed to publicity only at the whim of the

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> punished by a fine not exceeding one thousand dollars, or by imprisonment not exceeding one year, or both, at the discretion of the court. (Emphasis added).

[17] "The truth is, however, that the intention was to provide complete publicity of the returns made by these corporations." Comments of Mr. Fitzgerald, 45 Cong. Rec. 4137 (1910).

[18] "It will be noted that the law does not provide the returns shall be subject to public inspection, but that the returns shall become public records and subject to inspection as such … [T]he mere branding of these instruments as public records did not carry with it the right of indiscriminate public inspection[.]" Comments of Mr. Smith, 45 Cong. Rec. 4136 (1910).

[19] Act of June 17, 1910, 36 Stat. 468, 494.

Administration, as provided by the bill. The majority, however, chose the approach that returns would be made public only on the order of the President.

Left standing was the notion of the 1909 Act that returns constituted "public records" open to public inspection. The 1910 effort to revise Congressional intent merely added on the seemingly contradictory and confusing concept that these "public" records would be available only upon order of the President.

2. Revenue Act of 1913

Even though the statute seemed to have two rather inconsistent threads, Congress wove both of them into the Tariff Act of 1913.[20] In pertinent part, it provided:

> G.(d) When the assessment shall be made, as provided in this section, the returns, together with any corrections thereof which may have been made by the commissioner, shall be filed in the office of the Commissioner of Internal Revenue and shall constitute public records and be open to inspection as such: *Provided*, That any and all such returns shall be open to inspection only upon the order of the President, under rules and regulations to be prescribed by the Secretary of the Treasury and approved by the President…

In 1913, the Congress thereby merged the mismatching philosophies from the 1909 Act and the 1910 amendment. Although there was, through the years, some change in language, the basic pattern adopted in 1913 remained part of the law until 1976.

3. 1913 to 1976

The enactment of each revenue act subsequent to 1913 was, at least through 1934, accompanied by debate on the question of whether or not individual and corporate returns should be made fully public. Two main arguments were made in favor of making tax returns public:

1) publicity in the affairs of businesses generally is appropriate and would serve to end improper trade policies, business methods, and conduct, and
2) publicity would assure fuller and more accurate reporting by taxpayers.

The proponents of full disclosure obtained their fundamental philosophy from a speech by former President Benjamin Harrison who, before the Union League Club of Chicago, stated:

> each citizen has a personal interest, a pecuniary interest in the tax return of his neighbor. We are members of a great partnership, and it is the right of each to know what every other member is contributing to the partnership and what he is taking from it.[21]

The other point of view, consistently taken over the years by the Department of the Treasury, opposed the publicity of tax information. Early on, this position was articulated as follows:

> While the government does not know every source of income of a taxpayer and must rely upon the good faith of those reporting income, still in the great majority

[20] Tariff Act of 1913, ch. 16, 38 Stat. 114, 177.

[21] Rogovin, *supra* note 8, at C4.

> of cases this reliance is entirely justifiable, principally because the taxpayer knows that in making a truthful disclosure of the sources of his income, information stops with the government. It is like confiding in one's lawyer.[22]

Secretary Mellon later observed that:

> there is no excuse for the present publicity provision except the gratification of idle curiosity and the filling of newspaper space at the time the information is released. [23]

The proponents of full disclosure had a limited victory in 1924. The Revenue Act of 1924 provided that the Commissioner would:

> as soon as practicable in each year cause to be prepared and made available to public inspection . . . lists containing the name and . . . address of each person making an income-tax return . . . together with the amount of income tax paid by such person. [24]

As a result of the 1924 Act, newspapers devoted pages to publishing the taxes paid by taxpayers, and the right of newspapers to publish these lists was upheld by the Supreme Court.[25] The Revenue Act of 1926, however, removed the provision requiring that the amount of tax be made public while leaving the requirement that a list be published containing the name and address of each person making an income tax return.[26]

In 1934, after a widely publicized income tax evasion scandal, those favoring publicity obtained enactment of another form of limited disclosure. The Revenue Act of 1934 contained provision for the mandatory filing of a so-called "pink slip" with the taxpayer's return.[27] The pink slip, to be filed with the return, was to set forth the taxpayer's gross income, total deductions, net income and tax payable. The pink slip was to be open to public inspection. Fueled by images of kidnappers sifting through pink slips looking for worthwhile victims,[28] the provision was repealed even before it took effect.[29]

From 1934 until 1976, there was no substantial change in the statute respecting the disclosure of tax returns. The pre-1976 statute was thus very much the product of the 1909 and

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[22] This quote has been attributed to Secretary of the Treasury Mellon.

[23] *Hearings on Revenue Revision 1925 Before the House Ways and Means Comm.*, 69th Cong., 1st Sess. 8-9 (1925).

[24] Act of June 2, 1924, ch. 234, 43 Stat. 253, 293. One news article reported that in 1924, within 24 hours after it was announced that tax lists were ready for inspection, Internal Revenue officers throughout the country were besieged by applications from promoters, salespeople, and advertisers. *See* Jannsen, *supra* note 8.

[25] *U.S. v. Dickey*, 268 U.S. 378 (1925).

[26] Act of Feb. 26, 1926, ch. 27, 44 Stat. 9, 52.

[27] Act of May 10, 1934, ch. 277, 48 Stat. 680, 698.

[28] *See generally* Janssen, *supra* note 8, at 18; and Rogovin, *supra* note 8, at C4.

[29] Act of April 19, 1935, ch. 74, 49 Stat. 158.

1910 legislation, continuing with the oddity of "public" records open to inspection only under regulations or orders of the President.

Although corporate returns were, in 1910, made available to the public, as well as to other government agencies, individual returns were kept within Treasury until 1920. In 1920, individual returns joined corporate returns as being generally available to Federal agencies.[30] The 1930's saw a new trend of more general access being granted to specific agencies as well as to Congressional committees. The 1940's, 1950's, and 1960's were marked by almost unrestrained growth in the use of tax returns by government agencies. During this time, tax returns became a generalized governmental asset. The public, however, was denied access.

This diverse history on disclosure reveals the existence of a statute which, in all significant respects, went unchanged since 1910. Thus, the story is one of the exercise of discretion granted by a Congress unwilling to define precisely the policy to be followed. Having committed discretion to the President, and an agency headed by his designee, it was not surprising that the power was exercised toward expanding the use of information. Indeed, it would have been unrealistic to assume that the President could have been expected to resist agency arguments for more information on which to base important decisions, even though such information might not be necessary and might well be used for many purposes other than that apparently intended.

4. Developments in the 1970's

By the mid-1970's Congress became increasingly concerned about the disclosure and use of information gathered from and about citizens by agencies of the Federal government.[31] The events leading to the revision of the tax disclosure laws in 1976 can, however, be directly traced to Executive Orders 11697 and 11709, issued by President Richard M. Nixon in 1973 authorizing the Department of Agriculture to inspect the tax returns of all farmers "for statistical purposes."

During 1973, two subcommittees of the House of Representatives held hearings regarding the Department of Agriculture's need for the tax data disclosed by the two executive orders.[32] During these hearings, sentiments against the orders were expressed. Officers of the Justice Department testified that the two orders were prototypes of future orders opening other tax returns to inspection by other agencies. Responding to the adverse sentiment expressed in these two hearings, the President revoked both orders on March 21, 1974.[33]

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[30] T.D. 2961, 2 C.B. 250 (Jan. 7, 1920)

[31] This concern led directly to the enactment of the Privacy Act of 1974, 5 U.S.C. § 552a.

[32] *Hearings on Executive Orders 11697 and 11709 Permitting Inspection by the Department of Agriculture of Farmers' Income Tax Returns Before House Subcomm. On Foreign Operations and Government Information of Comm. on Government Operations*, 93rd Cong., 1st Sess. (1973); *Hearings on Inspection of Farmers' Federal Income Tax Returns by the U.S. Department of Agriculture Before the House Subcomm. on Department Operations of the Comm. on Agriculture*, 93rd Cong., 1st Sess., at 81 (1973).

[33] Exec. Order No. 11,773, 3 C.F.R. (1971-1975).

The concern over tax return confidentiality that remained after revocation of the two orders was increased by revelations made in hearings of both the Senate Select Committee on Presidential Campaign Activities (Watergate Committee) and the House Judiciary Committee investigating the possible impeachment of President Nixon. The Watergate Committee's hearings revealed that former White House counsel John Dean had sought political information on so-called "enemies" from the IRS. Furthermore, it was disclosed to that committee that the White House actually was supplied information on IRS investigations of Howard Hughes and Charles Rebozo. The Committee noted that tax information and income tax audits were commonly requested by White House staff and supplied by IRS personnel.

The House Judiciary Committee's impeachment inquiry also revealed apparently unauthorized use of IRS tax data by the President. One of the Articles of Impeachment proposed by the Judiciary Committee alleged that President Nixon had:

> endeavored to obtain from the Internal Revenue Service, in violation of the constitutional rights of citizens, confidential information contained in income tax returns for purposes not authorized by law. . . [34]

Congressional interest in tax return confidentiality also manifested itself in 1974 when, as part of the Privacy Act of 1974, Congress ordered the newly-established Privacy Protection Study Commission to report to the President and Congress on the proper restrictions which should be placed on the disclosure of Federal income tax information. This report was issued on June 9, 1976, and suggested major changes in the distribution of tax data to the Justice Department for both tax and nontax law enforcement, distribution of tax data to the states and to local governments, and transfer of information to the President and the executive agencies. It also recommended more severe penalties for wrongful disclosure of tax data. The commission did not recommend a general denial of tax data to nontax Federal agencies.

On June 10, 1976, the Senate Finance Committee issued its report on H.R. 10612, the Tax Reform Act of 1976, in which it proposed substantial revisions in the rules governing tax return confidentiality.[35] The Finance Committee's proposal dealt with the same general issues as had the Privacy Protection Study Commission's report, but it resolved them differently. With few technical changes, the Conference Committee on H.R. 10612 adopted the Senate Finance Committee's version of the tax confidentiality rules as part of the Tax Reform Act of 1976.

5. The Tax Reform Act of 1976

Congress recognized that the IRS had more information about citizens than any other Federal agency, and that other agencies routinely sought access to that information. Congress also recognized that citizens reasonably expected that the tax information they were required to supply to the IRS would be kept private. If the IRS abused that reasonable expectation of privacy, the loss of public confidence could seriously impair the tax system.

Although Congress felt that the flow of tax information should be more tightly regulated, not everyone agreed where the lines should be drawn. The debates on accessibility were most heated in the area of nontax criminal law enforcement. One side, led by Senator Long, sought

[34] *Report on the Impeachment of Richard M. Nixon, President of the United States*, H.R. Rep. No. 93-1305, at 3 (1974).

[35] S. Rep. No. 94-938, 94th Cong., 2d Sess.(1976).

more liberal access rules in order to fight white collar crime, organized crime, and other violations of the law. This side felt "the Justice Department is part of this Federal Government. It is all one Government."[36] The other side, led by Senator Weicker, wanted very restrictive rules. This side recognized that it was cheaper and easier for the Justice Department to come directly to the IRS. But they also felt that when citizens prepared their tax returns, they prepared them for the IRS, and no one else.

Ultimately Congress amended section 6103 to provide that tax returns and return information are confidential and are not subject to disclosure, except in limited situations, as delineated by the Code, where disclosure is warranted. In each area of allowable disclosure, Congress attempted to balance the particular office or agency's need for the information with the citizen's right to privacy, as well as the impact of the disclosure upon the continuation of compliance with the voluntary tax assessment system.[37] In short, Congress undertook direct responsibility for determining the types and manner of permissible disclosures.

C. Structure of Section 6103

The Tax Reform Act of 1976 enacted a comprehensive statutory scheme regulating the use and disclosure of tax returns and tax return information. There are four basic parts to this statutory scheme.

1) The general rule that makes tax returns and tax return information confidential except as expressly authorized in the Code;
2) The exceptions to the general rule detailing permissible disclosures;
3) Technical, administrative, and physical safeguard provisions to prevent the recipients of tax information from using or disclosing the information in an unauthorized manner, and accounting, recordkeeping and reporting requirements that detail what disclosures are made for what purposes to assist in Congressional oversight; and
4) Criminal penalties, including a felony for the willful unauthorized disclosure of tax information, a misdemeanor for the unauthorized inspection of tax information, and a civil cause of action for the taxpayer whose information has been inspected or disclosed in a manner not authorized by section 6103.

1. General Rule and Definitions

Section 6103(a) is the general rule, providing that returns and return information are confidential and, except as authorized in the Code, cannot be disclosed by Federal and state employees, and other recipients of tax information under specific provisions of the statute. Section 6103(b) provides definitions for key terms such as return, return information, state, and tax administration.

2. Permissible Disclosures

Subsections (c) through (o) of section 6103 contain exceptions to the general rule of nondisclosure. These subsections permit disclosures as described generally below:

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[36] 122 Cong. Rec. 23996 (July 27, 1976) (statement of Sen. Long).

[37] Staff of the Joint Committee on Taxation, 94th Cong., 2d Sess., *General Explanation of the Tax Reform Act of 1976*, 313-16 (Comm. Print 1976).

- Section 6103(c) – Disclosures to taxpayer's designees (consent);
- Section 6103(d) – Disclosures to state tax officials;
- Section 6103(e) – Disclosures to the taxpayer and persons having a material interest;
- Section 6103(f) – Disclosures to committees of Congress;
- Section 6103(g) – Disclosures to the President and White House;
- Section 6103(h) – Disclosures to Federal employees for tax administration purposes;
- Section 6103(i) – Disclosures to Federal employees for nontax criminal law enforcement purposes and to the General Accounting Office;
- Section 6103(j) – Disclosures for statistical purposes;
- Section 6103(k) – Disclosures for certain miscellaneous tax administration purposes;
- Section 6103(l) – Disclosures for purposes other than tax administration;
- Section 6103(m) – Disclosures of taxpayer identity information;
- Section 6103(n) – Disclosures to contractors for tax administration purposes;
- Section 6103(o) – Disclosures with respect to wagering excise taxes.

These provisions are discussed in greater detail below.

In addition to disclosures permitted under provisions of section 6103, other provisions of the Code also authorize disclosure of tax information. For example, section 6104 specifically authorizes disclosure of certain returns and return information regarding tax exempt organizations, trusts claiming charitable deductions, and qualified pension plans. Section 6110 authorizes disclosure of certain written determinations and background files relating to those determinations.[38]

3. Recordkeeping, Safeguards, and Reporting

a) Recordkeeping

Section 6103 requires the IRS to maintain a standardized system of permanent records on the use and disclosure of tax information. This includes copies of all requests for inspection or disclosure of tax information and a record of all inspections and disclosures of tax information.[39] The recordkeeping requirements do not apply in certain situations, including disclosure of tax information open to the public generally (accepted offers in compromise, the amounts of outstanding tax liens, etc.), disclosures to Treasury (including IRS) employees or the Justice Department for tax administration and litigation purposes, disclosure to the taxpayer and other persons with a material interest, disclosures to persons with the taxpayer's consent, disclosures to the media of taxpayer identity information for unclaimed refunds, and disclosures to contractors who perform tax administration functions.

In addition to the recordkeeping requirements imposed on the IRS, section 6103 provides that each Federal and state agency that receives tax information is required to maintain a

[38] *See also* sections 274(h)(6) (Caribbean Basin exchange agreements); 3406 (backup withholding); 4424 (wagering tax information); 6323(f) (notice of Federal tax lien); 7461 (publicity of Tax Court proceedings).

[39] Section 6103(p)(3)(A).

standardized system of permanent records on the use and disclosure of that information.[40] Maintaining such records is a prerequisite to obtaining and continuing to receive tax information.[41]

b) Safeguards

The Congress decided that, although it is necessary to permit the disclosure of tax information to other Federal, state, and local agencies in certain situations for purposes other than the administration of the Federal tax laws, no such disclosure should be made unless the recipient agency complies with a comprehensive system of administrative, technical, and physical safeguards designed to protect the confidentiality of the tax information and to make certain that the information is not used for purposes other than the purposes for which it was disclosed.

Section 6103 provides that no tax information may be furnished by the IRS to another agency (including commissions, states, local agencies etc.) unless the other agency establishes physical, administrative and technical safeguards satisfactory to the IRS for protecting the return information it receives.[42] Disclosure of tax information to other agencies is conditioned on the recipient agency maintaining a secure place for storing the information, restricting access to the information to people to whom disclosure can be made under the law, providing other safeguards necessary to keep the information confidential, and returning or destroying the information when the agency is finished with it. The IRS is to review, on a regular basis, safeguards established by other agencies.[43]

If there are any unauthorized disclosures by employees of the other agency, disclosure of tax information to that agency may be discontinued until the IRS is satisfied that adequate protective measures have been taken to prevent a repetition of the unauthorized disclosure. In addition, the IRS may terminate disclosure to any Federal, state, or local agency authorized to receive tax information if the IRS determines that adequate safeguards are not being maintained by the agency in question.

Tax information received pursuant to section 6103(g) by the President, White House, and other Federal agencies is not subject to the physical, administrative, and technical safeguard requirements. The safeguard requirements also do not apply to information provided pursuant to the taxpayer's written consent under section 6103(c).

c) Reports to Congress

Because the use of tax information for purposes other than tax administration resulted in serious abuses of the rights of taxpayers in the past, and because the potential for abuse necessarily exists in any situation in which tax information is disclosed for purposes other than the administration of the Federal tax laws, Congress believed that it must review very closely the

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[40] Section 6103(p)(4)(A).

[41] *Id.*

[42] Section 6103(p)(4).

[43] Detailed instructions for safeguarding returns and return information are provided in IRS Publication No. 1075, *Tax Information Security Guidelines for Federal, State, and Local Agencies: Safeguards for Protecting Federal Tax Returns and Return Information* (Rev. 3/99).

use of tax information and the extent to which taxpayer privacy is being protected.[44] In order to permit that review, Congress decided to require that the IRS make certain comprehensive annual reports to the Joint Committee on Taxation as to the use of tax information.

The IRS is required to make an annual report to the Joint Committee on Taxation containing a summary record of disclosure.[45] In addition, under section 6103(p)(3)(C), the IRS must prepare a report to the Joint Committee on Taxation for disclosure to the public of agencies receiving tax information, the number of cases in which such disclosure was made during the year, and the general purposes for the disclosure requests. Specifically, reports are required with respect to disclosures to Federal agencies, state tax agencies, Federal and state law enforcement agencies receiving tax information under section 6103(i)(3)(B)(i), Federal, state and local child support enforcement agencies and the General Accounting Office. Also, reports to the Joint Committee on Taxation are only required with respect to disclosures for which the IRS is required to account, e.g., disclosures to IRS and Treasury Department employees for tax administration purposes are not subject to the accounting requirements and no reporting to the Joint Committee on Taxation is required.[46]

Finally, the IRS must furnish a report each year to the tax writing committees of Congress describing the procedures and safeguards established by recipient agencies to ensure the confidentiality of returns and return information.[47]

4. Criminal and Civil Enforcement Provisions

In section 6103(a), Congress explicitly applied the prohibition against disclosure to present and former officers and employees of the United States, as well as to certain other recipients of tax information under the statute. In order to ensure adherence to the confidentiality scheme established by section 6103(a), Congress increased the criminal penalties for unauthorized disclosures and provided a civil remedy for taxpayers whose information was disclosed in an unauthorized manner.

Prior to 1977, violations of the disclosure laws were misdemeanors punishable by a fine of up to $1,000 and up to one year imprisonment. Pursuant to amendments effective in 1977, a criminal violation of the disclosure laws became a felony, with a fine up to $5,000, and up to five years imprisonment.[48] The criminal penalties of section 7213 apply to: (1) the willful unauthorized disclosure of tax information by Federal and state employees and other persons having access to tax information, including contractors performing tax administration services, pursuant to various specific exceptions; (2) the willful offering of any item of material value in exchange for tax information and the receipt of such information pursuant to such an offer; and (3) the willful unauthorized disclosure of tax information received by one percent shareholders under the material interest provision of section 6103(e). In the case of a Federal officer or

[44] S. Rep. No. 94-938, *supra* note 35, at 345-46.

[45] Section 6103(p)(3)(B).

[46] Section 6103(p)(3)(C).

[47] Section 6103(p)(5).

[48] Under 18 U.S.C. § 3571, fines of up to $250,000 and $100,000 could be imposed for violation of sections 7213 and 7213A, respectively.

employee, section 7213 mandates that the employee or officer be dismissed from office or discharged from employment upon conviction. Penalties arising under section 7213 apply to former employees as well.

Section 7431 provides a civil remedy for any taxpayer damaged by an unlawful disclosure of tax information.[49] Liability extends to actual damages plus court costs. Punitive damages are also authorized in situations where actual damages are awarded and the unlawful disclosure is willful or is the result of gross negligence. Because of the difficulty in establishing in monetary terms the damages sustained by a taxpayer as the result of the invasion of privacy caused by an unlawful disclosure of tax information, section 7431 provides that these damages are, in no event, to be less than liquidated damages of $1,000 for each disclosure.

A disclosure of returns or return information made pursuant to a good faith, but erroneous interpretation of the confidentiality rules is not an actionable disclosure. Instead, disclosures that give rise to civil liability are limited to those situations where the unauthorized disclosure results from a willful or negligent failure of the person to comply with the law. Liability under this section will not arise for a disclosure made at the request of the taxpayer.

Since 1977, additional statutes, both within and outside of the Code, have been enacted to enhance criminal penalties for the unauthorized use and disclosure of tax information. The Taxpayer Browsing Protection Act of 1997 created section 7213A to specifically make the unauthorized inspection of tax information a misdemeanor, punishable by a fine up to $1,000, and up to one year imprisonment. Liability arises for a willful inspection of tax information that is not authorized by the Code. Penalties arising under section 7213A apply to Federal and state employees,[50] and other persons having access to tax information under various subsections of 6103. For Federal officers and employees, conviction results in a dismissal from office or discharge from employment. In 1996, Congress amended 18 U.S.C. § 1030(a)(2) to make the unauthorized access of government computers a felony. This provision would include the unauthorized access of tax information in government computer files. The IRS is required to notify taxpayers whenever an unauthorized disclosure or inspection leads to criminal charges under sections 7213 or 7213A or 18 U.S.C. §1030(a)(2).

III. Section 6110

Section 6110 was added to the Code by section 1201 of the Tax Reform Act of 1976,[51] largely in response to the litigation that had arisen regarding the IRS's refusal to disclose,

[49] The civil damage provision originally permitted the wronged party to bring an action against the Federal employee who made the disclosure (section 7217). In 1982, Congress changed the law by repealing section 7217, and enacting section 7431. Under this provision, the civil action resulting from a disclosure made by a Federal employee could be brought against the United States, rather than against the employee. Individuals other than Federal employees who can be sued under this provision (including, for example, IRS contractors and state tax officials) can be held liable for damages in their individual capacity.

[50] Penalties under section 7213A do not apply to former Federal officers and employees.

[51] Pub. L. 94-455.

pursuant to the FOIA, private letter rulings and technical advice memoranda.[52] As explained by the JCT staff, the Congress was concerned that (1) a few major tax practitioners had developed extensive files of private letter rulings, which constituted a "secret law" of the agency to which the general public did not have access; (2) the existence of this "secret law" had reduced public confidence in the tax laws; and (3) the secrecy surrounding these private rulings had generated suspicion that the tax laws were not being applied on an evenhanded basis.[53]

Section 6110 allows public inspection, with certain identifying and other information deleted, written determinations and certain types of background materials relating to those written determinations. The term "written determination" is defined in section 6110(b)(1) as "a ruling, determination letter, technical advice memorandum, or Chief Counsel advice," although these terms are not themselves defined in the statute. In general terms, rulings, determination letters, and technical advice memoranda are documents which recite the relevant facts, explain the applicable provisions of law, and show the application of the law to the facts. Under section 6110(i)(1), Chief Counsel Advice is written advice or instruction from the national office of IRS's Office of Chief Counsel to IRS or Office of Chief Counsel employees in the field conveying legal interpretations or positions of the IRS or Office of Chief Counsel concerning "revenue provisions," including, for example, provisions of the Code itself, regulations, revenue rulings, revenue procedures, tax treaties, court decisions, or other legal interpretations or guidance.

Section 6110 establishes procedures for recording third party contacts with the IRS regarding written determinations pending before the IRS, and for disclosure of the date and category (e.g., from Congress, from an industry group, etc.) of any such contact along with the redacted, public version of the written determination, itself. Section 6110 also requires that affected taxpayers be consulted regarding the redaction of section 6110 documents into a publicly available form that does not identify them directly or indirectly. Taxpayers may challenge the proposed redaction of too little identifying data, while a member of the public may challenge the withholding of too much identifying data. Public disclosure under section 6110 procedures is the exclusive means of access (other than court ordered discovery) to tax information governed by those procedures – in particular, access under FOIA is not available. Finally, under section 6110(k)(3), section 6110 documents issued by the IRS have no precedential value, may not be cited as precedent, and may only be relied upon by the taxpayer to whom the written determination was issued.

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[52] *Tax Analysts and Advocates v. Internal Revenue Service*, 505 F. 2d 350 (D.C. Cir. 1974); *Fruehauf Corp. v. Internal Revenue Service*, 522 F. 2d 284 (6th Cir. 1975), *vacated*, *Internal Revenue Service v. Fruehauf Corp.*, 479 U.S. 1085 (1977), *on remand*, *Fruehauf Corp. v. Internal Revenue Service*, 566 F.2d 574 (6th Cir. 1977).

[53] Staff of the Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1976, supra* note 37, at 303-04.

IV. The Freedom of Information Act

The Freedom of Information Act ("FOIA") generally provides that any person has a right, enforceable in court, of access to Federal agency records, except to the extent that such records (or portions thereof) are protected from disclosure by one of nine exemptions or by one of three special law enforcement record exclusions.

Enacted in 1966, the FOIA established for the first time an effective statutory right of access to government information. The purpose of the FOIA is the disclosure of information that "sheds light" on an agency's performance of its statutory duties. The statute was enacted based upon the fundamental principle that an informed citizenry is essential to the democratic process and that the more the American people know about their government the better they will be governed.[54]

Under the FOIA, virtually every record possessed by a Federal agency must be made available to the public in one form or another, unless it is specifically exempted from disclosure or specifically excluded from the Act's coverage in the first place. The nine exemptions of the FOIA ordinarily provide the only bases for nondisclosure, and generally they are discretionary, not mandatory, in nature.

Dissatisfied record requesters are given a remedy in the United States district courts, where judges determine the propriety of agency withholdings de novo and agencies bear the burden of proof in defending their nondisclosure actions.

Under the FOIA, certain categories of information must automatically be disclosed by Federal agencies. Paragraph (a)(1) of the FOIA requires disclosure through publication in the *Federal Register* of information such as descriptions of agency organizations, functions, procedures; substantive rules; and statements of general policy. This requirement provides automatic public access to very basic information regarding the transaction of agency business.

Paragraph (a)(2) of the FOIA requires that certain types of records – final opinions and orders rendered in the adjudication of cases, statements of policy and interpretations adopted by agencies, and certain administrative staff manuals and instructions to staff that affect a member of the public – be routinely made "available for public inspection and copying." This is commonly referred to as the "reading room" provision of the FOIA, and since the enactment of the Electronic Freedom of Information Act of 1996, it requires that some such records be made available by agencies in "electronic reading rooms" as well.

Under paragraph (a)(3) of the FOIA, all records not made available to the public under paragraphs (a)(1) or (a)(2) are subject to disclosure upon an agency's receipt of a proper FOIA request from any person.

Notwithstanding the FOIA's general rule of disclosure, no record need be disclosed if it falls within one of the exemptions listed in subsection (b). These exemptions permit withholding of agency records (or parts of agency records) where:

1) The material is properly classified, by executive order, as exempt from release for reasons of national defense or foreign policy;

[54] *See NLRB v. Robbins Tire & Rubber Co.*, 437 U.S. 214, 242 (1978).

2) The records relate solely to internal personnel rules and practices of an agency;
3) The release of the records is prohibited by another Federal statute;
4) The records are trade secrets, or, under certain circumstances, where the records contain confidential or privileged commercial or financial material;
5) The records are inter agency or intra agency memoranda or letters that would not be available, in discovery, to a party engaged in litigation with the agency;
6) The records contain information about individuals, disclosure of which would constitute a clearly unwarranted invasion of personal privacy, e.g., personnel or medical records;
7) The records were compiled for law enforcement purposes, to the extent their disclosure would impair ongoing law enforcement efforts, or lead to other foreseeable harm including disclosure of law enforcement techniques, reveal the identity of a confidential informant, or endanger the life or physical safety of an individual;
8) The material is, or relates to, a report for use by an agency responsible for overseeing financial institutions; and
9) The record contains geological and geophysical information, including maps, concerning wells.

In addition to these general exemptions, subsection (c) of the FOIA contains three specific law-enforcement exclusions.

Subsection (d) of the FOIA makes clear that the Act was not intended to authorize any new withholding of information, including from Congress. While individual Members of Congress possess merely the same rights of access as those guaranteed to "any person" under paragraph (a)(3), Congress as a body (or through its committees and subcommittees) cannot be denied access to information on the grounds of FOIA exemptions.

V. The Privacy Act

The Privacy Act of 1974, enacted in the aftermath of Watergate, preceded the enactment of section 6103. It was intended to regulate the collection, maintenance and disclosure of information about individuals by government agencies. In summary, the Privacy Act:

- Permits an individual to have access to records containing personal information on him for purposes of inspection, copying, and, with certain exceptions including tax records, correction;
- Makes known to the American public the existence and characteristics of all "systems of records" of Federal agencies containing information about individuals;
- Limits availability of records containing personal information to agency employees who need to access them in the performance of their duties;
- Requires agencies to keep an accurate accounting of disclosures and make such an accounting available to the individual;

- Requires agencies to publish in the Federal Register the routine disclosures that are made of their information outside of the agency ("routine uses") and establish procedures for access;
- Provides a civil remedy for individuals who have been denied access to their records or whose records have been used or disclosed in contravention of the Act.

Principles found in the Privacy Act form an important foundation of section 6103. One important, but not immediately obvious, principle is that agencies are only to collect information they need to perform an agency function.[55] Another important principle is that information is to be used by agencies consistent with the purpose for which it was collected.

In order to come within the Privacy Act's restrictions, the information must be a "record" contained within a "system of records." A "record" is any information about an individual (not to include a corporation, partnership, or other entity) maintained by the agency that contains the individual's name or other identifying particular, such as a social security number.[56] A "system of records" is a group of records from which information is retrieved by the individual's name or identifying particular.[57] As can be expected, many of IRS's systems of records contain tax returns and return information protected by section 6103.[58]

The Privacy Act prohibits the disclosure by agencies of information about individuals without the consent of the individual involved unless the disclosures are within one or more statutory exceptions.[59] If an agency willfully or intentionally discloses information in violation of the Privacy Act, the affected individual may bring a civil action against the agency and may recover the actual damages (but not less than $1,000) sustained as a result of the failure to comply with the statute, as well as costs and reasonable attorney's fees.[60]

The Privacy Act, like the FOIA, contains a provision permitting an individual a right of access to information about themselves contained in an agency's system of records: "Each agency that maintains a system of records shall – upon request by any individual to gain access to his record or to any information pertaining to him which is contained in the system, permit him and upon his request, a person of his own choosing to accompany him, to review the record and have a copy made of all or any portion thereof in a form comprehensible to him, except that the agency may require the individual to furnish a written statement authorizing discussion of that individual's record in the accompanying person's presence."[61]

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[55] 5 U.S.C. § 552a(e)(1).

[56] 5 U.S.C. § 552a(a)(4).

[57] 5 U.S.C. § 552a(a)(5).

[58] The most recent comprehensive publication of the IRS's systems of records is at 63 F.R. 69716-69719 (contents) and 69842-69929 (December 17, 1998).

[59] *See* 5 U.S.C. § 552a(b).

[60] 5 U.S.C. § 552a(g).

[61] 5 U.S.C. § 552a(d)(1).

The Privacy Act provides individuals with a means of access similar to that of the FOIA. The statutes overlap, but not entirely. The FOIA is entirely an access statute; it permits "any person" to seek access to any "agency record" that is not subject to any of its nine exemptions or its three exclusions. By comparison, the Privacy Act permits *only* an "individual" to seek access to his *own* "record," and *only* if that record is maintained by the agency within a "system of records"– i.e., is retrieved by that individual requester's name or personal identifier – subject to twelve Privacy Act exemptions. Thus, the primary difference between the FOIA and the access provision of the Privacy Act is in the scope of information requestable under each statute.

An individual's right to access his own record maintained in a system of records must be determined under *both* the Privacy Act and the FOIA.[62] An individual is entitled to the maximum access permissible under either statute when it comes to his or her own records.

The Privacy Act also contains provisions: (1) requiring an agency to publish its systems of records in the Federal Register; (2) permitting an individual the right to amend records concerning himself that are erroneous; and (3) requiring accountings of records concerning an individual that are disclosed. The amendment provisions of the Privacy Act do not apply to records relating to the determination of tax.[63] In addition, section 6103 has specific provisions overriding the accounting provisions of the Privacy Act with respect to certain disclosures.[64]

As discussed above, the Privacy Act provides that information about an individual may be disclosed without the individual's consent only if it comes within one of twelve statutory exemptions. One of those exemptions is for disclosure pursuant to a "routine use" that is published in the Federal Register. A routine use is a disclosure outside the agency that is consistent with the purpose for which the information was collected. For all IRS systems of records containing returns and return information, a routine use for disclosures is any use authorized by section 6103.

The Privacy Act was amended by the Computer Matching and Privacy Protection Act of 1988[65] and again by the Computer Matching and Privacy Protection Amendments of 1990.[66] In general, these amendments place certain procedural requirements upon agencies engaged in computer matching programs, i.e., computerized comparisons of two or more automated systems of records for such purposes as verifying eligibility for benefit programs or recouping payments or delinquent debts under such programs.[67] The amendments also specify procedural due process rights of individuals with respect to whom such matches are made.[68] Most IRS matches,

[62] 5 U.S.C. § 552a(t). *See* H.R. Rep. No. 98-726, 98th Cong., 2d Sess., pt. 2, at 16-17 (1984); Internal Revenue Manual 1.3.13.3.9(3).

[63] Section 7852(e).

[64] Section 6103(p)(3)(A).

[65] Pub. L. No. 100-503.

[66] Pub. L. No. 101-508.

[67] *See* 5 U.S.C. § 552a(a)(8), (o).

[68] 5 U.S.C. § 552a(p).

e.g., those with state taxing authorities and others for tax administration purposes, are not included within the definition of a "matching program" for these purposes.[69]

[69] 5 U.S.C. § 552a(a)(8)(B)(iv).

Part Three – Issues Relating to the Confidentiality of Returns and Return Information

I. Introduction

This section examines first the policy of, and then specific issues relating to, the confidentiality of taxpayer information. Most of these issues arise in connection with the administration of section 6103. Treasury does not recommend that the Congress make any significant changes to either the policy or structure of section 6103, but, rather, offers recommendations designed to remedy specific issues. This section also offers recommendations regarding the interaction of section 6103 with both the FOIA and the Privacy Act as well as access to the working law of the IRS under section 6110.

II. Policy Underlying Section 6103

As discussed above, section 6103 grew out of a desire to protect return information from unfettered use by the President and various Federal agencies. Congress believed that not only did taxpayers have a reasonable expectation of privacy in the personal information they were asked to turn over to the IRS, but that such privacy protection was also an important component of continued voluntary compliance with the internal revenue laws.

The legislative history of section 6103 describes the policy concerns underlying the statute as follows:

> It has been stated that the IRS probably has more information about more people than any other agency in this country. Consequently, almost every other agency that has a need for information about U.S. citizens, therefore, logically seeks it from the IRS. However, in many cases, the Congress has not specifically considered whether the agencies which have access to tax information should have that access.
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> Questions have been raised and substantial controversy created as to whether the present extent of actual and potential disclosure of return and return information to other Federal and State agencies for nontax purposes breaches a reasonable expectation of privacy on the part of the American citizen with respect to such information. This, in turn, has raised the question of whether the public's reaction to this possible abuse of privacy would seriously impair the effectiveness of our country's very successful voluntary assessment system which is the mainstay of the Federal tax system.[70]

A. The Importance of Privacy

Technology now makes it possible for large amounts of data on individuals to be collected, stored, and widely disseminated with the push of a button. Consequently, privacy concerns are at the center of a national debate over what various entities – financial, medical, and governmental to name a few – can do with the vast amounts of information they maintain on

[70] S. Rep. No. 94-938, *supra* note 35, at 316-17.

individuals. The President, in his State of the Union Address, mentioned privacy as a major concern. Congress, for the first time, has created a caucus made up of House and Senate Members from both parties, and the Senate has formed a task force to focus on privacy issues. Recent legislation, supported by the Administration, seeks to protect the privacy of both medical records and financial records. Thus, the concerns about taxpayer privacy underlying section 6103 have been made even more important since 1976.

Some have argued that because much of the information available from the IRS is now fairly readily available from other sources, taxpayers' reasonable expectations of privacy have diminished and the law should, in effect, catch up.[71]

To the contrary, Treasury believes that the fact such information is available from other sources weighs in favor of obtaining it elsewhere and does not necessarily translate into a diminished desire on the part of taxpayers for the information they voluntarily submit to the IRS to be kept confidential *by the IRS*. Indeed, information in IRS's hands may well reveal more than the same or similar information available elsewhere, e.g., in many cases it may reveal the fact and nature of IRS's interest in a particular taxpayer.

Treasury continues to believe that, if IRS data is to be provided at all, the IRS should be the last stop – not the first – for information for purposes unrelated to tax administration.

B. The Relationship of Confidentiality to Voluntary Compliance

1. Confidentiality Promotes Compliance

Breaching the confidentiality of returns and return information can affect compliance in several ways. For example, the IRS determined that as a result of the institution of the refund offset program, some taxpayers changed their withholding (so that there would be no refund to offset) and a greater number of taxpayers stopped filing returns altogether.[72] Overtly tying tax reporting to needs-based government benefits may lead some individuals to underreport their income in order to qualify for such benefits, thus jeopardizing tax collections. Conversely, overtly tying tax reporting to the ability to qualify for loans, credit, etc., may lead some individuals to *over*report their income. In both cases, the integrity of data provided to the IRS by taxpayers is undermined, diminishing the utility of the data for the very purposes for which it was originally collected and ultimately disclosed. In addition to these specific effects on tax compliance, there is the more general issue of confidence in the tax system. Taxpayers who view the IRS as a resource for a variety of other interests will be less inclined to voluntarily turn over sensitive financial information out of a fear of where it might ultimately land.

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[71] *See* George Guttman, *The Confidentiality Statute Needs Rethinking*, Tax Notes at 322 (Jan. 17, 2000). This is particularly true, some assert, in the case of particular categories of information, such as a taxpayer's address or place of employment. *See* Letter from Roy Nix, Chief, Collections, Division of Program Operations, Office of Child Support Enforcement, to the Department of the Treasury (Nov. 15, 1999).

[72] Over the period 1985-1988, the IRS found that $719 million was lost due to an increase in nonfilers, accounting for $621 million of the total, and an increase in balance-due filers, accounting for the remaining $98 million. Over this same period, approximately $1.3 billion was offset from the same population. IRS Research Division, *The Impact of Nontax Refund Offsets on Voluntary Compliance* (Rev. 2/93), at 5-4.

2. Publicizing Names of Non-filers Would Not Improve Compliance

While keeping returns and return information confidential thus appears to have a positive impact on voluntary tax compliance, a related question is whether publication of the names of individuals who have *not* complied with the tax laws by filing a tax return similarly positively impacts compliance. As indicated by the historical discussion above, this debate is as old as the tax system itself. Treasury concurs with the JCT staff's analysis and recommendation in this regard *not* to publish the names of non-filers.[73] First, as the JCT staff points out, non-filers are not necessarily delinquent taxpayers – there may be a number of reasons for which no return is due. Although some states publish the names of delinquent taxpayers, none publishes the names of non-filers. Second, experience with comparable state programs is insufficient to warrant instituting such a program at the Federal level.[74] Third, the risk of inaccuracies and unnecessary embarrassment or other adverse consequences outweigh any possible benefits to be derived from such a program. Moreover, to the extent such inaccuracies erode taxpayers' confidence in the tax system, tax compliance could be *negatively* impacted. In short, the benefits to be derived from such a program are speculative at best and thus do not warrant this invasion of taxpayers' privacy.

Recommendation: Treasury strongly recommends against publishing the names of non-filers or delinquent taxpayers. The benefits to be derived from such a program are speculative at best and do not warrant taking the risk of inaccuracies or other adverse consequences that may undermine taxpayer confidence in the tax system.

3. Disclosure of Taxpayer Identity Information Related to Accepted Offers-in-Compromise

Section 6103(k)(1) permits disclosure of return information to the public to the extent necessary to permit inspection of accepted offers-in-compromise. Such information was available to the public prior to the 1976 revision of section 6103. The provision appears to have grown out of a concern that compromises might result from favoritism or undue influence.

Section 206 of TBOR 2000 would eliminate taxpayer identification numbers ("TINs") and street addresses from the information to be made public in connection with accepted offers-in-compromise, but would otherwise continue to permit taxpayers' identities to be disclosed under section 6103(k)(1). The reason given for this change is to protect the privacy of the individual. Treasury is concerned that the risk of mistaken identity where an individual in a particular city has a common name infringes upon the privacy of other taxpayers. In addition, disclosing the identity of taxpayers who compromise their tax liabilities with the IRS may discourage taxpayers from entering into such offers, thus decreasing revenue collection. The policy underlying section 6103(k)(1) appears to conflict with Treasury's policy of wishing to encourage taxpayers to make offers-in-compromise in appropriate circumstances. Thus, consistent with Treasury's other recommendations concerning publicity of taxpayer identity generally, Treasury does not believe taxpayer identity information should be made public in connection with accepted offers-in-compromise.

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[73] JCT Study at 230-40.

[74] *See* General Accounting Office, *Tax Administration: Few State and Local Governments Publicly Disclose Delinquent Taxpayers* (GAO/GGD-99-165, August 1999).

Congress should consider whether the reasons underlying the enactment of the predecessor of section 6103(k)(1) apply as strongly today. If not, repealing section 6103(k) may be appropriate. Alternatively, if section 6103(k)(1) is regarded as having continued importance, the public's interest in ensuring that compromises are not the result of favoritism or undue influence and in ensuring government accountability should be met without the invasion of privacy caused by disclosure of identifying information. This could be accomplished by either redacting all identifying information from the public reports and/or by discontinuing such inspection and making the information available to the appropriate tax-writing committees of Congress pursuant to section 6103(f).

Recommendation: Section 6103(k)(1) should be repealed and such information made available to the appropriate Congressional tax-writing committees. Alternatively, accepted offers-in-compromise should be publicized without taxpayer-identifying information.

4. Public Record Data/Publicity of Criminal Tax Cases

The question of whether return information continues to be protected by section 6103 once it is made public (e.g., in connection with a court proceeding or a notice of Federal tax lien) has been addressed by a number of courts with varying results. Some courts have held that, once tax information is in the public domain, it loses its section 6103 protection.[75] Others have held that, due to the absence of an explicit exception to section 6103 addressing the issue, information that has been made public nonetheless remains confidential in the hands of the IRS.[76] Still others have held that the question turns on the source of the information, i.e., the IRS may release otherwise confidential information if its immediate source is a public document.[77]

Treasury concurs with the analysis contained at pages 69-81 of the JCT Study and with the recommendation at pages 197-98 that "returns and return information properly made a part of public records, i.e., court records and lien filings, pursuant to Federal tax administration activities should not be protected by section 6103." A legislative clarification of this point would resolve a much-litigated legal dispute. Treasury would not, however, limit this to cases in which the return information was made public in connection with a tax administration activity. For example, if return information were made public as a result of a section 6103(i) order, it would similarly be appropriate to treat this information as no longer protected by section 6103.

In addition, Treasury believes that the disclosure rules should be liberalized as necessary to permit elaboration upon the facts that are contained in the public record with respect to criminal tax cases. Elaboration is necessary because frequently media will not publish stories relating to criminal tax cases because the public record data does not contain specific identifying information (such as home address, age, and occupation). As a result, IRS is unable to develop a comprehensive media strategy for publication in criminal tax cases comparable to other law enforcement agencies. This eviscerates the potential deterrent effect of publicizing criminal tax

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[75] *See, e.g., Lampert v. United States*, 854 F.2d 335 (9th Cir. 1988), *cert. denied*, 490 U.S. 1034 (1989).

[76] *See, e.g., Mallas v. United States*, 993 F.2d 1111 (4th Cir. 1993).

[77] *See, e.g., Thomas v. United States*, 890 F.2d 18, 21 (7th Cir. 1989); *Rice v. United States*, 166 F.3d 1088 (10th Cir. 1999), *cert. denied*, 120 S. Ct. 334 (1999).

cases. Moreover, the failure to release more complete identifying information can lead to cases of mistaken identity and embarrassment in cases where an individual shares the same name as another in the same city.

Treasury does not believe section 6103 and/or section 7431 should hamper the publicity of tax crimes relative to other crimes. This creates the impression that tax crimes are not serious offenses. Publicizing these crimes, on the other hand, could have a substantial deterrent effect and thus, in contrast to other disclosures of tax information, have a positive impact on taxpayer compliance. Accordingly, IRS should be able to issue press releases in criminal cases to supplement information in the public record.

Recommendation: Information reflected in returns and return information properly made a part of the public record should not be protected by section 6103. IRS should be authorized to issue press releases supplementing certain details in the public record regarding criminal tax cases to ensure that criminal tax enforcement is effectively publicized.

III. Interaction of Section 6103 with Other Statutes

A. Non-Title 26 Disclosure Provisions

Section 6103(a) provides, "Returns and return information shall be confidential [and shall not be disclosed] except as authorized by this title." Consistent with tenets of statutory construction, the IRS has long interpreted this provision to allow non-title 26 disclosure provisions to override section 6103 only if they explicitly state so.[78] Nonetheless, frequent disputes have arisen with other agencies regarding the legal significance of non-title 26 disclosure provisions. Section 201 of TBOR 2000 would attempt to address this issue by inserting "and notwithstanding any other provision of law" at the end of the quoted language.

Section 6103 was written by Congress specifically to govern the confidentiality of tax returns and other tax information. Under well-settled principles of statutory construction, this specific provision takes precedence over other Federal statutes of general application that give a

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[78] The 20-year dispute between the National Archives and Records Administration ("NARA") over whether tax information may be disclosed to NARA for records management and appraisal purposes under Title 44 highlights this point. While NARA's statute, Title 44, generally, requires Federal agencies to disclose records to NARA, section 6103 contained no such express disclosure authority. In RRA 1998, section 6103(l)(17) was added to the Code to specifically authorize disclosure of tax information to NARA for purposes of appraisal of tax records for retention or destruction. *See also* Treasury Inspector General for Tax Administration, Office of Audit, *The Internal Revenue Service's Individual Taxpayer Identification Number Program Was Not Implemented in Accordance with Internal Revenue Code Regulations* (Sept. 1999) (Ref. No. 094505) (highlighting the issue of the conflict between section 6103 and the Illegal Immigration Reform and Immigrant Responsibility Act of 1996, which states that information concerning illegal alien status should be provided to the Immigration and Naturalization Service *notwithstanding* any other law). Consistent with the above discussion, any attempt to reconcile these two statutes must include an amendment to, or explicit override of, section 6103.

right of access or require disclosure of agency records to other Federal and state agencies.[79] This is true whether the other statute was enacted before or after section 6103.

Although an explicit override of section 6103 may be possible (e.g., "Notwithstanding section 6103 of Title 26…"), Treasury recommends that all disclosure authority pertaining to return information be contained in Title 26. Permitting disclosure provisions outside of the Code is not consistent with the policy decisions made by Congress regarding the protection of returns and return information in the Tax Reform Act of 1976. The general rule of nondisclosure in section 6103(a) is clearly the centerpiece of the protections afforded tax information, but, as discussed above, there are other critical pieces of the statutory scheme. The civil and criminal penalties for unauthorized inspection or disclosure of return information found in sections 7431, 7213, and 7213A and the recordkeeping, reporting, and safeguarding requirements of section 6103 do not apply to provisions outside of the Code. Provisions outside of the Code thus potentially avoid the panoply of protections intended to apply to sensitive and confidential tax information. Moreover, amendments to the Code are more likely to be weighed by committees of Congress having jurisdiction over the internal revenue laws, as generally amendments affecting the Code are reviewed by the Senate Finance Committee and House Ways and Means Committee. Providing disclosure authority outside of the Code also creates confusion as to the law.

Recommendation: It should be clarified that section 6103 preempts any law outside of Title 26 that would otherwise authorize the disclosure of returns or return information, unless such other law explicitly overrides section 6103.[80]

B. Application of the FOIA to Returns and Return Information

A number of courts have addressed the relationship between section 6103 and the FOIA. Most courts that have addressed the issue have treated section 6103 as a FOIA exemption 3 statute.[81] Exemption 3 of the FOIA provides that the FOIA does not apply to matters that are:

> Specifically exempted from disclosure by statute (other than section 552b of this title), provided that such statute (A) requires that the matters be withheld from the public in such a manner as to leave no discretion on the issue, or (B) establishes particular criteria for withholding or refers to particular types of matters to be withheld.[82]

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[79] *See Edmond v. United States*, 520 U.S. 651, 657 (1997); *Busic v. United States*, 446 U.S. 398, 406 (1980); *Preiser v. Rodriguez*, 411 U.S. 475, 489-90 (1973).

[80] Certain conforming changes to the Code may be necessary as a result of this preemption for those few discrete provisions outside of the Code that currently permit the disclosure of tax information. *See, e.g.*, 42 U.S.C. § 432 (disclosure of tax information to SSA necessary to facilitate combined annual wage reporting, i.e., W-2 reporting), 8 U.S.C. § 1645 (disclosure of quarters of coverage information to welfare agencies).

[81] *See, e.g.*, *Church of Scientology v. IRS*, 484 U.S. 9 (1987) (parties agreed, court did not decide issue); *Tax Analysts v. IRS*, 117 F.3d 607, 611 (D.C. Cir. 1997) ("That § 6103 is the sort of nondisclosure statute contemplated by FOIA exemption 3 is beyond dispute.").

[82] 5 U.S.C. § 552(b)(3).

Under this approach, a person who is not entitled to information pursuant to section 6103 will not be provided such information pursuant to the FOIA because it is exempt from disclosure pursuant to exemption 3.

A few courts, on the other hand, have held that section 6103 preempts FOIA with respect to access to returns and return information.[83] The principle significance of one approach versus the other is that determinations under section 6103 are subject to a deferential "abuse of discretion" review standard under the Administrative Procedure Act, while FOIA determinations are subject to de novo review. In addition, the FOIA includes certain procedural requirements not found in section 6103, such as time limits for responses and the duty to segregate and release non-exempt portions of documents.

Following the recommendation of the JCT Study,[84] section 201 of TBOR 2000 would clarify that section 6103 preempts the FOIA with respect to access to returns and return information. The justification for this separate right of access appears to be that section 6103, with its emphasis on confidentiality, and the FOIA, with its emphasis on disclosure, cannot be harmonized. Moreover, the type of information that is confidential under section 6103 generally is not the same as that intended to be brought to light by the FOIA.

Section 201 of TBOR 2000 also creates a separate right of action, wholly outside of and parallel to the FOIA, for persons described in section 6103(c), (e), (k)(1), and (k)(2) to request returns and return information. Procedures similar to those found in FOIA would apply, and denials would be subject to de novo review.

As discussed above, Treasury agrees that it should be clarified that the confidentiality provisions in section 6103 preempt any disclosure authority found in other provisions of the United State Code that purport to give other agencies or persons access to tax information. However, Treasury has concerns about section 201 of TBOR 2000 insofar as it, in effect, places IRS outside of the FOIA for requests for tax information. The proposal creates unnecessary dual tracks for the processing of information and potential confusion for the public and the agency. Insofar as section 6103 otherwise preempts the FOIA, there does not appear to be *any* available procedure for a person requesting return information that does not fall into the category of section 6103(c), (e), (k)(1), or (k)(2). This has caused the publisher Tax Analysts to question whether it will effectively be precluded from seeking access to any information that the IRS categorizes as return information.[85] Treasury believes that this result is undesirable and unnecessary.

Moreover, Treasury believes that the FOIA and 6103, through exemption 3, can and do work effectively together. The court described how the FOIA and section 6103 can be harmonized in *Church of Scientology of California v. IRS*:

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[83] *See, e.g., Zale Corp. v. IRS*, 481 F. Supp. 486 (D.D.C. 1979) (which was later repudiated by its own Circuit Court of Appeals in *Scientology*); *White v. IRS*, 707 F.2d 897 (6th Cir. 1983); *King v. IRS*, 688 F.2d 488 (7th Cir. 1982).

[84] *See pp.* 93-96, 200-01.

[85] *See* Sheryl Stratton, *TBOR 2000 Disclosure Provisions May Do Less Than Promised*, Tax Notes 465, 466 (April 24, 2000).

> From what has been said, it should be clear that we do not share Zale's concern over our "duty to reconcile" FOIA and § 6103 … or over preventing FOIA from "negat[ing], supersed[ing], or otherwise frustrat[ing] the clear purpose and structure of § 6103 … The two statutes seem to us entirely harmonious; indeed they seem to us quite literally made for each other: Section 6103 prohibits the disclosure of certain IRS information …. FOIA, which requires all agencies, including the IRS, to provide nonexempt information to the public, establishes the procedures the IRS must follow in asserting the § 6103 (or any other) exemption. … . [W]e hold … that Section 6103 does not supersede FOIA but rather gives rise to an exemption under Exemption 3 … .[86]

Treasury thus believes that the principle that section 6103 is an exemption 3 statute should be codified to avoid further litigation or uncertainty over the issue and to ensure the consistent administration of section 6103 as it relates to the FOIA and vice versa. In addition, consistent with the principle that all disclosure authority should reside in Title 26, section 6103 should be amended to expressly permit disclosure of tax information to the taxpayer, the taxpayer's representative, or the taxpayer's designee, pursuant to a FOIA request. Thus, if a taxpayer, the taxpayer's attorney, or the taxpayer's designee pursuant to consent, makes a request under the FOIA, the taxpayer's own tax information can be disclosed pursuant to the FOIA subject to any conditions imposed by section 6103, such as the need for a determination that such disclosure would not seriously impair tax administration.[87] Moreover, this would not affect the taxpayer's right to get information independently under section 6103 without submitting a properly constituted FOIA request. In the event of litigation under the FOIA by a member of the public not authorized by section 6103 to receive return information, the court should be able to make an in camera inspection to determine whether any document either consists of return information in its entirety, and thus is exempt from disclosure, or contains return information that can be redacted and disclosed.

Recommendation: Section 6103 should be amended to explicitly indicate that section 6103 is an exemption 3 statute under the FOIA and that the FOIA is not one of the laws preempted by section 6103. Section 6103 should also be amended to expressly permit disclosure of tax information to the taxpayer, the taxpayer's representative, or the taxpayer's designee, pursuant to a FOIA request. Finally, in the case of FOIA litigation involving a member of the public who is not authorized by section 6103 to receive return information, the court should be expressly permitted to make an in camera inspection to determine whether a document either consists of or contains return information. IRS should also have explicit authority to disclose such information to the Justice Department in connection with such cases.

C. Application of the Privacy Act to Returns and Return Information

The JCT staff recommended "that it should be clarified that sections 6103 and 7431 preempt the Privacy Act with respect to the disclosure of returns and return information and the remedy for unauthorized disclosures."[88] Treasury supports this recommendation.

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[86] 792 F.2d 146 (D.C. Cir. 1986), *aff'd on other grounds*, 484 U.S. 9 (1987).

[87] *See* section 6103(c), (e).

[88] JCT Study at 204.

Several courts of appeals have reached the conclusion that the Privacy Act is preempted by section 6103 when individuals seek access to tax returns and return information. The Court of Appeals for the D.C. Circuit held in *Lake v. Rubin*[89] that "individuals seeking 'return information' …must do so pursuant to section 6103 of the Internal Revenue Code, rather than the Privacy Act." In so holding, the D.C. Circuit cited with approval the opinion of the Court of Appeals for the Seventh Circuit in *Cheek v. IRS*.[90] Both courts of appeals noted that the more specific and comprehensive treatment of tax returns and return information in section 6103, which was amended in 1976, indicated that Congress had intended for that provision to preempt the more general provisions of the Privacy Act of 1974.[91]

Recently, the D.C. Circuit Court of Appeals reached a similar conclusion in the context of a damages action for wrongful disclosure of return information. In *Gardner v. United States*,[92] the court found that the Code preempts the Privacy Act with respect to remedies for disclosure of tax information and held that section 6103 "is the exclusive remedy for a taxpayer claiming unlawful disclosure of his or her tax returns and tax information." The court cited its earlier decision in *Lake* as well as *Cheek* and the recent case of *Hobbs v. U.S.*[93] In *Hobbs*, the Fifth Circuit held that the damages portion of the Privacy Act, as it relates to remedying unauthorized disclosures of tax returns and return information, is preempted by the civil remedy provision of section 7431 to the extent there is a conflict between them. The court observed:

> Here . . . there is a present conflict. Although the Privacy Act and §7431 create damages actions for unauthorized disclosures, only §6103 provides for a variety of tax-return-specific exceptions to the general confidentiality rule. . . . To the extent the Privacy Act would recognize a cause of action for unauthorized disclosure of tax return information even where §6103 would provide an exception for the particular disclosure, §6103 trumps the Privacy Act.

The *Hobbs* court cited *Sinicki v. U.S. Dept. of Treasury*,[94] for the proposition that "[s]ection 6103 should only implicitly repeal the Privacy Act to the extent it presents an irreconcilable conflict." *Sinicki* found that "the language, structure, purpose and legislative history of Section 6103 do not make manifest and clear a legislative intent to repeal the Privacy Act as it applies to tax return information."

Thus, although the majority of courts that have addressed the issue have concluded that section 6103 and the remedy provisions of section 7431 do preempt the Privacy Act with respect to returns and return information, an explicit legislative clarification would be helpful to avoid future conflict.

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[89] 62 F.3d 113 (D.C. Cir. 1998), *cert. denied*, 526 U.S. 1070 (1999).

[90] 703 F.2d 271 (7th Cir. 1983).

[91] *See Lake, supra* note 89, at 115-16; *Cheek, supra* note 90, at 271.

[92] 213 F.3d 735 (D.C. Cir. 2000).

[93] 209 F.3d 408 (5th Cir. 2000).

[94] No. 97 Civ 0901, 1998 U.S. Dist. Lexis 2015 (S.D.N.Y. Feb 24, 1998).

Recommendation: Sections 6103 and 7431 should be amended to explicitly state that they preempt the Privacy Act with respect to the disclosure of returns and return information and the remedy for unauthorized disclosures.

IV. Disclosures Related to Tax Administration

Section 6103 contains a number of exceptions permitting disclosures related to tax administration.

A. Definition of Tax Administration

Section 6103(b)(4) defines tax administration as:

> (i) the administration, management, conduct, direction and supervision of the execution and application of the internal revenue laws or related statutes (or equivalent laws and statutes of a state) and tax conventions to which the United States is a party, and
>
> (ii) the development and formulation of Federal tax policy relating to existing or proposed internal revenue laws, related statutes, and tax conventions, [including] assessment, collection, enforcement, litigation, publication and statistical gathering functions under such laws, statutes, or conventions.

This definition is critical to the basic premise of section 6103. Broader disclosure of returns and return information for tax administration purposes is permitted to, for example, IRS, Treasury, and Justice Department employees, because such use is consistent with the purpose for which the information was collected. The disclosure of returns and return information for purposes other than tax administration is more strictly limited because such disclosures are not consistent with the purpose for which the information was collected, and, as noted above, because of the potential detrimental effect on compliance with the internal revenue laws.

As discussed below, two provisions of section 6103 relate to specific disclosures for tax administration purposes: section 6103(h) and section 6103(k).

B. Section 6103(h) Disclosures

1. Disclosures to Officers or Employees of the Department of the Treasury

a) Inspection of Taxpayer Representatives' Returns

Section 6103(h)(1) authorizes the disclosure of returns or return information to officers and employees of the Treasury Department for tax administration purposes. In a 1999 Chief Counsel Advice memorandum, the Office of the Assistant Chief Counsel (Disclosure Litigation) opined that the IRS was authorized by section 6103(h)(1) to access the Integrated Data Retrieval System (IDRS) to ascertain whether practitioners who submit Form 2848, Power of Attorney and Declaration of Representative, are current in their Federal income tax obligations.[95]

Under Section 204 of TBOR 2000, section 6103(h) would be amended to provide that the return of a representative of a taxpayer whose return is under examination by an officer or employee of Treasury cannot be inspected or disclosed to such officer or employee solely on the

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[95] Internal Revenue Service National Office Chief Counsel Advice No. 199941038 (Aug. 19, 1999).

basis of the representative's relationship to the taxpayer unless the officer or employee's supervisor approves such inspection or disclosure on another basis.[96]

Recommendation: Treasury supports section 204 of TBOR 2000.

2. Disclosures to Justice Department and in Connection with Tax Proceedings

a) Disclosures to Justice Department

28 U.S.C. § 516 provides that, except as otherwise permitted by law, the Justice Department represents the United States in all United States courts. Thus, the Justice Department represents the IRS in Federal tax matters in the district courts, bankruptcy courts, the Court of Federal Claims, state courts, Federal courts of appeals, and the Supreme Court. Section 6103(h)(2) and (3) provides the mechanism for the Justice Department to obtain tax information for these civil and criminal tax matters. Section 6103(h)(2) describes what information can be disclosed, and for what purposes. Section 6103(h)(3) contains procedural prerequisites for disclosure.

In a matter involving tax administration, section 6103(h)(2) provides that certain tax data may be disclosed to the Justice Department for use in: (1) any proceeding before a Federal grand jury; (2) preparation for any proceeding before a Federal grand jury or Federal or state court; or (3) an investigation which may result in such a proceeding before a Federal grand jury or any Federal or state court. Section 6103(h)(2) also prescribes what type of information may be disclosed, or, more precisely, whose tax information may be disclosed. That is, tax information can be disclosed to the Justice Department in a matter involving tax administration if:

> (A) the taxpayer is or may be a party to the proceeding, or the proceeding arose out of, or in connection with, determining the taxpayer's civil or criminal liability, or the collection of such civil liability in respect of any tax imposed under [Title 26];
>
> (B) the treatment of an item reflected on a return is or may be related to the resolution of an issue in the proceeding or investigation [the "item test"]; or
>
> (C) such return or return information relates or may relate to a transactional relationship between a person who is or may be a party to the proceeding and the taxpayer which affects, or may affect, the resolution of an issue in the proceeding or investigation [the "transaction test"].

Section 6103(h)(2) recognizes the need of the Justice Department to access tax information in carrying out its responsibilities in the civil and criminal tax arena. Congress therefore permitted the disclosure of tax information of the taxpayer whose liability is at issue or whose liability gave rise to the case. Recognizing, however, the sensitivity of and privacy issues involved in disclosing the tax information of persons who were not involved in the proceeding, Congress imposed restrictions on the disclosure of third party tax information.

The legislative history indicates that only those portions of the third party's return or return information that reflect the item or transaction should be disclosed to the Justice

[96] *See* JCT Study at 206.

Department.[97] Further, returns and return information of unrelated but similarly situated third party taxpayers (e.g., "third party comparables") cannot be disclosed to a Justice Department officer or employee because neither the item nor the transaction test can be met.[98] This is discussed in more detail below.

b) Disclosures of Third-Party Tax Data in Judicial or Administrative Proceedings

(1) In General

Section 6103(h)(4) permits the disclosure of a return or return information in a Federal or state judicial or administrative proceeding pertaining to tax administration in circumstances that parallel, but are stricter than, disclosures to the Justice Department under section 6103(h)(2)):

> (A) if the taxpayer is a party to the proceeding, or the proceeding arose out of, or in connection with, determining the taxpayer's civil or criminal liability, or the collection of such civil liability, in respect of any tax imposed under [Title 26];[99]
>
> (B) if the treatment of an item reflected on such return is directly related to the resolution of an issue in the proceeding;
>
> (C) if such return or return information directly relates to a transactional relationship between a person who is a party to the proceeding and the taxpayer which directly affects the resolution of an issue in the proceeding; or
>
> (D) to the extent required by order of a court pursuant to section 3500 of title 18, United States Code, or rule 16 of the Federal Rules of Criminal Procedure, such court being authorized in the issuance of such order to give due consideration to congressional policy favoring the confidentiality of returns and return information as set forth in [Title 26].

Thus, for most purposes, third-party returns or return information can only be disclosed if they meet the tests set forth in either (B) (the "item test") or (C) (the "transaction test") above.

In enacting section 6103(h)(4), Congress indicated it wanted to limit the circumstances under which third-party returns or return information could be disclosed.[100] The legislative history of sections 6103(h)(2)(B) and (C) (discussed above) explains the intended scope and application of the "item" and "transaction" tests and provides the following examples:

(a) Item Test

The legislative history contains the following discussion of the item test:

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[97] *See* S. Rep. No. 94-938, *supra* note 35, at 326.

[98] *Id.* at 325-26.

[99] The latter part of section 6103(h)(4)(A), as well as similar language in section 6103(h)(2)(A), were added at the suggestion of the Justice Department, because there was some uncertainty that the item and transactional relationship tests were broad enough to cover disclosures in summons enforcement proceedings (where the taxpayer was not a party), and nominee and transferee liability cases.

[100] S. Rep. No. 94-938, *supra* note 35, at 325-26.

The return or return information of a third party would be disclosed …in the event that the treatment of an item reflected on his [i.e., the third party's] return is or may be relevant to the resolution of an issue of the taxpayer's liability under the Code. Thus, for example, the returns of subchapter S corporations, partnerships, estates, and trusts may reflect the treatment of certain items which may be relevant to the resolution of the taxpayer's liability because of some relationship (*i.e.*, shareholder, partner, beneficiary) of the taxpayer with the corporation, partnership, estate, or trust.

In cases involving the assessment of a penalty upon a person for failure to pay over withholding taxes, the reflection of such items on a corporate return as wages paid, taxes withheld, and the corporate office held by the person, may be relevant to the resolution of the issue of liability for the penalty.

The treatment (or absence of treatment) of alleged loans and gifts on a return may also be relevant to the resolution of the issue in criminal fraud net worth cases.[101]

(b) Transaction Test

The legislative history illustrates the intended operation of the "transaction" test as follows:

The return or return information of a third party would also be disclosed …where the third party's return or return information relates or may relate to a transaction between the third party and the taxpayer whose tax liability is or may be at issue and the [third party's] return information pertaining to that transaction may affect the resolution of an issue of the taxpayer's liability. For example, the treatment on a buyer's return regarding his purchase of a business would be relevant to the seller's tax liability resulting from the sale of the business. The buyer may be amortizing what he claims to be a covenant not to compete, whereas the seller may be claiming capital gain treatment upon the alleged sale of "goodwill."[102]

(c) Examples of Situations Meeting Neither Test

The legislative history also provides examples of situations not meeting the item or transaction test:

The return reflecting the compensation paid to an individual by an employer other than the taxpayer whose liability is at issue would not meet either the item or transaction tests described above in a reasonable compensation case. Thus, for example, the reflection on a corporate return of the compensation paid its president would not represent an item the treatment of which was relevant to the liability on an unrelated corporation with respect to the deduction it claims for the salary it paid its president.

In section 482 cases (involving the reallocation of profits and losses among related companies), where it is sometimes necessary to determine the prices paid for certain services and products at arms-length between unrelated companies, the

[101] *Id.* at 325.

[102] *Id.*

> return or return information of a company which was unrelated to the taxpayer company would not be disclosable under either the item or transaction tests described above.
>
> …[T]he return of a third-party witness could not be introduced in a tax proceeding for purposes of discrediting that witness except on the item and transaction grounds stated above.[103]

(2) Uses of Third-Party Data in Judicial Proceedings

According to the Justice Department, the following are examples of the myriad circumstances in which third-party data may properly be disclosed during the course of a judicial tax administration proceeding.

In criminal tax prosecutions, the Justice Department may need to disclose tax information of a person who is not a party to the proceeding in the following contexts:

- return preparer prosecutions under 26 U.S.C. § 7206(2) (returns of individuals named in the various counts of the indictment)[104]
- prosecution of an officer or director of a corporation for tax evasion, failure to file, false statement, offenses regarding collected taxes, or conspiracy under 26 U.S.C. §§ 7201, 7203, 7206, and 7215, and 18 U.S.C. § 371 (the Justice Department typically prosecutes corporate officials rather than corporations for tax offenses so that the corporation, whose returns are directly related to the prosecution, is not ordinarily a defendant)
- prosecution of a tax shelter promoter under 26 U.S.C. § 7206 and/or 18 U.S.C. § 371 (the partnership (if a partnership entity was used) and the investors would not be defendants but their returns would be directly related to the issue)

In civil tax cases, the Justice Department may need to disclose tax information of a person whose tax liability gave rise to the litigation but who is not a party to the proceeding in the following contexts:

- interpleader cases (the taxpayer has or may have an interest in a fund deposited with the court, but is not a party to the proceeding)
- failure to honor a levy (suits against a person who has been served with a levy and holds property in which the taxpayer has an interest; the taxpayer is not a party to such proceedings)
- Section 3505 suits (suits to hold third parties liable for withholding taxes when they financed the payment of wages knowing that the taxpayer would not pay the withheld taxes; the taxpayer is not a party to such proceedings)
- Section 6672 suits (the corporation is not a party to these proceedings; some of the responsible persons may not be parties)

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[103] *Id.* at 325-26.

[104] The Justice Department advises that the indictment in one recent tax return preparer case charged violations relating to 69 separate returns and amended returns filed by 25 individuals, and another indictment charged offenses relating to 84 returns or amended returns filed by 14 individuals.

- fraudulent conveyance (the taxpayer is often not a party to a suit seeking a determination that a conveyance is fraudulent)
- transferee liability (same)
- nominee liens (same)
- ex parte proceedings for securing a search warrant
- orders for entry on premises
- orders for entry to safe deposit boxes

In civil tax cases, the Justice Department may also need to disclose tax information of a person who is not a party to the proceeding in the following contexts:

- return preparer penalty cases
- abusive tax shelter promoter penalty cases
- aiding and abetting tax understatement penalty cases
- suits to enjoin income tax return preparers
- suits to enjoin promoters of abusive tax shelters
- alimony disputes
- dependency exemption cases
- allocation of purchase (or selling) price to tangible and intangible assets, including covenants not to compete
- characterization of payments to corporate officers' as salary versus dividends
- joint return situations where only one party brings suit
- employee-independent contractor cases
- partnership income tax liability
- suits to collect partnership employment taxes from partners
- Subchapter S corporation cases
- liability of an individual attributable to, or derived from, an estate or trust

As is evident from the list above, there are numerous circumstances in which third-party tax data may be necessary to the case.

(3) Disclosure of Unrelated Third Party Information – *Bristol-Myers & Shell Petroleum*

Although the previous section indicates that there are numerous instances where the disclosure of third-party returns or return information may be necessary to a judicial tax proceeding, in general, case law has narrowly construed section 6103(h)(4).[105] However, two

[105] *See LeBaron v. United States*, 794 F. Supp. 947 (C.D. Cal. 1992) (parishioner/church); *Tavery v. United States*, 32 F. 3d 1423 (10th Cir. 1994), *aff'g* 1991 U.S. Dist. LEXIS 15592 (D. Colo. Oct. 18,1991) (husband/wife); *Mindell v. United States*, 693 F. Supp. 847 (C.D. Cal. 1988) (return preparer/client); *Christoph v. United States*, 1995 U.S. Dist. LEXIS 1997, 77 A.F.T.R.2d (RIA) 809 (S.D. Ga. 1995) (husband/wife); *Guarantee Mut. Life Ins. Co. v. United States*, 78-2 U.S. Tax Cas. (CCH) ¶ 9728, 42 A.F.T.R.2d (RIA) 5915 (D. Neb. 1978) (employer/employee); *Cory Pools v. United States*, 213 Ct. Cl. 751 (1977) (employer/employee); *L.A.S. Enterprises, Inc. v. United States*, 213 Ct. Cl. 698 (1977) (employer/employee); *Estate of Stein v. United States*, 81-1 U.S. Tax Cas. (CCH) ¶ 13405, 47 A.F.T.R.2d (RIA) 1311 (D. Neb. 1981) (donor/donee); *First W. Gov't Sec. v. United States*, 578 F. Supp. 212 (D. Colo. 1984), *aff'd*, 796

recent orders, one in district court and one in the Court of Federal Claims, cast doubt on the principle that only related third party tax information can be disclosed in a judicial proceeding.

Bristol-Myers Barceloneta, Inc. et al. v. United States,[106] involves the issues of (1) whether the plaintiffs were entitled to change their tax years through the automatic approval process provided by Rev. Proc. 92-13 and (2) whether the IRS's refusal to allow the plaintiffs to automatically change their tax year constituted disparate treatment based on the judicial principles enunciated in *I.B.M. v. United States*.[107]

In its discovery requests, Bristol-Myers sought to obtain returns and return information concerning unrelated third party taxpayers that are section 936 corporations and have changed their tax year during the prescribed time period. The Justice Department filed a motion for protective order on the grounds that the defendant is barred from disclosing third party taxpayer information pursuant to section 6103. The United States District Court for the District of Puerto Rico entered an order denying the defendant's motion for protective order. The defendant filed a motion for reconsideration of the court's order and the court again denied the defendant's motion for reconsideration. Consequently, the IRS was required to produce the returns and return information of the unrelated third party taxpayers.

While the basis for the court's decision was not stated, the court apparently relied on *IBM v. United States*[108] as support for the disclosure. The IBM case involved what was then the only two competitors in a small industry. Remington Rand received a favorable PLR with regard to an excise tax issue. IBM also applied for a favorable ruling and was denied. While the IRS also revoked Remington Rand's ruling, it did not do so retroactively. IBM sued for a refund for those years in which Remington Rand's favorable ruling was in effect. The court held that the IRS had abused its discretion under section 7805(b) in not granting retroactive relief to IBM, and that the IRS could not ultimately give different tax treatment to taxpayers having substantially the same facts, and held IBM was entitled to the refund.

On its face, *IBM* stands for the unremarkable proposition that the IRS should not treat similarly situated taxpayers that apply for private letter rulings differently. However, disclosure of third-party tax information was not an issue in that case, and the case was decided before the Tax Reform Act of 1976. The *Bristol-Myers* court appears to have disregarded the language and legislative history of section 6103(h)(4) as well as the majority of case law on this point. If a

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F.2d 356 (10th Cir. 1986) (shelter promoter/investors); *Davidson v. Brady*, 559 F. Supp. 456 (W.D. Mich. 1983), *aff'd on other grounds*, 732 F.2d 552 (6th Cir. 1984) (borrower/lender); *Nevins v. United States*, 88-1 U.S. Tax Cas. (CCH) ¶ 9199, 71A A.F.T.R.2d (RIA) ¶ 93-3023 (D. Kan. 1987) (individuals arrested together for purchasing marijuana). One of the few cases in which unrelated third party tax information was permitted to be disclosed was *Beresford v. United States*, 123 F.R.D. 232, 89-1 U.S. Tax Cas. (CCH) ¶ 9166, 63 A.F.T.R.2d (RIA) 990 (E.D. Mich. 1988) (select portions of third party tax data that IRS had relied upon in its valuation of taxpayer/party's stock, which valuation was squarely at issue in the taxpayer/party's tax refund suit, satisfied the requirements of section 6104(h)(4)(B)).

[106] Civil No. 97-2567CC (D. P.R.).

[107] 343 F.2d 914 (Ct. Cl. 1965), *cert. denied*, 382 U.S. 1028 (1966).

[108] *Id.*

claim of disparate treatment is sufficient to require the disclosure of third-party return information, the ramifications for taxpayer privacy could be significant.

Shell Petroleum, Inc. v. United States[109] involves a refund claim by Shell based on entitlement to the section 29 credit for production of oil from tar sands. In discovery, Shell requested that the IRS produce the section 43 certificates of third parties, in order to compare production methods. One of the requirements for the section 29 credit is that the technology not have been widely available in 1980. Shell seeks the section 43 certifications to inferentially support its assertion that the cyclic steam or steam drive technology it used was not used by anyone else in the industry and was thus not widely available. In the first opinion, the Court of Federal Claims ordered the government to produce, for in camera inspection, the section 43 certifications of the unrelated third party taxpayers, finding that the question of whether the technology was widely available "necessarily involved an analysis of the technology used by other companies, including Shell's competitors." The court found that section 6103(h)(4)(B) justified the disclosure, finding that the certificates "directly related" to proving Shell's case.

In response to the order, the government filed a motion for reconsideration. In its motion, the government cited the legislative history noted above, which clearly indicates that the provisions of section 6103(h)(4)(B) and (C) do not permit the disclosure of unrelated third party tax information. The Court of Federal Claims issued its second opinion on September 21, 2000. The court ruled in favor of Shell and ordered production of the certificates to the court for in camera inspection.

In finding against the government, the court stated:[110]

> Although the Court is not prepared to say that Congress intended to permit the disclosure of any and all tax return information that would be admissible evidence at trial, the Court does find that the standard of admissibility in the Federal Rules of Evidence serves as a helpful guide in understanding the meaning of the phrase, "directly related."

Thus, the court interpreted "directly related" as a concept akin to admissibility, without regard to whether there was any relationship between the parties. It is clear from the legislative history discussed above, however, that the item test was designed to permit disclosures based on some relationship or dealings – shareholder, partner beneficiary, lender, donor.[111]

Further, in addressing the legislative history that specifically noted that unrelated third party data would not be disclosed in the context of an unreasonable compensation case, the court held:

> It is surely correct that X corporation's deduction for salary is not, by itself, relevant as to whether Y corporation's compensation is reasonable. However, a sample of deductions for corporate salaries within Y's industry would be highly relevant as to whether Y's corporate compensation was reasonable …. Nowhere did Congress contemplate that a sample of tax return information from third

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[109] No. 97-945 T (Fed. Cl.).

[110] Slip opinion at 10.

[111] See S. Rep. No. 94-938, *supra* note 35.

parties containing items that are directly related in nature to a taxpayer's item at issue would be outside the scope of the exception of Section 6103(h)(4)(B). [112]

These two cases, *Bristol-Myers* and *Shell*, are troublesome in that they reflect a basic misunderstanding of the purpose of section 6103(h)(4) and the third party privacy interests these provisions were designed to protect.

In response to the order in *Bristol-Myers*, section 205 of TBOR 2000 would require that when nonparty returns and return information are to be disclosed under section 6103(h)(4)(B) or (C) (whether in an administrative or judicial proceeding), the nonparty taxpayer should be given notice prior to the disclosure and an opportunity to participate in the redaction process. Treasury does not believe this is the correct approach to dealing with the issue presented, nor does Treasury believe this is necessary in the situations to which section 6103(h)(4) was intended to apply. Treasury recommends that the item test be clarified to indicate that the treatment of the item must be directly related to the resolution of an issue in the proceeding due to the operation of the Code or some relationship between the parties. This would encompass those situations in which the item test has traditionally been applied, for example, the pass-through of partnership items to partners, the taxation of trust income to trust beneficiaries, or the treatment of gifts or loans on tax returns. Thus, the provision would not apply to similarly situated but completely unrelated taxpayers (such as in a case involving disparate treatment issues).

The TBOR 2000 solution, interjecting a notice and redaction procedure in every administrative or judicial proceeding in which third party tax data may be introduced, will impose a significant burden on the IRS and the Justice Department and cause significant delay in judicial and administrative proceedings. Further, and potentially more serious, it could be interpreted as implicitly condoning the disclosure of unrelated third party tax information under the item test, a result that Treasury believes poses serious privacy issues.

In addition, although Treasury does not believe the disclosure of unrelated third party tax information should be permitted where disparate treatment is alleged, if it is determined that such third-party disclosures should be allowed, the statute should be specifically amended to permit disclosures in these situations. Such disclosures should be predicated on a prima facie showing of disparate treatment by the taxpayer. Moreover, if the statute is specifically amended to permit disclosures in disparate treatment situations, the unrelated third parties should be notified by the IRS and given a statutory right of intervention to protect fully their privacy and/or proprietary interests. Absent a statutory grant of the right to intervene, whether a third party is permitted to intervene rests with the discretion of the trial judge. Without the right to intervene, these unrelated third party taxpayers are inadequately armed with the tools to protect their interests. In *Bristol Myers*, after the IRS decided to notify the third party taxpayers of the court-ordered disclosure of their tax information, the district court judge denied various third party taxpayers' motions to intervene in the discovery dispute.

It should also be noted that section 6103(h)(4) permits state tax agencies to disclose return information in their judicial and administrative tax proceedings. Section 205 of TBOR 2000, as currently drafted, would place the burden of notification on the Secretary even in state tax cases. If this provision is enacted, this burden should be placed on the states.

[112] Slip opinion at 11.

(4) How Much Third-Party Information Can be Disclosed

The legislative history of section 6103(h)(4) indicates that only those portions of the third party's return or return information which reflect the item or transaction should be disclosed in a tax administration proceeding.[113] While the statute has been read more broadly to permit disclosure of any third party return information when the item or transaction test has been met,[114] Treasury believes a more narrow reading is consistent with the privacy interests intended to be protected by the statute. At the same time, the statute should not be given too narrow an interpretation. As a practical matter, the IRS and the Justice Department could not introduce into evidence a single line item from a return – it would not be sufficient from the standpoint of the rules of evidence. For example, in the case of an individual, the Form 1040 itself should be disclosed along with the pertinent schedule relating to the item or transaction.

Section 205 of TBOR 2000 would restrict the disclosure to the "portion of such return …that directly relates to the resolution of an issue in the proceeding." While Treasury believes the amount of information that should be disclosed should be minimized as much as possible, Treasury believes TBOR 2000 may go too far in restricting the amount of information that may be disclosed.

Recommendation: The notice and redaction procedures of section 205 of TBOR 2000 should not be enacted. Rather, it should be clarified that the item test does not apply to a similarly situated, but completely unrelated, taxpayer. Specifically, the item test should be clarified to indicate that the treatment of the item must be directly related to the resolution of an issue in the proceeding due to the operation of the Code or some relationship between the parties. Alternatively, if it is determined that third-party tax disclosures should be allowed in judicial proceedings involving disparate treatment issues, disclosure should be predicated on a prima facie showing of disparate treatment. In addition, third parties in judicial proceedings involving disparate treatment issues should be notified by the IRS and given a statutory right of intervention. Treasury would not recommend codifying the standard regarding how much third party information can be disclosed proposed by section 205 in order to ensure the necessary flexibility for purposes of meeting the rules of evidence.

C. Investigative Disclosures

Section 6103(k)(6) deals with the disclosure of return information by IRS officers or employees for investigative purposes. It provides that such an officer or employee may disclose return information "*to the extent that such disclosure is necessary* in obtaining information, which is not otherwise reasonably available, with respect to the correct determination of tax, liability for tax, or the amount to be collected or with respect to the enforcement of any other provision of this title. Such disclosures shall be made only in such situations and under such conditions as the Secretary may prescribe by regulation." (emphasis supplied) These regulations provide, in part, "In connection with the performance of official duties relating to any … criminal investigation, … an officer or employee of the Internal Revenue Service … is authorized to disclose taxpayer identity information (as defined in section 6103(b)(6)), the fact

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[113] *See* S. Rep. No. 94-938, at 325-26 (1976).

[114] *See, e.g., LeBaron v. United States*, 794 F. Supp. 947 (C.D. Ca. 1992); *Conklin v. United States*, 61 F.3d 915 (10th Cir. 1995).

that the inquiry pertains to the performance of official duties, and the nature of the official duties in order to obtain necessary information relating to the performance of such official duties….”[115]

Gandy v. United States [116] involved verbal disclosures by a special agent that the plaintiff was under criminal investigation and revelation of enforcement credentials that indicated the special agent was affiliated with IRS-Criminal Investigation Division (now "CI").[117] These disclosures were made in the context of interviews, serving summonses, and telephone contacts. The court held that the disclosure that the plaintiff was under criminal investigation either directly or through the use of identifying credentials was not necessary to secure the desired information.

In response to the *Gandy* case, the JCT staff recommended that IRS special agents "be required to identify themselves and the nature of their investigation when interviewing third parties."[118] Treasury agrees that the inability of a special agent to identify him/herself and the criminal nature of the investigation can, in some cases, interfere with the performance of his or her duties and hamper investigations. At the same time, however, there may be circumstances, covert operations in particular, where such identification is undesirable. Thus, Treasury believes that special agents, should be *permitted* but not *required* to identify themselves and the nature of their investigation. Treasury would also clarify that this rule would apply to third party contacts that do not necessarily involve "interviews" of those witnesses as well as to written contacts, e.g., letters intended to gather information about the target of an investigation from third parties having a known or probable transactional relationship with the target.

Recommendation: IRS CI special agents should be permitted (but not required) to identify themselves, their organizational affiliation, and the criminal nature of their investigation when contacting third parties in person or in writing. Treasury recommends that this clarification be made to section 6103(k)(6) and/or to section 7608(a).

D. Miscellaneous Tax Administration Disclosures

1. Disclosures of Levies on Government Employee Wages

In 1992, to encourage greater Federal tax compliance among current and retired Federal employees, the IRS initiated the Federal Employee/Retiree Delinquency Initiative ("FERDI"). In connection with this outreach program, a number of Federal agencies have inquired as to whether they can be notified of a Federal employee's tax delinquency for purposes of enforcing agency ethics regulations.[119] Pursuant to the authority of section 6103(k)(6), return information can be disclosed in connection with placing a levy on an individual's wages.

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[115] Treas. Reg. §301.6103(k)(6)-1(a).

[116] 99-1 USTC para. 50,237 (E.D. Tex. 1999), *appeal docketed*, No. 99-40205 (5th Cir. Feb. 23, 1999).

[117] *See also Payne v. United States*, 91 F.Supp. 2d 1014 (S.D. Tex. 1999), *appeal docketed*, Nos. 00-20107 and 00-20139 (5th Cir.); *Roebuck v. United States*, 83 A.F.T.R. 2d 99-957) (E.D.N.C.) (1999), *aff'd*, 1999 U.S. App. LEXIS 30473 (4th Cir. 1999) (unpublished opinion).

[118] JCT Study at 208.

[119] 5 C.F.R. § 2635.809, which deals with standards of ethical conduct for employees of the executive branch, provides in pertinent part that "[e]mployees shall satisfy in good faith their

A question has arisen as to whether Federal agency employees who receive return information as a consequence of receiving a notice of levy,[120] are subject to the general prohibition on redisclosure contained in section 6103(a) and thus are not permitted to disclose the information within their agency for possible disciplinary action. The section 6103(a) redisclosure prohibition extends to any return or return information obtained by statutorily covered persons in any manner in connection with their service as officers, employees, or otherwise, or under the terms of section 6103. Federal agency employees are covered by section 6103(a).

Although a literal reading of section 6103(a) suggests that Federal and state agency employees are prohibited from redisclosing return information obtained as a consequence of receiving a notice of levy or otherwise under section 6103(k)(6), a better interpretation, based on the structure of section 6103 as a whole, is that the Congress did not intend to regulate or control redisclosures of return information obtained pursuant to section 6103(k)(6). There are no safeguard requirements on, or use restrictions for, recipients of section 6103(k)(6) disclosed information. Further, there does not appear to be any reason to treat government recipients of tax information under these provisions differently from private recipients. Finally, section 6103(k)(8), which was enacted in 1997, places statutory use restrictions on one particular category of levy – levies on FMS. This suggests that levies on other government agencies are not subject to the use restrictions in the statute. As such, a compelling argument exists that Federal and state agency recipients of tax information under section 6103(k)(6) are not currently subject to the statutory redisclosure restrictions in section 6103(a). However, in order to protect Federal and state employees against unauthorized disclosure lawsuits for redisclosure of information in their hands by virtue of section 6103(k)(6), it is recommended that the statute be clarified to reflect this position.

Recommendation: Section 6103 should be amended to clarify that persons otherwise included in section 6103(a) who receive tax information under section 6103(k)(6) are not subject to the redisclosure restrictions of section 6103 for such information.

2. Disclosures by TIGTA and Safeguarding

Under current law, it is not explicit that officers and employees of the Treasury Inspector General for Tax Administration ("TIGTA") are "internal revenue officers and employees" who are able to make disclosures of tax information under section 6103(k)(6) connected with their tax administration duties.

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obligations as citizens, including all just financial obligations, especially those such as Federal, State, or local taxes that are imposed by law."

[120] Similar issues are presented in connection with other investigative disclosures and with respect to State agency employees as well. Section 6103(k)(6) permits the disclosure of tax information that is necessary to obtain information that is not otherwise reasonably available. This would include, for example, disclosures to third party witnesses to obtain information, or disclosures in furtherance of collection activity, such as in a notice of levy. *See* Treas. Reg. § 301.6103(k)(6)-1. This could also include disclosures during a criminal investigation to other government agencies to find out whether they had any information concerning the taxpayer.

A second issue involves the safeguarding requirements currently applicable to TIGTA. Under the law prior to RRA 1998, the IRS Inspection Service was responsible for conducting audits of the IRS and investigations of matters related to the integrity of the IRS. These activities required regular and continuous access to tax information. The Treasury Department Inspector General ("IG") was rarely involved in matters requiring the disclosure of tax information, and procedures under the Inspector General Act ("IGA") required the IG to submit a written notice of intent to access tax information before the IG could access tax data. Pursuant to the IGA, information disclosed to the IG was subject to the accounting and safeguard provisions of the Code. When the functions of the Inspection Service were transferred to the new TIGTA, the accounting and safeguard requirements were not removed. Given the TIGTA's regular and continuous involvement with all phases of the tax administration process, the safeguarding and accounting requirements in the Inspector General Act are unnecessarily difficult to administer and burdensome. There does not appear to be any policy reason to treat disclosures to TIGTA any differently from disclosures to other IRS and Treasury employees who have access to tax information for tax administration purposes under section 6103(h)(1).

Recommendation: Section 6103(k)(6) should be amended to clarify that it includes disclosures by TIGTA.[121] In addition, the Inspector General Act should be amended to remove the accounting and safeguarding requirements for information disclosed to the TIGTA under section 6103(h)(1).

3. Disclosures in Connection With Levies on FMS Payments

Section 6103(k)(8) provides disclosure authority for serving levies on FMS for government payments pursuant to section 6331(h). Section 6331(h) makes levies on certain government payments continuous, and provides that the levy attaches up to 15 percent of the payment. Together, sections 6103(k)(8) and 6331(h), added to the Code in 1997, were designed to implement the FMS Levy Program.

The FMS Levy Program utilizes FMS's Treasury Offset Program (used for collection of nontax debts by administrative offset of Federal payments, and known as "TOP") to automate IRS levy of payments disbursed by FMS (e.g., vendor payments, Federal pensions, etc.). As originally envisioned, the IRS would serve a "mass" levy on FMS of all delinquent persons owing taxes.[122] If a person owing taxes were also receiving a Federal payment, FMS would take 15 percent of the payment and remit it to IRS in satisfaction of the levy.

The general authority for disclosure of return information in connection with serving levies is section 6103(k)(6). There were confidentiality concerns with giving FMS the entire delinquent taxpayer database under section 6103(k)(6), because there are no safeguard requirements or use restrictions on recipients of section 6103(k)(6) data. Accordingly, Congress

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[121] A technical correction making this change was included in section 1602(a) of the House version of H.R. 2488, 106th Cong. 1st Sess. (1999).

[122] A similar concept is used in the State Income Tax Levy Program, in which the IRS levies by sending its delinquent taxpayer database for a particular state to a state tax agency. The state tax agency matches the levy tape against its database of taxpayers receiving state tax refunds. If there are matches, the state honors the levy and remits the state tax refund to the IRS in satisfaction of the levy.

enacted section 6103(k)(8) as a companion provision to the continuous levy authority in section 6331(h), placing restrictions on FMS's use of the information. According to section 6103(k)(8), FMS may use the tax information disclosed to it under this section only for the purpose of, and to the extent necessary in: (1) transferring levied funds in satisfaction of the levy; (2) maintaining appropriate agency records in regard to such levy or the release thereof; (3) notifying the taxpayer and the agency certifying the payment that the levy has been honored; and (4) in the defense of any litigation ensuing from the honor of such levy.

Numerous implementation issues have arisen with respect to the continuous levy program. First, there are two instances when pre-levy disclosure from IRS to FMS is necessary to run the program: (1) testing with live data, and (2) transmission of data to FMS to determine if all required notices have been sent. Secondly, there is an issue regarding FMS's authority to re-disclose information to the Federal Reserve Banks ("FRBs") of San Francisco and Philadelphia for testing and levy implementation. Finally, there is an issue regarding IRS's pre-levy disclosure to the Social Security Administration ("SSA") to notify SSA that its payment recipients may be levied. In enacting section 6103(k)(8), the Congress did not envision many of these issues. While the agencies have been able to resolve these implementation issues using other disclosure authorities in the Code (e.g., section 6103(n)), the appropriate place for this disclosure authority is section 6103(k)(8).

a) Pre-levy Disclosures from IRS to FMS

(1) Testing

It became apparent that testing with live data was necessary to ensure that the program in operation worked as anticipated and would not incapacitate FMS's payment and offset program. Section 6103(k)(8) does not expressly permit disclosures for testing purposes. To accomplish testing, a contract under section 6103(n) with FMS has been executed.[123]

(2) Verification That Notices Have Been Sent

Prior to implementation, Congress enacted RRA 1998. RRA 1998 requires that a collection due process notice be sent to the taxpayer prior to any levy notifying the taxpayer of administrative appeal rights. Additionally, in situations where the FMS match is for a SSA benefit payment, the IRS will generate a special notice to the taxpayer indicating that the benefit payment has been identified and will be levied unless the account is resolved. (The special SSA notice is not statutorily required; however, it is our understanding that assurances were given by IRS officials to Congress at the time current section 6331(h) was enacted that a special notice would be given to Social Security benefit recipients.) Accordingly, prior to levying on certain payments, IRS will send its delinquent taxpayer file to FMS to determine if any of those taxpayers are receiving Federal payments and to make sure that all notices have been sent. This pre-levy disclosure to FMS, which is not authorized by 6103(k)(8), is being accomplished pursuant to a section 6103(n) contract with FMS. In accordance with the Congressional intent with regard to the levy program, the 6103(n) agreement restricts FMS's use of the delinquent taxpayer database information to carrying out the levy program.

[123] The IRS is permitted by section 6103(n) to disclose return information to contractors that perform services related to tax administration.

b) Pre- and Post-levy Redisclosures to FRB

Currently, as fiscal agent of the United States under 12 U.S.C. § 391, the FRBs of Philadelphia and San Francisco build, maintain, and service the FMS offset and levy operation. In connection with such services, it is necessary for FMS to redisclose information to the FRBs for testing and for processing the actual levies. This was not apparent at the time the statute was drafted; thus, section 6103(k)(8) does not permit FMS to redisclose information to the FRB or for IRS to disclose such information directly to FRB. In order to implement the program, IRS and FMS have entered into a section 6103(n) contract with FRB.

c) Social Security Administration

SSA has expressed the concern that when a benefit payment recipient receives the special pre-levy SSA notice from the IRS, the recipient will call SSA instead of the IRS. SSA will then be unable to provide the taxpayer with assistance, because it will not have any information about the potential levy of the taxpayer's benefit payments. Thus, to be able to respond effectively to customer inquiries, SSA would like IRS to disclose to it the pre-levy information contained in the special notice. SSA has indicated that, with this pre-levy information, it will be able to redirect callers to the IRS for case resolution. It is currently planned that SSA will have similar information prior to administrative offset of SSA payments.

SSA views this as a major customer service issue. However, there is no provision in the Code that expressly gives SSA, or any other levy source, the authority to receive pre-levy notification. Note that section 6103(k)(8) permits FMS to disclose return information to certifying agencies, such as SSA, *once a levy on a taxpayer's payment has been honored*. This provision does not allow certifying agencies to receive any return information prior to honoring the levy. This pre-levy disclosure from IRS to SSA will be authorized by a 6103(n) agreement.

d) Future Implementation Issues

(1) Salary Levy

FMS plans to enhance TOP to implement administrative offset and levy of Federal salary payments. Due to the complexity of determining what portions of Federal salaries are legally available for offset and levy, such calculations will be performed by the salary paying agencies prior to the payments being certified to Treasury for payment. This means that FMS must transmit tax levy information to the salary paying agencies prior to satisfaction of the levy in order to ensure that the correct amount of salary will be levied. Section 6103 does not contain any provision that expressly allows for such disclosure; however, because the salary paying agencies are necessary for FMS's ability to fully comply with the levy, they arguably fall under the provisions of 6103(k)(8)(B). While authority exists to use the levy information as necessary to transfer funds in satisfaction of the levy, the authority to disclose the levy information to the salary paying agencies to make the calculation of the amount of each payment to be levied should be clarified.

(2) Non-Treasury Disbursed Payments

FMS also plans to implement administrative offset of Federal payments disbursed by other agencies in the executive branch, such as the Department of Defense and the Postal Service. Once the system is operational, IRS could levy up to 15% of these payments under 6331(h) if there were a corresponding disclosure authorization in 6103. Section 6103(k)(8)(C), however, expressly limits disclosure of information for levies on payments disbursed by FMS.

Additionally, the levy of payments disbursed by other executive agencies would work operationally in the same manner as the levy of Federal salaries. FMS would transmit information regarding levies to the non-Treasury disbursing offices so that they could levy the payment and send the funds back to IRS, through FMS, prior to disbursing the remainder of the payment to the recipient. FMS would update and maintain all information regarding the tax debt in the same manner as for Treasury-disbursed payments. Like the Federal salary levy program, this program would require that FMS redisclose levy information to the agencies prior to satisfaction of the levy.

Recommendation: Section 6103(k)(8) should be amended to expressly permit: (1) testing, (2) disclosures to the FRB, (3) pre-levy disclosure to SSA, (4) disclosure to salary paying agencies to calculate the amount to be levied, and (5) levy of and disclosure to non-Treasury disbursing offices for purposes of carrying out section 6331(h).

4. TIN Matching

The Code imposes information reporting requirements upon payors of income. Among the items of information the payor is required to furnish is the payee's TIN, which the payee furnishes to the payor. Each year, over 30 million information returns are received by the IRS that contain missing or incorrect name and TIN information. Often the error is not discovered until relatively late in the tax cycle, e.g., when the payor submits a Form 1099 for the payee. The IRS is able to correct the error less than half of the time. The Code, however, only permits disclosure of the error to the payor at the point at which the payment is subject to backup withholding under section 3406.

The IRS reports that compliance would be enhanced if payors, as well as paying agents, qualified intermediaries, electronic return originators, and certain Federal agencies seeking to enter into contracts with service providers, had the ability to verify TINs when they were subject to a reporting requirement (including, e.g., filing W-2s) prior to submitting the information to the IRS. IRS also believes such authority is critical to the goal of speeding up notification to taxpayers of possible underreporting, a goal implicit in section 3305 of RRA 1998.

Treasury believes it would be appropriate to amend section 6103(k) to permit TIN verification by persons required to furnish such information to the IRS. This verification should be limited to whether or not the information provided by the payor matches IRS records. The IRS would not disclose correct TINs if there were an error; it would be the responsibility of the payor to obtain the correct information. Treasury believes these disclosures would be consistent with the purpose for which the information is collected in the first place and would enhance both compliance and customer service.

Recommendation: Section 6103(k) should be amended to permit TIN verification by persons required to provide such information to the IRS. This verification should be limited to whether or not the information provided by the payor matches IRS records.

5. Disclosures to Organizations Regulating Tax Practitioners

The Director of Practice is authorized to institute disciplinary proceedings against practitioners (attorneys, certified public accountants, and enrolled agents) who violate the

regulations governing practice before the IRS.[124] In a dozen or so cases a year, such proceedings result in suspension or disbarment by an impartial administrative law judge ("ALJ"). Usually, one or two of these disciplinary sanctions is imposed after an evidentiary hearing; the remainder are default judgments, where the practitioner has not responded to the complaint.

Disciplinary case files are contained in systems of records that are protected as confidential under the Privacy Act. However, for many years, "a routine use" exception has permitted disclosure of information concerning ALJ-imposed suspensions and disbarments to professional organizations, such as state bar associations and accountancy boards.[125] This routine use is of limited value, because most of the ALJ-imposed sanctions stem from practitioners' failure to file required Federal income tax returns. At present, there is no authority in section 6103 to disclose return information for these purposes.

Recommendation: Section 6103(k) should be amended to permit the IRS to disclose return information contained in ALJ-imposed suspensions and disbarments to professional organizations regulating tax practitioners such as state bar associations and accountancy boards.

6. Treasury Personnel and Claimant Representative Matters

Section 6103(l)(4)(A) permits the disclosure of relevant and material tax information, upon written request, to an employee or former employee of the Treasury Department (or to the authorized representative of such employee or former employee) to prepare for, and to use in, any administrative action or proceeding affecting the personnel rights of the employee or former employee. Section 6103(l)(4)(A) also permits disclosures in disciplinary proceedings involving the Director of Practice or subsequent proceedings before an administrative law judge ("ALJ").

Section 6103(l)(4)(B) permits the disclosure of tax information to officers and employees of the Treasury Department for use in any action or proceeding described in section 6103(l)(4)(A), or in preparation for such action or proceeding, to the extent necessary to advance or protect the interests of the United States.

A significant issue with respect to section 6103(l)(4) is the placement of this section among those provisions of the Code dealing with nontax matters, and its interaction with those provisions of the Code dealing with tax administration. There is an inherent connection between the administration of the internal revenue laws and employee discipline and integrity. This principle was reinforced by the enactment of section 1203 of RRA 1998, which made the consequence of certain acts termination of employment. Further, the regulation of practice before the IRS clearly implicates the administration of the tax laws.

Case law similarly has found certain disclosures of return information in connection with matters pertaining to the discipline and integrity of government employees that perform tax administration duties to be authorized by section 6103(h).[126] However, to the extent section

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[124] *See* 31 C.F.R. Part 10, which is published in pamphlet form as Treasury Department Circular No. 230.

[125] *See* Treasury/IRS 37.005, 60 F.R. 69881 (Dec. 17, 1998).

[126] *See, e.g., Hobbs v. United States*, Civil Action, No. H-96-4260 (S.D. Tex. July 6, 1998) (subsequent history omitted) (court held that section 6103(h)(4)(A) authorized the disclosure of tax information in a Merit Systems Protection Board proceeding and in a Title VII lawsuit where the issue in each case centered around Hobbs' dismissal from IRS employment for failure to

6103(l)(4) and section 6103(h) are not entirely coextensive, legislative clarification of the connection between tax administration and employee discipline and integrity would be useful.

Treasury thus recommends that the disclosure authority of section 6103(l)(4) be transferred to section 6103(h). As transferred, such authority should be clarified to encompass judicial proceedings the outcome of which may affect the personnel rights of an employee. In addition, such authority should be broadened to authorize disclosures to and use by the Justice Department arising out of conduct by Justice Department employees whose duties include administering and enforcing the tax laws.

Finally, the legislative history of the provision should indicate that it authorizes disclosures not only in traditional personnel matters, such as adverse actions and EEO, unemployment compensation and worker's compensation proceedings, but also in other proceedings affecting an employee's personnel rights, or challenging a former employee's actions arising out of tax administration activities, such as investigations by the Office of Special Counsel or the Merit Systems Protection Board, Bivens actions in Federal courts, proceedings before state bars, TIGTA investigations, and grand jury investigations.

Recommendation: The disclosure authority currently found in section 6103(l)(4) should be transferred to section 6103(h), as such personnel and integrity matters are inherently connected to the administration of the internal revenue laws. Such authority should be broadened to authorize disclosures to and use by the Justice Department in defending personnel and integrity matters arising from tax administration. This expansion should also authorize disclosures in connection with personnel and integrity matters arising out of conduct by Justice Department employees whose duties include administering and enforcing the tax laws. In addition, this provision should be clarified to encompass all administrative and judicial proceedings the outcome of which may affect the personnel rights of an employee.

E. Disclosure to States

1. In General

Section 6103(d) is the basis for a successful information exchange program with state tax agencies. In 1976, Congress realized that many states were dependent on IRS information for the operation of their own taxation systems, which often use Federal concepts as the starting point for their own returns. Further, cooperation and disclosure between the IRS and state tax agencies was thought to enhance, rather than detract from, voluntary compliance.[127]

Section 6103(d) requires a written request from the head of the state tax agency, designating the state tax officials who can receive the information, before disclosure can be made. Information received from the IRS can only be used for state tax purposes, not for general

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comply with the tax laws – a personnel matter involving tax administration); *Rueckert v. I.R.S.*, 775 F.2d 208 (7th Cir. 1985) (court held, in the context of defining "state tax administration," that the "management" and "supervision" of a state's internal revenue laws includes ensuring that its employees are free from conflicts of interest that could undermine the integrity of its system of administering the state tax laws); *Gardner v. United States*, 211 F.3d 1305 (D.C. Cir. 2000).

[127] Report on Administrative Procedures of the Internal Revenue Service, Sen. Doc. 94-266 at 998 (October 1975).

state civil or criminal law enforcement. The state officials who receive the information can redisclose it to other officers and employees of the tax agency, the agency's legal representative, or the agency's contractors (but only for state tax administration purposes).

In practice, the written request requirement is met by the execution of two agreements by the IRS and state tax agency. The basic agreement is executed by the Commissioner and the head of the state tax agency. The basic agreement provides for the exchange of tax data and the required procedures and safeguards. The implementing agreement is executed by the district director and the head of the state tax agency. The implementing agreement makes arrangements for those disclosures that are to be made on a continuing basis and contains the tolerances and criteria for those disclosures, e.g., all revenue agent reports with adjustments over a specified amount. If additional information beyond that covered by the implementing agreement is necessary, a separate written request can be made. Also, the IRS has entered into a number of memoranda of understanding involving discrete projects with state tax agencies, e.g., joint examination agreements and joint installment agreements. These memoranda are structured so as to meet the requirements of section 6103(d).

An important concept related to section 6103(d) is need and use. In the late 1970s, the General Accounting Office found that the IRS was disclosing more tax information to state tax agencies than they needed or were able to use.[128] While the information was not misused, there was potential for misuse. In response, the implementing agreement was created, which sets tolerances and criteria for disclosure to the state tax agency, and the IRS also conducts periodic need and use reviews.

As discussed above, state tax agencies are also permitted to use Federal tax information in their administrative and judicial tax appeals apparatus.

2. Joint Filing Programs

If a state models its income tax system on the Federal tax system, there may be many elements of data that are common to the Federal and state return. In fact, many states require the taxpayer to attach a copy of a Schedule A or the entire Federal return to the state tax return. In order to reduce taxpayer burden, many, including President Clinton,[129] have proposed a single return that would satisfy both Federal and state tax filing requirements. A single joint return that is filed with the IRS, or a contractor of the IRS, would be protected by section 6103, notwithstanding the fact that it also could be filed to fulfill a state tax obligation, and notwithstanding the fact that it would not be protected by section 6103 if it were filed with the state separately.

The IRS can participate in a joint filing program with a state tax agency under current law pursuant to section 6103(d). However, as described above, taxpayer identity information and the common data elements are protected by section 6103 and could only be used by the state for state tax purposes. Many states permit state tax data to be used for both tax and nontax purposes, and thus states are reluctant to participate in a joint filing program that does not permit them to

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[128] Comptroller General of the United States, *Better Management Needed in Exchanging Federal and State Tax Information*, GGD -78-23 (May 22, 1978).

[129] 95 TNT 113-54, *White House Release on Reducing Government's Burden on Small Business, Individuals* (June 12, 1995).

use data on the return for legitimate state nontax purposes. From an IRS safeguards perspective, as states modernize their systems and update their computerized records from numerous sources, it may become difficult to track which items of data the state has received from IRS, and which items of data are from other sources.

The Simplified Tax and Wage Reporting System ("STAWRS") Project, which is a joint endeavor of IRS, the Treasury Department, the Labor Department, and the Small Business Administration, is working with states and employer groups to develop changes and use technology in ways that would reduce taxpayers' tax and wage reporting burdens. One project would develop a Standardized Employer Identification Number ("EIN") that would be used for both tax and non-tax purposes. Currently, employers have an EIN for Federal tax purposes and one or more EINs for each State in which they operate. Both taxpayers and state agencies are interested in pursuing EIN standardization. For taxpayer burden reductions to be achieved through use of common EINs, an amendment of section 6103 may be required for implementation and even for testing of various pilot programs.

Section 6103(d)(5) was added to provide for a five-year pilot employment tax reporting project with the IRS and the State of Montana. The common data items for that form are the taxpayer identifying information and the signature. Section 6103(d)(5) permits the IRS to disclose that information to the state, and such information in the state's hands is not subject to the redisclosure restrictions in section 6103(a), or the safeguards or criminal penalty provisions. In effect, it is as if the state had received the return directly from the taxpayer. The Treasury Department has supported legislation for a number of years that would achieve this result generally with respect to any joint filing program with any state tax agency.

While regulations could be drafted under section 6103(c) to achieve this result without the need for a legislative change, consistent with Treasury's other recommendations regarding consents, Treasury would prefer that this result be achieved legislatively.

Recommendation: The disclosure permitted by section 6103(d)(5) for the STAWRS program and described in section 976 of the Taxpayer Relief Act of 1997 should be extended permanently to all joint filing programs with state tax agencies and should be expanded to permit the disclosure of all common data elements in addition to taxpayer identity and signatures. Subsections (a)(2) and (p)(4) of section 6103 and section 7213 and 7213A should not apply to disclosures or inspections made pursuant to section 6103(d)(5).

3. Safeguarding Issues with Respect to States' Use of Federal Tax Data

Although, for the most part, the IRS views its exchange of information with state taxing authorities as highly successful, as the JCT staff reported, state taxing agencies have been found in violation of safeguard requirements from time to time.[130] This appears, at least in part, to have informed the JCT staff's recommendation that states be required to monitor contractors performing state tax administration functions.

State tax authorities, like Treasury, are permitted to use contractors under section 6103(n). Under TBOR 2000, much of the responsibility for oversight of safeguards by contractors performing tax administration functions would be transferred to the states. States

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[130] JCT Study at 168.

would be required to submit annual reports to the IRS, including certification that all contractors had been found to be in compliance with safeguard requirements.

Increasingly, states have turned to sophisticated computer analysis to examine the efficiencies and strengths and weaknesses of their current tax systems, and to explore alternatives and make revenue estimates. These sophisticated computer models use a database, representing the population, on which a simulation program operates. These models require large amounts of data to simulate the population. States have been using Federal tax data to create written statistical reports on their tax systems for a number of years and now seek to use the large amounts of Federal tax information they receive under section 6103(d) for use in their tax simulation models. These dynamic computer models create a number of challenges to the current system. Tax modeling and revenue estimating services are marketed by a number of the large accounting firms or their affiliates. As such, if permitted to do so, these large accounting firms, which do work for several states, could have access to large portions of the Individual and Business Master Files. Unlike the static written reports of the past, the computer models may be used for numerous purposes. Given the large amount of data necessary to run these models, the potential exists for the large accounting firms to accumulate a large amount of tax data for identifiable taxpayers.[131] Moreover, these models, if combined, could be used to produce competing revenue estimates for Federal legislation.

The IRS has indicated that any model created with Federal tax data[132] can only be used, consistent with section 6103(d), for state tax purposes. Nonetheless, the potential for unauthorized use of tax data by such contractors exists, and the consequences of such unauthorized use could be significant. IRS and state agencies currently are engaged in a dialogue over these issues.

Treasury generally supports TBOR 207 and recommends that it be initiated in pilot form. Additional recommendations regarding contractor access to return information are set forth later in this report.

Recommendation: Treasury supports section 207 of TBOR 2000 insofar as it requires states to certify compliance of their tax administration contractors with section 6103(p)(4) safeguards. If adopted, this provision should be initiated in pilot form and include a sunset date. In addition, section 6103(p)(4) should be clarified to explicitly include disclosures to contractors pursuant to section 6103(n).

V. Disclosures to Congress

Returns and return information may be disclosed to the extent specified in a written request from the chairman of the House Ways and Means Committee, Senate Finance

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[131] When possible, such data is "blurred" (numerous taxpayers' information is combined and averaged) to prevent disclosure of identifiable data. Such blurred data is not return information protected by section 6103 because it is "data in a form which cannot be associated with or otherwise identify, directly or indirectly, a particular taxpayer." Section 6103(b)(2). It is not always possible to blur such data.

[132] Such limitations apply either if tax data is used directly in the model, or if Federal data was blurred to use in the model.

Committee, or Joint Committee on Taxation.[133] Information that can directly or indirectly identify a specific taxpayer can only be furnished to such committee when sitting in closed executive session (unless the taxpayer consents in writing). Returns and return information may be disclosed to the Chief of Staff of the Joint Committee on Taxation, subject, generally, to the same conditions as disclosure to the tax writing committees.[134]

Disclosure of tax information to nontax committees generally requires a written request by the committee chairman supported by a resolution of the House or Senate (or, in the case of a joint committee, a concurrent resolution).[135] The statutory procedures require (1) a committee action approving the decision to request such information, (2) an authorizing resolution of the House or Senate, as the case may be, and (3) the written request by the Chairman of the committee on behalf of the committee for disclosure of the information. As noted by the JCT staff in its study, these requests are fairly infrequent.

The limitation of section 6103(f)(1) requests to the *chairmen* of the House Ways and Means Committee, Senate Finance Committee, and Joint Committee on Taxation, has also raised some issues when minority members and their staff delegates have been denied access to the information obtained by the chairman. It has been suggested that ranking minority members of the tax-writing committees should have access to return information, particularly return information obtained by the chairmen.

The tax writing committee chairmen and the Chief of Staff of the Joint Committee on Taxation may designate an agent (for example, the General Accounting Office is routinely so designated) to receive tax information on their behalf.[136] As provided above, information that can directly or indirectly identify a specific taxpayer can be furnished by such agent to such committee only when sitting in closed executive session (unless the taxpayer consents in writing).

Any person (i.e., a whistleblower) who otherwise has or had access to any return or return information under section 6103 may disclose such return or return information to a tax writing committee or to an agent of a tax writing committee - if such person (the whistleblower) believes that such return or return information may relate to evidence of possible misconduct, maladministration, or taxpayer abuse.[137] The IRS has discussed procedures for such disclosures with the tax writing committees, but nothing has been finalized.

VI. Disclosures Not Related to Tax Administration

A. Nontax Criminal Cases

1. In General

The use of tax information for prosecuting nontax crimes was one of the areas of particular sensitivity when section 6103 was revised in 1976. The ability of the Justice

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[133] Section 6103(f)(1).

[134] Section 6103(f)(2).

[135] Section 6103(f)(3).

[136] Section 6103(f)(4).

[137] Section 6103(f)(5).

Department to obtain tax returns almost at will for law enforcement purposes was, at the time, particularly troubling, as indicated in the legislative history:

> The committee decided that the information that the American citizen is compelled by our tax laws to disclose to the Internal Revenue Service was entitled to essentially the same degree of privacy as those private papers maintained in his home. Present law and practice does not afford him that protection – the Justice Department and other Federal agencies, as a practical matter, being able to obtain that information for nontax purposes almost at their sole discretion.[138]

These concerns were addressed in the 1976 revisions to section 6103. The requirements for obtaining tax information for use in Federal nontax criminal cases were refined, and made somewhat more lenient, in 1982.

Section 6103(i) provides limited authority for the disclosure of tax information in the investigation and prosecution of nontax Federal crimes. Federal agencies seeking the disclosure of returns, and other tax information provided by the taxpayer or the taxpayer's representative ("taxpayer return information"), for purposes of prosecuting nontax crimes must obtain an ex parte order from a Federal district court judge or magistrate.[139] Return information the IRS receives from other than the taxpayer, e.g., from banks or other third party witnesses, may be disclosed for use in a criminal investigation pursuant to a written request from the head of a Federal agency or other specified government officials.[140] In addition, if the IRS has evidence of a Federal nontax crime that is not on a tax return, or other information that is not "taxpayer return information," the IRS can disclose that information to the head of the appropriate Federal agency on the IRS's own initiative.[141] These provisions, paragraphs (1) through (3), provide for use during the criminal investigation. Further disclosure in the criminal trial is governed by section 6103(i)(4). Generally, in order to introduce returns, or return information provided by the taxpayer, the court must find that the information is probative evidence of a matter relating to the commission of the crime, or the guilt or liability of a party.

The counterintelligence community has recommended amending section 6103(i) to authorize disclosure of tax information for counterintelligence purposes, claiming that section 6103(i) does not address their needs. Further, there are general claims by the law enforcement community that section 6103(i) unduly restricts access to tax information and that the procedures are burdensome. Further, it has been suggested that section 6103 should be amended to permit access for state and local criminal law enforcement purposes. Treasury believes that the current statutory scheme strikes the proper balance between the legitimate needs of law enforcement and the privacy rights of taxpayers. Further, with regard to disclosures for state and local law enforcement purposes, it was noted by former Commissioner Kurtz in 1981 that there were 19,000 state and local law enforcement agencies in the United States, and that many of those

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[138] S. Rep. No. 94-938, *supra* note 35, at 328.

[139] *See* section 6103(i)(1).

[140] *See* section 6103(i)(2).

[141] Section 6103(i)(3)(A).

agencies did not have the "minimum ability to safeguard [tax] information."[142] The same concerns still exist today.

2. Disclosure in Case of Imminent Threat of Death or Physical Injury

Section 6103(i)(3) authorizes the disclosure of return information to the extent necessary to apprise Federal and state law enforcement agencies in circumstances involving imminent danger of death or physical injury to an individual. (Typically this information is limited to the nature of the threat and the location of the taxpayer.) Very few of these disclosures are made each year. These disclosures are subject to safeguard requirements in the Code, as well as the prohibition on redisclosure. In many instances, state law enforcement agencies are not in the best position to address situations involving an imminent danger of death or physical injury. For example, if the taxpayer has threatened suicide, it may be more appropriate to notify a local police agency or a suicide hotline. The Taxpayer Advocate recommended extending the disclosure authorized by section 6103(i)(3)(B)(i) to local law enforcement agencies in the case of credible suicide threats.[143] Treasury believes it is appropriate to lift the prohibition on redisclosures for these matters (so the Federal or state agency can disclose the information to the proper local agency or suicide hotline) and to permit disclosures by the IRS directly to suicide prevention authorities and local police departments. Treasury does not, however, believe that disclosures to local law enforcement agencies should be limited to cases where the taxpayer has threatened suicide, but, rather should also be available in other cases of imminent death or physical injury as contemplated by section 6103(i)(3)(B)(i). Given the limited number of disclosures that are made under this provision, and the circumstances involved, there does not appear to be a great countervailing privacy interest.

Recommendation: The disclosure permitted by section 6103(i)(3)(B)(i) in cases of imminent death or physical injury should be extended to local law enforcement agencies and local suicide prevention authorities and should not be subject to the safeguards of section 6103(p)(4). Similarly, Federal or state law enforcement agencies should be permitted to disclose such information directly to such local law enforcement agencies and local suicide prevention authorities. Civil penalties should apply to disclosures of such information for other purposes.

3. Civil Forfeiture

The civil forfeiture provisions of many criminal statutes allow the seizure (i.e., forfeiture) of property or income prior to any criminal proceedings. Although section 6103(i)(4)(A) permits the disclosure of information obtained pursuant to section 6103(i)(1) in any judicial or administrative proceeding pertaining to the enforcement of a specifically designated Federal criminal statute or related civil forfeiture, section 6103(i)(1) does not permit the initial disclosure solely for use in, or preparation for, a civil forfeiture unrelated to any criminal proceeding. Thus, under section 6103(i)(1), a Federal agency cannot obtain returns and return information for the

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[142] Disclosure of IRS Information to Assist with the Enforcement of Criminal Law, Hearing before the Subcommittee on Oversight of the Internal Revenue Service of the Committee on Finance, U.S. Senate, S. 732, 97th Cong., 1st Sess. 184-185 (November 9, 1981). It would also be practically impossible for the IRS to perform safeguard reviews of that many agencies.

[143] IRS National Taxpayer Advocate's Annual Report to Congress for Fiscal Year 1999 (Jan. 4, 2000), Proposal no. 7.

purposes of locating such property and/or income for purposes of a civil forfeiture prior to criminal proceedings. This often undermines the purpose of the civil forfeiture provisions, which is to destroy the financial basis for criminal activity by seizure of the property or proceeds that provide the profit motive for the crime.

Recommendation: Section 6103(i)(1) should be amended to permit the Justice Department to obtain an ex parte court order permitting disclosures in preparation for proceedings pertaining to civil forfeitures.

4. Form 8300 Disclosures

Section 6050I requires that persons engaged in a trade or business who receive more than $10,000 in cash in a single transaction (or two or more related transactions) file an information return with respect to such transaction (Form 8300, Report of Cash Payments Over $10,000 Received in a Trade or Business). Because this information is collected under Title 26, it is subject to the protection of section 6103 and available to IRS Special Agents under section 6103(h)(1) for tax administration purposes. Section 6103(l)(15), however, also authorizes the disclosure of Form 8300 information to Federal, state, local and foreign agencies for civil, criminal and regulatory nontax purposes. Section 6103(l)(15) disclosures are subject to the safeguard requirements of section 6103(p)(4).

Form 8300 is very similar (though broader in applicability) to another form required under Title 31, the Currency Transaction Report ("CTR" or Form 4789), which is required to be filed by financial institutions in connection with currency transactions of more than $10,000. Although CTRs are filed with the IRS, the form clearly states that it is required by Title 31 and administered by the Financial Crimes Enforcement Network ("FinCEN"). Disclosure of CTRs is governed by rules unique to Title 31; section 6103 does not apply unless the CTR is incorporated into a tax file. Because the section 6103(p)(4) requirements are perceived to be cumbersome, particularly by local law enforcement agencies, it has been proposed that the Form 8300 regime be moved into Title 31 and subjected to the disclosure rules pertaining to CTRs, rather than the disclosure rules of section 6103. This proposal was included in anti-crime legislation proposed by the Administration last year – "The 21st Century Law Enforcement and Public Safety Act."

Because the transactions subject to the reporting requirements of section 6050I are not purely financial transactions, some have argued that Title 31 is not the appropriate place for this program and FinCEN is not the appropriate agency to administer the form in light of its other tax purposes. For example, Forms 8300 currently are disclosed to states under section 6103(d). Treasury, however, believes that retaining Form 8300 reporting in Title 26 without section 6103(p)(4) safeguards for disclosures under section 6103(l)(15) would be inappropriate. If form 8300 were transferred to Title 31, however, it would be important to ensure that other current uses of Forms 8300, for example, by state tax authorities pursuant to section 6103(d), would be preserved.

Recommendation: Pursuant to the Administration's anti-crime legislation, the administration of Form 8300 (currently under section 6050I of Title 26) should be transferred to Title 31.

B. Use of Tax Information for Federal Benefit and Loan Programs

As discussed above, concern about Federal and state agencies' use of returns and return information for nontax purposes was a key factor in the 1976 overhaul of section 6103. The legislative history states:

> [Q]uestions have been raised with respect to whether tax returns and tax information should be used for any purposes other than tax administration.
>
> …
>
> The committee has reviewed each of the areas in which returns and return information are now subject to disclosure.
>
> With respect to each of these areas, the committee has tried to balance the particular office or agency's need for the information involved with the citizen's right to privacy and the related impact of the disclosure upon the continuation of compliance with our country's voluntary assessment system.[144]

Over the years, numerous additional exceptions have gradually been added to section 6103, raising questions about whether the balance Congress sought in enacting section 6103 has been maintained. Treasury and the IRS frequently receive legislative proposals from other agencies seeking access to taxpayer information for purposes unrelated to tax administration.

Government-wide data-sharing initiatives also have bumped up against section 6103's limited and specific disclosure provisions. A few examples of such initiatives include:

- In 1995, the Director of OMB, Alice M. Rivlin, formed a multi-agency Benefit Systems Review Team ("BSRT") to identify strategies for improving the effectiveness and efficiency of Federally supported benefit programs through better coordination of information systems. The BSRT issued a report in 1996.[145]
- In 1998, the President's Council on Integrity and Efficiency ("PCIE") Ad Hoc Committee on Benefit Eligibility Verification also issued a report that identified a need for across-the-board Federal benefit and credit program eligibility verification to prevent error and fraud.[146]
- In 1998, the House Committee on Government Reform and Oversight proposed legislation (H.R. 2347) that would have allowed Federal agencies administering any Federal benefit program to gain access to taxpayer information.
- At the request of the Senate Governmental Affairs Committee, GAO recently prepared a report examining whether improved data-sharing among Federal benefit

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[144] S. Rep. No. 94-938, *supra* note 35, at 317-18.

[145] Benefit Systems Review Team, *Strategies for Efficiency: Improving the Coordination of Government Information Resources* (June 1996).

[146] PCIE Ad Hoc Committee on Benefit Eligibility Verification, *Eligibility Verification Needed to Deter and Detect Fraud in Federal Government Benefit and Credit Programs* (May 1998).

and loan programs (including access to IRS data) might lead to more accurate eligibility determinations.[147]

In the past, Treasury has resisted large-scale disclosure initiatives encompassing a number of agencies. Rather, Treasury has favored a more incremental approach involving narrowly tailored legislative exceptions or, in certain cases, disclosures by consent in an effort to limit disclosures to a small number of problematic cases. As discussed below, however, the latter solution – disclosure by consent – raises certain issues under current law and will become increasingly problematic as technology makes it easier for a wide range of both private and public entities to seek access to taxpayers' return information. In addition, the incremental approach has been criticized as resulting in inconsistencies.[148]

The discussion below highlights the competing governmental goals of fraud and error reduction and efficiency represented by recent data-sharing initiatives on the one hand and protecting taxpayer privacy and tax compliance as embodied by section 6103 on the other.

C. Evaluating Specific Proposals for Governmental Disclosures

In evaluating specific proposals for additional disclosures, Treasury believes the burden should be on the requesting Federal, state, or local agency to make the case for disclosure and to provide assurances that the information will be safeguarded appropriately. To the contrary, Treasury frequently finds itself in the position of justifying why it should *not* provide access to the requested data prior to receiving an adequate demonstration of why it *should*.

Treasury believes that it is important to apply specific criteria in a consistent manner in evaluating proposals for additional disclosures.[149] The following is a list of criteria Treasury and the IRS have applied in evaluating such proposals:

<u>Criteria to be addressed by the requester</u>:

1) Is the requested information highly relevant to the program for which it is to be disclosed?
2) Are there substantial program benefits to be derived from the requested information?
3) Is the request narrowly tailored to the information actually necessary for the program?
4) Is the same information reasonably available from another source?

<u>Criteria to be addressed by the requester and Treasury/IRS</u>:

5) Will the disclosure involve significant resource demands on the IRS?
6) Will the information continue to be treated confidentially within the agency to which it is disclosed, pursuant to standards prescribed by the IRS?

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[147] GAO, *Benefit and Loan Programs: Improved Data Sharing Could Enhance Program Integrity* (GAO/HEHS-00-119), Sept. 13, 2000.

[148] *See* Benefit System Review Team, *supra* note 145, at 19.

[149] In 1994, the IRS elaborated on these criteria and proposed providing a description of such criteria to prospective requesters. This memorandum is attached as Appendix B.

7) Other than section 6103, are there any statutory impediments to implementation of the proposal?

Criteria to be addressed by Treasury/IRS:

8) Will the disclosure have an adverse impact on tax compliance or tax administration?

9) Will the disclosure implicate other sensitive privacy concerns?

Treasury believes these criteria are consistent with a reasoned and careful approach to providing exceptions to the rule of confidentiality and that third parties seeking access to taxpayer information should be informed of such criteria and demonstrate satisfaction of them.

Although it is difficult to measure the risk to compliance that disclosure of return information for nontax purposes poses, it is not a risk that should be taken lightly. A change of even one percentage point means a loss of over $10 billion of revenue to the Federal government annually. This cost must be weighed against the purported benefits of any proposed disclosure program.

Recommendation: Additional exceptions to the confidentiality of taxpayer information under section 6103 should be granted in rare circumstances and only where the agency can demonstrate, using established criteria, a need for the information that clearly outweighs taxpayer privacy interests and concerns about the effects on voluntary tax compliance.

Issues with respect to both consent-based and statutorily authorized disclosures are discussed below.

D. Obtaining Returns and Return Information Pursuant to the Taxpayer's Consent

1. Section 6103(c)

Section 6103(c) permits disclosure, subject to the requirements and conditions prescribed by regulations,[150] to a person the taxpayer designates in a request for or consent to disclosure. Disclosure is also permitted to any person at the taxpayer's request to the extent necessary to comply with the taxpayer's request for information or assistance. Section 6103(c) further provides, however, that "return information shall not be disclosed to such person or persons if the Secretary determines that such disclosures would seriously impair Federal tax administration."

Unlike statutory exceptions to section 6103 for specific purposes, which typically specify which items of information can be disclosed to whom and for what purposes, section 6103(c) disclosures are not subject to use restrictions nor are they subject to statutory safeguards.

The regulation implementing section 6103(c) is divided into two parts. The first part of the regulation deals with disclosures to any third party.[151] It requires a separate written document, pertaining solely to the authorized disclosure, containing the taxpayer's taxpayer identity information, the type of tax and taxable years. The consent must be signed and dated by the taxpayer. The consent must be received by the IRS within 60 days of execution by the taxpayer. The requirement that the document pertain solely to the authorized disclosure is

[150] *See* Treas. Reg. § 301.6103(c)-1.

[151] Treas. Reg. § 301.6103(c)-1(a).

intended to assure a knowing disclosure, preventing the disclosure language from being buried in the fine print of a multi-page loan document, for example.

The second part of the regulations deals with requests for advice or assistance by the taxpayer in connection with a tax matter.[152] This type of consent must be signed and dated by the taxpayer, and contain enough information to allow the IRS to respond to the request for advice or assistance. The most common example of a consent under this part of the regulation is a letter to a Member of Congress from a constituent requesting assistance with an IRS matter, e.g., a private letter ruling or a collection matter. The Member forwards the constituent's letter, which is a valid consent when received by the IRS, which permits the IRS to explain to the Member (or a person on his or her staff) the constituent's situation. A less obvious example of a consent under this part of the regulations is Form 8453 for electronic tax return filers, which contains a consent that allows the IRS to acknowledge receipt of the return to the electronic return transmitter.

In 1996, the Taxpayer Bill of Rights II eliminated the statutory requirement that a consent be made in writing. However, regulations have not yet been promulgated implementing this statutory change, and current regulations still require that a consent be written. "Written" has been construed to include electronic transmissions with electronic signatures. This also includes an electronically recorded assent to consent language that appears on a computer screen that is accompanied by an electronic signature.

The legislative history to the Taxpayer Bill of Rights II indicates that non-written consents are intended to facilitate movement to a paperless tax administration system. In the years since enactment, situations where non-written consents would help speed service to taxpayers have become more apparent, and will shape any new regulations. These situations include:

1) communicating with preparers and practitioners to resolve minor problems with returns, where such interaction does not involve practice before the IRS;

2) disclosures in meetings or telephone conferences with IRS personnel to persons not authorized to practice before the IRS, whom the taxpayer brings to the meeting or includes in the telephone conference, such as a friend or relative; and

3) further simplifying the consent required for electronic filing acknowledgments.

2. Overview of Consent Process and Proposed Transcript Delivery System

Under existing processes, and consistent with the regulations, taxpayers typically fill out and sign a separate form meeting IRS requirements (usually IRS Form 4506 or 8821), either the taxpayer or the third-party designee mails it to the IRS, the IRS reviews the consent form for compliance with the regulatory requirements, and mails a complete transcript of the taxpayer's account to the taxpayer or his or her designee.

Many requests for transcripts are from taxpayers (or their representatives) for their own information. In 1999, approximately 3 million requests came from taxpayers and an additional 1 million came from their representatives. These disclosures (of a taxpayer's own information) were made pursuant to section 6103(e).

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[152] Treas. Reg. § 301.6103(c)-1(b).

Most disclosures made to third-party designees using section 6103(c) consents were made to the financial/mortgage industry (2.5 million) and another 500,000 were made to either FEMA or SBA in connection with providing disaster relief. The remaining few were made to various Federal agencies or programs.

In September of 1999, the IRS announced its intent to institute a pilot Transcript Delivery System ("TDS") program under which consents would be executed and transmitted to the IRS electronically.[153] The program was to be limited to tax practitioners, financial institutions, mortgage lenders, and credit bureaus in California. The notice stated that moving to an electronic environment for taxpayer consents would reduce IRS processing time from seven to ten days (not including the time it takes to mail the information to the third party) to less than 24 hours.

The proposed TDS was believed to present a number of important benefits. Customer service would be greatly improved as a result of the ease of transmission and reduced turnaround time. In addition, there would be important privacy benefits. For one thing, the amount of data that would now be released would be limited to information actually requested/needed by the mortgage company. No longer would mortgage companies receive a taxpayer's entire transcript when they only needed a few lines of information. In addition, the practice of asking mortgage applicants to sign undated or incomplete consents would be eradicated because the forms could not be changed once executed.[154] Taxpayer consents would be signed electronically and dated upon completion and would expire after a period of time. Another benefit would be improved record-keeping and tracking, as the IRS currently does not retain the large volumes of paper consents it receives for more than 45 days. Finally, contracts with the financial institutions would contain a clause prohibiting secondary disclosure.[155]

Nonetheless, this proposal was criticized by some privacy advocates.[156] One of the chief concerns was the likely proliferation of third-party consent-based requests for information, i.e., the easier it becomes for institutions to receive tax information, the more institutions will want it. As one advocate put it, the program would "turn a trickle into a flood" of requests.[157] Indeed, based on inquiries received to date, Treasury believes that absent restrictions on the use of consents, the volume of requests for tax records to be sent to third parties could quickly increase by tens of millions from the current 3 million each year. Such an exponential increase in the number of instances in which taxpayers may be asked to consent to the disclosure of their return information not only will diminish the voluntariness of that consent, but it will also mean, in

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[153] 64 F.R. 49540 (Sept. 13, 1999).

[154] Section 208 of TBOR 2000 seeks to address this same issue by requiring transmitters to sign a statement as to the completeness of the consent under penalties of perjury.

[155] Section 208 of TBOR 2000 would amend section 6103(c) to codify the prohibition on redisclosure by third-party designees.

[156] *See,* Bruce Horovitz, *IRS E-Sharing Raises Privacy Fears*, USA Today, Oct. 1, 1999, at 1A; John Schwartz, *IRS Looks to E-Mail as a Tool*, The Washington Post, Oct. 23, 1999, at E1; Amy Hamilton, *Barr Discusses Proposal for Electronic Disclosure of Tax Data*, Tax Notes 576 (Nov. 1, 1999).

[157] Evan Hendricks, editor of *Privacy Times*, quoted in Horovitz, *id.*

effect, that every taxpayer can expect his/her return information to be disclosed by the IRS for some purpose, i.e., the consent exception will swallow the rule of confidentiality.

Technological advances in consent-based disclosures thus raise privacy issues generally and threaten to exacerbate some of the specific policy issues associated with the use of consents that are discussed in more detail below.[158]

3. Use of Consents by Government Agencies

a) In General

As discussed above, when Congress revised section 6103 in 1976, specific statutory exceptions to the general rule of confidentiality were provided only where Congress determined that a third party's need for the information outweighed concerns about taxpayer privacy and the related impact on continued compliance with our system of voluntary tax assessment.[159] Over the years, additional exceptions have been added to section 6103 pursuant to the same considerations, each narrowly tailored to achieve its intended purpose.

On occasion, an agency will solicit taxpayer consents despite the existence of a specific statutory authorization for disclosure. Usually this is done so that contractors can have access to the information (see discussion regarding "disclosures to contractors" below) or to provide access to items of information beyond those specified by statute. In addition, in recent years, Treasury has received several inquiries from other agencies seeking to implement new income verification programs using taxpayer consents incorporated into benefit or loan applications. In both cases, the use of consents avoids issues of how much information can be disclosed and to

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[158] It is important to distinguish consents to the disclosure of returns or return information in the possession of the IRS, which are governed by section 6103(c) and the regulations thereunder, from consents to disclosure or use of taxpayer return information by return preparers for purposes other than submission to the IRS, which are governed by section 7216 and the regulations thereunder. Treasury regulations require a tax return preparer to obtain the written consent of a taxpayer before using the information obtained from the taxpayer to solicit the taxpayer's business in matters unrelated to the IRS. A request for such consent must be made no later than the time the taxpayer receives his or her completed tax return from the preparer. Treas. Reg. § 301.7216-3(a). A separate written, signed consent must be obtained for each separate use or disclosure and must contain the following specific information (1) the name of the tax return preparer, (2) the name of the taxpayer, (3) the purpose for which the consent is being furnished, (4) the date on which such consent is signed, (5) a statement that the tax return information may not be disclosed or used by the tax return preparer for any purpose (not otherwise permitted under § 301.7216-2) other than that stated in the consent, and (6) a statement by the taxpayer, or his agent or fiduciary, that he consents to the disclosure or use of such information for the purpose described in subparagraph (3). Treas. Reg. § 301.7216-3(b). The consent to use the taxpayer's information in a solicitation is limited to the return preparer and its affiliates.

As IRS seeks to promote electronic filing, consistent with section 6011(f) and RRA 1998's goal of 80 percent electronic filing by 2007, issues have arisen as to how to interpret and apply these regulations in an electronic environment consistent with the Congressional purpose of protecting the privacy of taxpayer information in the hands of the return preparer.

[159] *See, e.g.,* S. Rep. No. 94-938, *supra* note 35, at 318.

whom typically addressed by narrowly tailored statutory exceptions. Moreover, as discussed above, disclosures pursuant to section 6103(c) are not subject to any restrictions as to use or redisclosure.[160] In addition, the recordkeeping and reporting requirements of section 6103(p)(3) and the safeguards required by section 6103(p)(4) do not apply to disclosures under section 6103(c) nor do the civil and criminal penalties of the Code.

Treasury believes that the use of consents for programmatic governmental purposes, without limitation, potentially circumvents Congressional intent in enacting section 6103 in its current form. As one court has observed, "In light of [section 6103's] legislative history, the IRS cannot use the consent exception of section 6103(c) as a 'catch-all' provision to circumvent the general rule of confidentiality established by Congress."[161] The JCT staff expressed a similar view:

> In enacting section 6103, the Congress sought to balance an agency's need for return information, the taxpayer's right to privacy, and the related impact on compliance with the tax laws. That balance is upset when an agency that has been granted access to returns and information subject to certain restrictions chooses to obtain a consent from the taxpayer that effectively waives those restrictions. Similarly, agencies and others who have not been granted access to returns and return information under section 6103 circumvent section 6103's restrictions when they utilize the consent provision to obtain access to returns and return information.[162]

At the same time, circumstances may arise that cause a particular disclosure provision to be unnecessarily difficult to administer. Thus, although open-ended unregulated consents allow agencies to potentially receive far more sensitive taxpayer information than they really need, narrow and inflexible statutory disclosure provisions can also be problematic.

Although Treasury would prefer that exceptions to section 6103's general rule of confidentiality arise as a result of explicit Congressional mandates, Treasury anticipates it will continue to receive requests for disclosures utilizing taxpayer consents. Treasury believes that before a government program is permitted to solicit taxpayer consents, a demonstration should be made (e.g., through a statistical test match or through a small-scale pilot) that the agency or program's need for the information outweighs concerns about taxpayer privacy and voluntary tax compliance, consistent with the criteria described above. If Treasury determines that such a business case has been made, it will then determine whether it is appropriate to proceed with a limited disclosure program pursuant to consents or whether a legislative amendment should be sought to permit direct access. If consent-based disclosures are utilized, they should be conducted in such a way as to ensure that a potential benefit recipient is aware of his or her substantive and procedural rights if his or her benefits are affected based on the return

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[160] Section 208 of TBOR 2000 would amend section 6103(c) to include use restrictions.

[161] *Tierney v. Schweiker*, 718 F.2d 449, 456 (D.C. Cir. 1983).

[162] JCT Study at 228.

information obtained and otherwise comply with the requirements of the regulations governing consents.[163]

In connection with this potential expansion of the use of consents, section 6103(c) should also be amended to provide that returns or return information disclosed pursuant to the taxpayer's consent may be disclosed or used by such persons only for purposes of, and to the extent necessary in, accomplishing the purpose of the disclosure. In addition, civil damages and criminal penalties for wrongful disclosure under sections 7431 and 7213 should be extended to apply to persons who receive returns or return information pursuant to the taxpayer's consent and use the information in a manner inconsistent with the consent. Finally, the safeguard requirements of section 6103(p)(4) should apply to such disclosure programs to the same extent as to disclosures pursuant to specific statutory exceptions.

b) Miscellaneous Governmental Uses of Consents

This section highlights some instances in which the use of consents by governmental agencies has been advantageous.

(1) Tax Checks

Under section 6103(g)(2), information regarding an individual under consideration for appointment to a position in the executive or judicial branch may be disclosed to the Executive Office of the President or the head of any Federal agency (or the FBI, on the President's or agency head's behalf), upon written request by the President or the head of the agency. This is referred to as a "tax check."

The return information that can be disclosed under section 6103(g)(2) is limited to whether the individual: (1) has filed income tax returns for the preceding three years; (2) has failed to pay any tax after notice and demand or has been assessed the negligence penalty[164] in the current or preceding three years; (3) has been or is under investigation for possible criminal offenses under the internal revenue laws and the results of such investigation; and (4) has been assessed the fraud penalty. Further, the IRS is required to inform individuals about whom it has received a "tax check" request of that request.

According to the annual reports made to the Joint Committee on Taxation, at least since 1980, no requests have been received from, nor have any disclosures been made to, the President, the White House, or any Federal agency for tax checks under section 6103(g)(2). For the past 20 years, all requests for, and disclosures in connection with, tax checks have been made pursuant to the written consent of the taxpayer under section 6103(c).

Tax checks on governmental appointees as part of the selection and appointment process preceded the revision of section 6103 in 1976, and date back at least to the early 1960's. In its revision of section 6103 in 1976, the Congress acknowledged the importance of such tax checks:

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[163] *See Tierney, supra* note 161 ("Without an understanding of their substantive and procedural rights, [benefit recipients] cannot be said to have consented knowingly and voluntarily to the release of their tax information.")

[164] The negligence penalty of former section 6653 has been made a part of the accuracy-related penalty in section 6662. A technical amendment to section 6103(g) is necessary to reflect this change.

"The President needs certain tax information, particularly (if not entirely) in the 'tax check' area."[165]

The practice of using consents for section 6103(g)(2) tax checks originated under President Ford. The election of President Carter in November 1976 exposed certain deficiencies in the tax check provisions of the new statute. In attempting to assemble a new administration, President-elect Carter could not access or authorize access to tax information to perform tax checks on new appointees. By its terms, section 6103(g) only authorizes disclosure to the President – not to the President-elect. Further, with the exception of information concerning criminal investigations, the statute only authorizes a "yes" or "no" answer for the other three items of information. Thus, even though the prospective appointee could proffer a reasonable explanation with respect to the IRS's response to any question, the explanation could not be verified with the IRS, nor could the IRS on its own offer additional explanatory information.

As an alternative to relying on section 6103(g)(2), the Carter transition team instituted the practice of conducting tax checks through the use of the taxpayer's written consent, under section 6103(c). This practice continued for tax checks after President Carter's inauguration and through all successive administrations, and the consent form developed after the inauguration has, in major respects, remained the same.

Disclosures under section 6103(g) are subject to the accounting and recordkeeping requirements of the Code. Disclosures pursuant to the taxpayer's consent under section 6103(c) are not. In early 1977, the IRS decided to include tax check disclosures in the annual report to the Joint Committee on Taxation, even though the disclosures were made pursuant to section 6103(c) rather than section 6103(g).

Treasury believes that the current practice of obtaining taxpayers' consent in connection with performing tax checks has important advantages.[166] For example, section 6103(g)(2) could be seen as too inflexible to accomplish its purpose and it does not permit the useful give-and-take of an employment background check. In addition, there are no policy reasons for not allowing a President-elect to perform background checks in connection with assembling his or her Cabinet or hiring other advisors.

The current practice of using consents also provides taxpayers with immediate notice that their tax return information will be subject to disclosure (rather than within three days as required by section 6103(g)(2)). This provides applicants or nominees with the option of withdrawing from the process at an earlier point in time to avoid potentially embarrassing situations, provides the opportunity to explain any potential problems prior to losing the appointment, and prevents potential disputes between applicants or nominees and their intended employers.

Consistent with Treasury's recommendations regarding consents generally, however, Treasury believes that the deficiencies in section 6103(g)(2) should be remedied legislatively if possible. In addition, notice of the "tax check" should be provided to the potential appointee at

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[165] Staff of the Joint Committee on Taxation*, General Explanation of the Tax Reform Act of 1976*, *supra* note 37, at 318.

[166] *See* Privacy Protection Study Commission, *Federal Tax Return Confidentiality* at 50 (June 1976) (recommending that IRS use consents for this purpose).

the time of applying for employment. If the requesting agency determines that additional information is needed in the course of performing the tax check, the taxpayer's consent to disclosure can be sought at that time. It should be noted that this would in no way limit the ability of the President to obtain return information in exigent circumstances under section 6103(g)(1).[167]

(2) Applications for Certain Loans

Section 6103(l)(3) permits the disclosure of whether or not an applicant for certain Federal loans has a tax delinquent account. This provision is rarely used, however, reportedly because it is restricted to heads of Federal agencies, only permits a "yes" or "no" answer, and does not permit disclosure to contractors of the agency. Instead, such disclosures are obtained pursuant to the taxpayers' consent. As suggested in the case of tax checks, although Treasury generally opposes the use of consents on a programmatic basis, consents can provide important notice to the taxpayer.

Consideration should be given to amending section 6103(l)(3) to eliminate the need for consents and to incorporate a notice requirement. Specifically, consistent with Treasury's recommendation with respect to access by contractors, and subject to the limitations thereon discussed below, consideration should be given to providing the information to contractors of agencies whose duties so require.

Some have argued for the extension of this provision to prospective contractors as well as to loan applicants. The justification is the same – that any person or entity wishing to obtain some loan, guarantee, or other benefit from the Government, including performing contract services, ought to be subject to minimal tax integrity and compliance standards that are demonstrated at the outset and perhaps even periodically verified throughout the term of the contract or benefit relationship.

Treasury recommends that, in any expansion or other revision of this provision, the standard of what constitutes a tax delinquent account should be defined in such a way as to ensure the taxpayer has had an opportunity for full due process. Otherwise, potential benefit recipients or contractors could be harmed unfairly.

(3) Miscellaneous

The IRS currently conducts, via consents, several joint programs with states that involve certification of payment of state and Federal taxes prior to issuing certain permits or licenses. In each of these cases, the IRS has determined that there is some nexus between the type of permit or license involved and the taxpayer's tax compliance. Both the Federation of Tax Administrators and the IRS view this as a significant compliance tool.

In addition there are a variety of other circumstances in which consents may be appropriate. One example is the administration of disaster loans by the Federal Emergency Management Agency or the Small Business Administration. IRS records often are critical

[167] Section 6103(g)(1) provides that the Secretary shall furnish a return or return information to the President upon a written request, signed personally by the President, which includes the name and address of the taxpayer, the kind of return or return information to be disclosed, the taxable period or periods covered by the request, and the specific reason why the inspection or disclosure is so requested.

sources of information necessary to provide relief in emergency circumstances. IRS should have the flexibility to permit the use of consents in such circumstances.

4. Private Sector Uses of Consents

Section 208 of TBOR 2000 seeks to provide "higher standards for requests for and consents to disclosure." Although applicable to all consents, the provision is aimed primarily at prohibiting mortgage companies from collecting signed but undated and/or otherwise incomplete consent forms and using those forms at a later date and potentially for purposes unrelated to the purpose of the initial authorization. Treasury agrees with the spirit of this recommendation insofar as it codifies requirements for valid consents and limits redisclosure. Treasury would suggest, however, that the codification of requirements for valid consents include all of the elements currently contained in Treasury regulations.[168] Treasury also recommends that in the case of private sector requests for consents, an approval process analogous to that recommended for governmental disclosures be instituted for large-scale private sector disclosures. Thus, in addition to ascertaining compliance with current regulatory requirements, IRS should impose the following conditions:

1) The requester must make a proper case for access (e.g., through a cost-benefit analysis and demonstration of relevance);
2) The request (and resulting disclosure) should be narrowly tailored to cover only the minimum amount of information necessary for the requester's program;
3) The disclosure program should be administratively feasible, and IRS should be compensated for providing the data;
4) The requester should provide assurances of appropriate safeguards.

5. Treasury's Recommendations Related to Consents

As discussed above, it is likely that improvements in technology will lead to increased requests from third parties for taxpayer consents to release of taxpayer information. Accordingly, Treasury believes it is appropriate to consider imposing some limitations on the use of consents by third parties, both governmental and private sector. In the case of disclosures to government agencies, a similar analysis should be applied to large-scale consent-based disclosures as is applied to requests for direct access to taxpayer information (see discussion above). Moreover, in the case of both governmental and private sector disclosures, enhanced privacy protections are warranted, including use and redisclosure limitations. Treasury would also extend appropriate civil damages and criminal penalties to third parties that receive tax information pursuant to the taxpayer's consent and use the information in a manner that is inconsistent with the consent. Treasury anticipates that improper disclosures by private-sector recipients would be enforced primarily through private causes of action.

Treasury's specific recommendations are as follows:

- Where a specific statutory authorization for a large-scale governmental progammatic disclosure does not exist, agencies generally should be permitted to solicit taxpayers' consent to disclosure for such purposes only upon a demonstration (e.g., through a statistical test match or through a small-scale pilot), applying established criteria, of a

[168] *See* Treas. Reg. § 301.6103(c)-1(a).

need for the information that clearly outweighs taxpayer privacy interests and concerns about the effects on voluntary tax compliance. Section 6103 should be amended to provide that the safeguard requirements of section 6103(p)(4) apply to such governmental disclosure programs to the same extent as to disclosures pursuant to specific statutory exceptions.

- Large-scale non-governmental third-party consent disclosures should be permitted only upon approval by the IRS, based on established criteria, on a programmatic basis. Such consents should specify the minimum amount of information necessary to achieve the intended purpose of the disclosure.
- Section 6103(c) should be amended to provide that returns or return information disclosed pursuant to the taxpayer's consent may be disclosed or used by such persons only for purposes of, and to the extent necessary in, accomplishing the purpose of the disclosure. In addition, appropriate civil damages and criminal penalties for wrongful disclosure and inspection should be extended to apply to persons who receive returns or return information pursuant to the taxpayer's consent and use the information in a manner inconsistent with the consent.
- Section 6103(g)(2) should be amended to codify existing practice with respect to tax checks, combining the notice provided by consent with statutory access (including by a President-elect) to the information necessary to effectively and efficiently conduct tax checks.
- Section 6103(l)(3) should be amended as necessary to achieve its intended purpose (for example, by permitting disclosures to contractors), and the practice of using consents for this purpose should be discontinued. Taxpayers should, however, receive notice of such potential disclosures.
- IRS should have the ability to enter into joint efforts with state licensing programs, on a case by case basis, where it determines that there is a nexus between the license and the tax information sought and that there are likely to be significant tax compliance benefits.
- IRS should have the flexibility to accept consents for such purposes as disaster relief.

E. Child Support Enforcement

One of the original exceptions to the general rule of confidentiality under section 6103 that was carved out by Congress in 1976 was the exception for disclosures for purposes of child support enforcement.

1. Background

Shortly before Congress embarked on the overhaul of section 6103 in 1976, it had completed an overhaul of the child support provisions of the Social Security Act and established a new comprehensive nationwide child support enforcement and collection program under Part D of Title IV of the Social Security Act (Title IV-D child support programs). Title IV-D went into effect in August 1975. Under Title IV-D, recognizing that it was first necessary to locate absent parents in order to force them to meet their child support obligations, Congress established a Federal Parent Locator Service ("FPLS") within an Office of Child Support Enforcement ("OCSE") that was itself contained within the Department of Health, Education, and Welfare

("HEW"), forerunner to the current Department of Health and Human Services ("HHS").[169] The FPLS replaced an arrangement that had operated since 1967 whereby:

> [E]ach quarter the Secretary of [HEW] provided the Secretary of the Treasury with a State developed list of individuals whose families were public assistance applicants or recipients and against whom there were outstanding court orders requiring them to contribute to their families' support. In such cases, the Secretary of the Treasury would provide the State welfare agency involved with the residence and place of employment information on the absent parent if such information could be found in the files of the IRS.[170]

The location capability of the FPLS was significantly broader than that of the prior program: disclosure of location information could be demanded "notwithstanding any other provision of law," from "files or records" of any "department, agency, or instrumentality of the United States," including the IRS. The only exceptions specified by Congress were disclosures of whereabouts information that "would contravene national policy or security interests of the United States or the confidentiality of census data."[171] In addition, location information for child support purposes was available from the FPLS, by application through the IV-D agency, to courts, prosecutors and certain other "authorized persons." For example, a "resident parent, legal guardian, attorney or agent of the child … (as determined by regulations prescribed by the Secretary [of HEW])" could obtain location information to find a parent "who has a duty to support and maintain" the child, regardless of whether the child was supported by public assistance or the absent parent was currently subject to a court order for support.[172]

In the context of Congress revisiting the confidentiality and disclosure of tax information, the Privacy Protection Study Commission, in its June 1976 report, observed the following with respect to the FPLS's access to tax data:

> The Internal Revenue Service is without doubt the best Federal source of recent address and place of employment information, and along with the Social Security Administration, is currently the [F]PLS's chief source of such information.
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> . . . [B]ecause the [F]PLS is so new, the [Privacy Protection Study] Commission is doubtful that anyone is capable of making a judgment about its utility or about its ability to function if it were denied access to IRS information.
>
> In principle, the Commission is troubled by the type of infringement upon the confidentiality of IRS records that the [F]PLS represents. Clearly, the disclosure of such information for the purpose of locating an absent parent is not compatible with the purpose for which the IRS collects it. Yet the Commission recognizes that the Congress expressly authorized this disclosure by statute and

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[169] *See* 42 U.S.C. § 653.

[170] Privacy Protection Study Commission Report, *supra* note 166, at 51 (1976).

[171] *See* 42 U.S.C. § 653(b).

[172] *See* 42 U.S.C. § 653(c).

> did so in a manner that indicated its intention to disregard the compatibility principle in this instance.
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> Thus, while the Commission reserves judgment for the time being on whether the Congress should permit the [FPLS] (and the State Parent Locator Services to which the Federal Service relates) to continue to have access to IRS information, it does believe that if such access is permitted to continue, stronger safeguards than now exist are essential. *Accordingly, if the Congress permits the [FPLS] to continue to have access to information maintained by the [IRS,] the Commission recommends that (1) such access be limited to instances in which the residence and place of employment information sought may serve to locate an individual against whom there is an outstanding court order for child support, the financial requirements of which are not being met, (2) there be a strict prohibition on the redisclosure of taxpayer identity information by any Federal or State agency recipient entitled to receive it from the Parent Locator Service, and (3) the penalties of section 7213 of the Internal Revenue Code for unauthorized disclosure of tax information shall apply to such recipients*.[173]

In amending section 6103 to establish a general prohibition on the disclosure of tax information except as specifically authorized under Title 26, Congress, in Treasury's view, overrode the "notwithstanding any other provision of law" language in 42 U.S.C. § 653(b), with the result that henceforth, information could be disclosed for purposes of child support enforcement only to the extent authorized by the Code.[174]

Treasury's interpretation of section 6103 as it relates to HHS's interpretation of Title 42 has resulted in conflicting views over which entities and individuals may receive which items of tax information for purposes of child support enforcement and precisely how theses individuals and entities may use the information they do receive. Both Treasury and HHS are anxious to resolve these issues, which are discussed in more detail below.

[173] Privacy Protection Study Commission Report, *supra* note 166, at 53 (emphasis in original).

[174] HHS disagrees with this construction of the Code and notes that, while the Title-IV-D statute has been amended numerous times in the intervening years, the "[n]otwithstanding any other provision of law" language has never been deleted.

2. Issues With Respect to Who May Receive Return Information for Section 6103(l)(6) and For What Purposes

In order to receive Federal tax information under section 6103(l)(6), the recipient must be a "Federal, State, or local child support enforcement agency" operating pursuant to Title IV-D of the Social Security Act. Currently, IRS and HHS and several states are at an impasse regarding the definition of "child support enforcement agency" for purposes of section 6103(l)(6). IRS interprets "Federal, State, or local" agency for purposes of these provisions as traditional Federal, state, or local government agencies. HHS and several states maintain that Congress intended, when it enacted Title IV-D, to permit states to continue operating through local Friend of the Court Offices, Clerks of Court, District Attorneys, and even the use of some private attorneys in rural areas as they had previously. Accordingly, in issuing regulations and approving state IV-D Plans, HHS has encouraged states to use a wide variety of enforcement entities and has consistently construed "local child support enforcement agency" broadly over the past twenty-five years.

With respect to Indian Tribes, Title IV-D now provides for Indian Tribes to operate Title IV-D programs under certain conditions and in accordance with HHS regulations.[175] For Code purposes generally, Indian tribes, Tribal organizations, and Tribal agencies are not treated as Federal, state, or local[176] agencies, except as explicitly provided for under section 7871. This provision does not treat Indian tribal government entities as Federal, state or local agencies for purposes of section 6103. Nor is there any support in section 6103 itself for the treatment of Indian tribes, Tribal organizations, or Tribal agencies as Federal, state, or local agencies.[177] Further, it appears that Congress, when it had occasion to specifically address access by Indian tribes to tax information under section 6103, chose to exclude them.[178] It is not clear why Indian tribes were excluded. As a policy matter, there does not appear to be a reason for excluding Indian tribes as recipients of Federal tax information for those Federal programs they administer, provided section 6103(p)(4) safeguards are met.

HHS thus submits the following are local child support enforcement agencies entitled to receive tax information:

- Full-service private for-profit entities that provide all IV-D services in a certain locality, and which have certified their commitment to comply with all IV-D statutory and regulatory requirements
- Indian tribes or Tribal organizations under cooperative agreement with the state to provide IV-D services

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[175] 42 U.S.C. §§ 654(33) and 655.

[176] "Local" is defined to mean a political subdivision of a state. *See* sections 6103(l)(8)(C), 103(c).

[177] *See* section 6103(b)(5) (definition of State for purposes of section 6103).

[178] *See* section 6103(l)(7)(C), added by Pub. L. No. 96-249, § 127(a)(1). As originally enacted, the provision was limited to Food Stamp programs, and specifically defined "State food stamp agency" by reference to a provision of the Food Stamp Act of 1977 (§ 3(n)(1)) that excluded Indian Tribes (which were covered by § 3(n)(2)). This provision was later amended in the Tax Reform Act of 1984, Pub. L. No. 98-369, § 2651(k)(1) (1984), to include additional programs.

- Courts, Friends of the Court, Clerks of Court, District Attorneys, or individual attorneys appointed by the court to provide all IV-D services in isolated rural areas

HHS argues that, as the agency charged with implementation of Title IV-D, its interpretation of the term "child support enforcement agency" is entitled to considerable deference.

Section 6103(l)(6)(C) contains the following restriction on disclosures under section 6103(l)(6): "Information may be disclosed under this paragraph only for purposes of, and to the extent necessary in, establishing and collecting child support obligations from, and locating, individuals owing such obligations." Precisely what this restriction means, as a practical matter, has been the source of a longstanding disagreement between HHS and Treasury. Treasury has been guided in its interpretation by both the language from the Privacy Protection Study Commission report quoted above and the following explanation of the JCT staff: "Congress did not intend that the child support enforcement agency be authorized to disclose Federal return information to third parties or in litigation relating to establishing or collecting child support obligations."[179] Under Treasury's interpretation, therefore, such return information can be used as a lead (for example, to locate individuals or funds), but must be independently verified before being used in litigation, for example. Moreover, although there is no explanation of what is meant by "third parties," Treasury interprets this, consistent with the rest of section 6103, to mean anyone other than an officer or employee of a child support enforcement agency.

HHS views this as an overly restrictive interpretation insofar as it fails to consider situations, for example, where a sheriff's deputy may need the non-custodial parent's address to serve a petition for establishment of paternity or may need the non-custodial parent's employer's address to serve a wage withholding order – activities that are integral to "establishing and collecting child support obligations." HHS also emphasizes, as discussed above, that Title 42 authorizes the disclosure of locate information to courts, prosecutors, and certain other "authorized persons."

A related issue is to what extent contractors performing various discrete functions for a child support agency are entitled to receive return information under section 6103(l)(6). Because this has implications beyond the child support area, it is discussed separately below.

Recommendation: Section 6103(l)(6) should be amended, or committee language should be drafted, to clarify which entities and individuals are entitled to receive return information for which specific purposes, and whether such information may be redisclosed for limited purposes necessary for establishment and enforcement of child support orders.

3. Types of Information Disclosed for Purposes of Child Support Enforcement

There are several issues with respect to the specific items of return information that are disclosed for child support enforcement purposes.

[179] Staff of the Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1976, *supra* note 37, at 337.

a) Information from the IRS Master File

The specific items of tax information of any person against whom child support obligations are sought to be established or enforced or of any person to whom child support is owed that may be disclosed for Title IV-D child support enforcement purposes under section 6103(l)(6) are divided into two categories. Under section 6103(l)(6)(A)(i), the following information from the master file of the IRS may be disclosed to Federal, state, and local child support agencies:

(1) social security account number(s)
(2) address
(3) filing status
(4) amount and nature of income
(5) number of dependents

It is Treasury's understanding that OCSE does not currently receive information regarding the number of dependents.

Recommendation: Section 6103(l)(6)(A)(i) should be amended, after consultation with OCSE, to eliminate information not currently used by OCSE or for which there is no anticipated need.

b) Disclosures of Information Returns

Under section 6103(l)(6)(A)(ii), the following information may be disclosed from returns filed by or on behalf of the individual (e.g., information returns such as Forms 1099 or W-2):

(1) information relating to the amount of such individual's gross income
(2) names and addresses of payors of such income
(3) names of any dependents

With respect to this category of information, the statute provides that such information may be disclosed only if "not reasonably available from any other source."[180] It should be noted that employer identification numbers are not included in the list of items that may be disclosed under section 6103(l)(6)(A)(ii). Child support enforcement agencies state that the EIN (disclosure of which IRS at one time interpreted to be permitted) is a critical data matching element for identifying assets that is more reliable than alternative identifiers such as the name and address of a financial institution. Without EIN information, payors may receive duplicate notices for the same case, and there may be delays in processing wage withholding actions.

Similarly, at one time, IRS disclosed Form 1098 information, relating to mortgage interest deductions, to HHS. IRS interprets section 6103(l)(6)(A)(ii) as not authorizing the IRS to disclose such information. HHS states that this information was extremely valuable in identifying assets of non-custodial parents.

Recommendation: Section 6103(l)(6)(A)(ii), if retained in its present form, should be amended to permit the disclosure of EINs with other Form 1099 information and should be expanded to include limited information regarding mortgage interest paid.

[180] Section 6103(l)(6)(A)(ii).

5. Disclosures by SSA for Child Support Enforcement Purposes

In 1980, Congress enacted section 6103(l)(8), which authorized SSA to disclose certain earned income information to state and local child support enforcement agencies for the same Title IV-D child support enforcement purposes that such agencies were entitled to obtain tax information directly from IRS under section 6103(l)(6). This amendment was necessary, at the time, to properly and efficiently accomplish disclosures that, in principle, were already authorized under a combination of sections 6103(l)(1)(A) and (l)(6).

Under sections 6103(l)(1)(A) and (l)(5), certain tax information is disclosed to SSA to administer the Social Security Act. Indeed, under the Combined Annual Wage Reporting System ("CAWRS") certain tax information (i.e., Form W-2 data) is filed directly with SSA, rather than with IRS as a matter of administrative and filing convenience. (The information subsequently is sent to IRS). However, under section 6103(a), as revised in 1976, SSA could itself use tax information to administer the provisions of the Social Security Act but was prohibited from redisclosing that information, e.g., to state or local child support enforcement agencies to administer Title IV-D program operations. Only IRS was permitted to make disclosures to state and local child support enforcement agencies to administer Title IV-D. However, IRS did not have direct access to tax information filed directly with SSA under CAWRS. To bridge this procedural "gap" in disclosure authority, Congress enacted section 6103(l)(8) to permit disclosure by SSA of certain earned income information directly to state and local child support enforcement agencies for the same Title IV-D purposes that these agencies were authorized to receive tax information under section 6103(l)(6).

With the passage of time, as disclosures of tax information to state and local agencies increasingly came to be channeled through OCSE serving as a Federal agency conduit, section 6103(l)(8) could no longer be utilized because it does not authorize disclosure to Federal child support enforcement agencies such as OCSE. It is important to note, however, that the dilemma that had driven the enactment of section 6103(l)(8) persisted, i.e., certain tax information in the hands of SSA could be more efficiently disclosed directly by SSA as opposed to the IRS.

The solution that was found, this time, was to employ section 6103(l)(6) (which authorizes disclosure to Federal as well as to state and local child support enforcement agencies for Title IV-D program purposes) in conjunction with Treas. Reg. § 301.6103(p)(2)(B)-1 (which permits a Federal agency, such as SSA, that obtains tax information from IRS, to redisclose that tax information to another Federal agency, such as OCSE, that could, itself, obtain the same tax information directly from IRS, provided the IRS Commissioner determines that the tax information is more readily available from the intermediary Federal agency source than directly from IRS).

Recommendation: A technical amendment to section 6103(l)(8) should be made to permit SSA to make disclosures to OCSE.

F. Disclosures to Contractors

In 1996, pursuant to section 316(g) of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 ("PRWORA"),[181] Congress added a new provision to section 6103(l)(6), permitting the disclosure of certain items of information to agents of the child support

[181] Pub. L. No. 104-193, 110 Stat. 2105.

enforcement agency under contract with the agency. These items of information are: (1) address of the non-custodial parent; (2) social security account number of that individual; and (3) amount of any Federal income tax refund that has been offset for child support enforcement under section 6402(c).[182] The amendment to section 6103(l)(6) to permit disclosures to contractors is still subject to the limitation of section 6103(l)(6)(C), however, and thus raises the same issues of interpretation discussed above.

Treasury received a number of comments from Federal and state child support agencies arguing for increased access by contractors to return information. For example, a contractor running automated computer matches of child support debtors and address or location information may need to have access to data to ensure that programs run effectively.

1. Arguments For Child Support Contractor Access

The following arguments were advanced in favor of increasing disclosure to contractors:

a) Authority Outside of Title 26

HHS observes that the SSA statutory and regulatory scheme clearly contemplates the contracting out of agency functions[183] and concludes, "Because the contractors cannot carry out these functions unless they get certain taxpayer information, such as address information, and because Congress did not include any limitations on the use of private contractors to carry out these functions, we must assume that Congress did intend that this information be shared."[184] HHS also points to references in both the Privacy Act (specifically 5 U.S.C. § 552a(m)(1)) and OMB Circular A-130 that extend the requirements and penalties of the Privacy Act to contractors of agencies.

Similarly, the Eastern Regional Interstate Child Support Association commented, "It would be illogical for Congress to endorse the practice of contracting out functions that ultimately remain the responsibility of the IV-D agency while disadvantaging those entities in

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[182] Section 6103(l)(6)(B). With these basic data elements, it was anticipated that State contractors would be able to operate new State Disbursement Units required to be established under the same legislation to provide for centralized statewide support collections distribution processing. *See* 42 U.S.C. § 654(27); 42 U.S.C. § 654B(a)(2)(A).

[183] *See, e.g.,* 42 U.S.C. § 653a(f)(1) (automated comparisons performed by State Directory of New Hires); 42 U.S.C. § 653a(h)(1) (disclosure of new hire data to contractors), 42 U.S.C. § 654(27) (staffing of state disbursement unit), and 42 U.S.C. § 654b(a)(2)(A) (operation of state disbursement unit); 45 C.F.R. § 302.12(a)(2) (with certain exceptions, the agency need not perform all of the functions of the IV-D program as long as it insures all these functions are being carried out properly, efficiently, and effectively).

[184] *See* HHS, Response to the Solicitation for Comment in Connection with a Study Being Conducted by the Department of the Treasury Relating to the Scope and Use of Provisions Regarding Taxpayer Confidentiality: Comments on Use of Taxpayer Information in the Child Support Enforcement Program (3/16/00) [hereinafter HHS Comments].

the performance of their IV-D duties by prohibiting them from obtaining and using the same tax data that is available to the agency itself for the performance of those functions."[185]

In Treasury's view, Congress's explicit statutory grant of access to contractors in section 6103(l)(6)(B) belies the argument that it intended such access for child support contractors all along. In other instances where Congress has intended for contractors to have access to return information, Congress has also been explicit.[186] Congress historically has permitted access to returns and return information by contractors in only a few very narrowly defined circumstances. At the same time, it may be appropriate to reexamine whether the limitations on contractor access to data are reasonable in light of the other requirements of Title 42.

b) Agency Safeguards

The second factor HHS cites is that under 45 C.F.R. § 302.12(a)(3), contractors are subject to the same safeguards required of the state agency. HHS concludes:

> We believe private contractors under contract to a child support agency should receive and use Federal tax information in the same manner as an employee of the child support agency to whom the entity is under contract, provided that such private contractors are subject to the same safeguarding requirements as the child support agency and provided that the child support agency remains ultimately accountable for compliance with those safeguards. For child support enforcement purposes we would encourage section 6103 to be interpreted and applied in a manner that permits this approach.[187]

Treasury agrees with HHS that the applicability of agency safeguards to contractors and the accountability of the agency are important factors in determining whether return information should be disclosed to an agency's contractors. These factors are not the only ones to be taken into account. At a minimum, the agency should be required to demonstrate general compliance with section 6103, compliance with IRS safeguards (not simply internal safeguards), and adequate control over its contractors.

c) Non-Title 26 Penalties

A third point HHS makes is that the applicability of penalties (i.e., complete denial of Federal child support funding if a state fails to operate its program in conformity with its IV-D state plan, and a denial of a portion of the state TANF block grant for lesser infractions) to state agencies that do not secure contractor data in compliance with Federal requirements is another factor to consider. HHS has indicated that it would be supportive of additional or increased penalties or sanctions on the state and its private contractors if tax data is misused, if IRS considered them warranted to increase individual accountability.[188]

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[185] The Eastern Regional Interstate Child Support Association, Comments on the Scope and Use of Provisions Regarding Taxpayer Confidentiality, Submitted by Vernon Drew, President (Nov. 15, 1999).

[186] *See* section 6103(m)(4), (n).

[187] HHS comments, *supra* note 184.

[188] *Id.*

Treasury believes that a review of an agency's penalty structure would be important to evaluating a proposal for disclosure to contractors, but emphasizes that the current penalty structure for unauthorized access or disclosure in the Code would also have to apply.

d) Other Potential Confidentiality Protections

HHS has pointed out that the state plan approval process, Federal funding, and the contract between a IV-D agency and the private contractor all present opportunities to implement redisclosure protections.[189] It is important to note that HHS/OCSE do not support extending access to return information by private child support collection agencies that operate outside of IV-D, and which, under current legislative proposals, would not be subject to mandatory safeguarding requirements.

2. Treasury's Recommendation With Respect to Contractors

The Congress and Treasury traditionally have resisted efforts to increase access by contractors to tax information. The JCT staff recommended that the present-law disclosures to contractors should not be expanded, noting, "[E]xpanding the number of persons who have access to returns and return information increases the likelihood that confidential information will be unlawfully disclosed…."[190]

Although Treasury agrees with the spirit of the JCT staff's recommendation, Treasury acknowledges that there is an apparent mismatch between tailored grants of authority to disclose tax information to "agencies" to administer particular nontax programs (e.g., the authority under sections 6103(l)(6) and (l)(7), for child support and welfare program operations, respectively), and the fact that it appears to have become the norm for these types of government programs to be administered by, or with assistance from, contractors rather than by government agency personnel – often with explicit statutory or regulatory permission.

Apart from issues related to contractors who actually administer child support and welfare programs, issues also arise as a result of computer support contractors who maintain agency databases as well as contractors who perform administrative functions. It is a common practice for government agencies to use contractors to perform such functions. Indeed this reality informs section 6103(n), which permits disclosures to contractors for tax administration purposes.[191] Moreover, although such contractors have access to the data, they are less likely to have a need to look at the actual data itself and thus, in some respects, may pose less of a risk than contractors administering the programs.

The apparent clash of the policy against contractor access with the realities of modern governmental agencies, creates anomalies in section 6103 that must be addressed. The effect of the prohibition against using contractors has been to nullify certain disclosure provisions, encourage circumvention of Congressional intent through the use of other, more general disclosure authority, e.g., section 6103(c) consents, and severely hamper agency operations. In

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[189] Addendum to 11/15/99 OCSE comments.

[190] JCT Study at 219.

[191] IRS applies rigorous safeguards to its own contractors. *See* Treas. Reg. § 301.6103(n)-1(d).

addition, proposals for additional statutory disclosures cannot be addressed without also addressing the issue of contractor access – the two issues have become intertwined.

Treasury thus believes that there may be cases, particularly in the child support area, where it is appropriate to bring statutory grants of disclosure authority into alignment with the reality of the agency's operations. Treasury believes that any significant change in policy with respect to contractors' access to tax returns and return information should only come as the result of a clear Congressional mandate and subject to certain restrictions described below.

Thus, where a threshold determination has been made that an agency's need for the information outweighs concerns about taxpayer privacy and compliance, access by contractors to such information should be granted if – and only if – the agency can demonstrate sufficient oversight of the contractors and can certify on an annual basis that such contractors are in compliance with the safeguards of section 6103(p)(4). The only exception to such a certification requirement would be for redisclosure of fact of discrepancy information to, for example, public housing authorities.

Treasury's recommendation regarding contractors generally is consistent with the JCT staff's recommendation regarding state tax administration contractors (incorporated in section 207 of TBOR 2000). As the JCT staff noted in its Study, IRS simply does not have the resources to monitor the compliance of the numerous contractors involved. Currently, IRS has only six staff members in the National Office of Safeguards. This staff is responsible for overseeing safeguard reviews of over 75 Federal agencies, 50 state welfare agencies, and 54 child support agencies. In this regard, IRS should not be expected to monitor compliance of contractors with safeguards if the appropriate certification has been received from the relevant agency.

The importance of the threshold determination cannot be overstated. Treasury agrees with the JCT staff that additional disclosures should only be granted upon a demonstration of a "compelling need" [192] (as demonstrated by satisfaction of the criteria enumerated above).

It is likely that an oversight and certification requirement will, in many cases, deter or even preclude access by an agency. Treasury believes that this strikes the appropriate balance. In some cases, agencies will be unable to demonstrate that their need for the information outweighs concerns about taxpayer privacy and compliance. At the same time, factoring the use of contractors into the decision about whether to provide disclosure authority at all will prevent the interagency conflicts that occur now.

Recommendation: Disclosures to contractors and agents of a Federal, state, or local agency should be permitted when the agency both has demonstrated a compelling need for contractors to have access to the requested information and is able to demonstrate oversight of its contractors and certify compliance of those contractors with the safeguards of section 6103(p)(4). Such disclosure/certification programs should be initiated on a pilot basis. Certification would not be necessary for contractors receiving only fact-of-discrepancy information.

[192] JCT Study at 196.

G. Other Benefit Programs

1. Issues With Respect to Which Entities Administer Programs

Under section 6103(l)(7), certain unearned income information may be disclosed to Federal, state, and local agencies administering a specific list of welfare and other benefit programs, for purposes of determining eligibility for, and the correct amount of, benefits under any of those programs. These programs include the Temporary Assistance for Needy Families ("TANF") and Medicaid programs.

Some of the same contractor issues described in reference to section 6103(l)(6) disclosures related to child support enforcement arise with respect to welfare programs. Unlike section 6103(l)(6), there has been no statutory grant of access by welfare contractors to returns or return information. This creates an apparent conflict with 42 U.S.C. § 604a, which permits TANF programs to be administered, at the state's option, by charitable, religious, or private organizations. This conflict is somewhat compounded by 42 U.S.C. § 1320b-7(a)(2), which directs states administering these programs to request information from the IRS available under section 6103(l)(7) to the extent that such information may be useful in verifying eligibility for, and the amount of, benefits available under specified programs.[193]

Finally, as in the case of child support, Indian Tribes have been granted authority to administer Tribal TANF programs,[194] but Tribes have not been granted access to tax data for such purposes.

Recommendation: Section 6103(l)(7) should be amended to permit Tribes, charitable, religious, or private organizations operating Federally recognized TANF programs to receive tax information for TANF program purposes.

2. Overlap Between (l)(6) and (l)(7) Disclosures

As indicated above, disclosures authorized under section 6103(l)(6) and (l)(7) and related provisions of the Social Security Act are not always a neat fit. For example, Title IV-D child support enforcement efforts are required to be made on behalf of children that also qualify for welfare benefits under Title IV-A, and custodial parents are required to cooperate with the IV-D agency as a condition of eligibility for TANF. These are overlapping and closely coordinated programs under the Social Security Act, but there is no Title 26 authority to share tax information as part of that overlap or coordination. Rather tax data is disclosed separately, under separate Title 26 authority, for each program and may not be pooled, shared or compared, not even to the extent both programs are entitled to receive the same tax information. In some states, case workers for the two programs may occupy the same office (or the same case worker may provide both IV-A and IV-D services for the family). For purposes of efficiency, it may be appropriate to facilitate the sharing of data within a state facility where its disclosure has been authorized for more than one program. To the extent different agencies are responsible for administering IV-A and IV-D programs within a state, it may be appropriate to address data-sharing among these agencies as well, although such inter-agency data-sharing raises additional

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[193] Under 42 U.S.C. § 1320b-7(c), agencies receiving information pursuant to section 6103(l)(7)(B) are required to independently verify certain information before taking potentially adverse actions based thereon.

[194] 42 U.S.C. § 612.

safeguard concerns. Although both intra- and inter-agency data-sharing with respect to common data elements could be authorized by an amendment to Treasury regulations,[195] Treasury would prefer that this result be achieved through an amendment to the statute.

Recommendation: Section 6103 should be amended to permit sharing of return information within a state agency that receives such information in connection with two or more programs under section 6103(l)(6) and/or section 6103(l)(7) with respect to the same individual, subject to Treasury's recommendation with respect to contractors. Similarly, consideration should be given to amending section 6103 to permit inter-agency data-sharing in similar circumstances.

3. Disclosures to Veterans Affairs

Section 6103(l)(7)(D)(viii) permits the disclosure of unearned income information in connection with eligibility determinations for needs-based pension, health care, and other programs administered by the Secretary of Veterans Affairs ("VA"). This provision will expire on September 30, 2003.

The GAO reported that safeguard violations had been discovered in connection with VA's use of tax data to administer certain programs.[196] The IRS reports that VA is addressing these problems satisfactorily.

Provided VA demonstrates continued need for the information disclosed pursuant to section 6103(l)(7)(D)(viii) and continued compliance with the safeguards of section 6103(p)(4), Treasury supports an extension of this provision.

Recommendation: Provided VA demonstrates (1) continued need for the information disclosed pursuant to section 6103(l)(7)(D)(viii) and (2) continued compliance with the safeguards of section 6103(p)(4), section 6103(l)(7)(D)(viii) should be extended beyond its current expiration of September 30, 2003.

H. Student Financial Aid Programs Administered by the Department of Education

Section 6103 contains two provisions authorizing disclosures to the Department of Education. Under section 6103(m)(4), the IRS may provide the Department of Education, upon written request, the mailing address of taxpayers who owe an overpayment of Pell grants or who have defaulted on student loans administered by the Department of Education. The provision also permits the Department of Education to redisclose such information to certain lenders, guarantee agencies, and educational institutions. In both cases, disclosures may be made to officers, employees, or agents of such organizations, but solely for purposes of locating such taxpayers to collect the overpayment or loan.

The second disclosure provision applicable to the Department of Education is section 6103(l)(13), added to the Code in 1993, which permits the IRS to disclose, upon written request, certain items of return information with respect to a taxpayer who has received an income contingent loan, i.e., repayment of such loan is based in whole or in part upon the taxpayer's income. The items of information that can be disclosed under this provision include the

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[195] *See* Treas. Reg. §301.6103(p)(2)(B)-1.

[196] GAO, *Taxpayer Confidentiality: Federal, State, and Local Agencies Receiving Taxpayer Information* (GAO-GGD-99-164), August 1999, p. 13.

taxpayer's identity information, the filing status, and the adjusted gross income. Information disclosed under this provision can only be used for purposes of and to the extent necessary for establishing the appropriate income contingent repayment amount for an applicable student loan.

Unlike section 6103(m)(4) disclosures, which can be made to contractors, section 6103(l)(13) disclosures may only be made to officers or employees of the Department of Education. In addition, this provision sunsets on September 30, 2003. The reasons for both of these limitations are explained in the legislative history:

> The committee believes that the Department of Education should be provided with access to tax return information to assist it in carrying out modifications of the Federal student loan program…. The committee, however, is also concerned about the increasing number of requests for disclosure of confidential tax information for nontax purposes and the effect of such disclosure on voluntary taxpayer compliance. Accordingly, *only the Department of Education and its employees* have been given access to the tax return information necessary to implement income-contingent repayment and the access has been granted only temporarily.[197]

In practice, disclosures for the purposes described in section 6103(l)(13) are made pursuant to taxpayer consents under section 6103(c) because the Department of Education uses contractors to administer the income contingent loan program. The IRS and the Department of Education have devised a system whereby taxpayer consents are imaged and transmitted to IRS electronically for review. The Department of Education then transmits a tape to IRS containing the items of information to be verified for such taxpayers. Approximately 100,000 consents are processed under this program each year.

The Higher Education Amendments of 1998 ("HEA") included an amendment to section 484(q) of the Higher Education Act of 1965 (20 U.S.C. §1091(q)), which authorized the Secretary of Education, in cooperation with the Secretary of the Treasury, to confirm certain items of information with the IRS for purposes of verifying information reported by applicants on student financial aid applications. This information included adjusted gross income, Federal income taxes paid, filing status, and exemptions reported by applicants and parents. The amendment also required the Secretary of Education to establish procedures under which an applicant would be notified of disclosures "under section 6103(l)(13)." This reference seems to be in error, because disclosures for purposes for verifying information reported by applicants are not authorized by section 6103(l)(13).

Because the HEA did not expressly override section 6103, disclosures pursuant to this provision may only be made with the taxpayer's consent. This has presented some

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[197] Staff of the Senate Finance Committee, 103d Cong., 1st Sess., *Fiscal Year 1994 Budget Reconciliation Recommendations of the Committee on Finance* 54 (Comm. Print 1993); Staff of the House of Representatives Committee on Ways and Means, 103d Cong., 1st Sess., *Fiscal Year 1994 Budget Reconciliation Recommendations of the Committee on Ways and Means* 366 (Comm. Print 1993) (emphasis added). The sunset provision was extended to September 30, 2003 by Pub. L. 105-277.

implementation issues for both the Department of Education and the IRS. The Department of Education receives approximately 10 million applications for student financial assistance each year. Because roughly half of the applicants are dependents, income information is needed for both the student and the parent(s). Thus, verification under this provision could apply to over 15 million taxpayers each year. Under the current consent regime, this means 15 million additional pieces of paper for the Department of Education to process (30 million application forms are actually printed each year), and 15 million consent forms for the IRS to review (whether in paper or electronic format).

The burden of processing this number of consents obviously would be reduced if the consents were executed and transmitted electronically. Accordingly, the Department of Education has asked to be included in the TDS program. IRS is currently conducting a test match for the Department of Education (under which information is disclosed in blurred form), which is designed to evaluate the incidence of error and suggest ways of targeting further verification efforts.

Recommendations:

- If the test match currently underway between the IRS and the Department of Education supports a business case for income verification by the Department of Education, section 6103 should be amended to permit disclosure of necessary items of information for income verification in connection with student financial aid eligibility determinations as contemplated by the Higher Education Act. Consistent with Treasury's recommendations regarding contractors generally, if adopted, this provision should permit access by contractors, subject to the limitations described above.
- The erroneous reference to section 6103(l)(13) in section 484(q)(2) of the Higher Education Act should be removed.
- Congress should amend section 6103(l)(13) to provide access to the items of information the Department of Education needs and to permit the use of contractors, subject to the limitations described above. As amended, this provision should be extended beyond its current expiration of September 30, 2003.

I. Statistical Use – Disclosures to Census Bureau, Etc.

1. In General

Gathering statistical data through censuses and surveys can impose significant burdens on respondents, and significant costs on statistical agencies. Some of the information reported on tax returns can potentially be used to help structure censuses and surveys, thereby reducing both respondents' burdens and statistical agencies' costs. These potential savings from the statistical use of tax return information have long been recognized, and a limited number of such uses were permitted by Executive order and administrative practice prior to their codification in section 6103(j) in the Tax Reform Act of 1976. Congress carefully balanced the potential savings from allowing disclosures of tax return information for statistical purposes against the potential costs of reduced privacy for taxpayers, and the risk of reduced voluntary compliance with the tax laws. This balance was achieved through a series of limitations in section 6103(j):

- First, disclosures were initially authorized to only four agencies, the Bureau of the Census and the Bureau of Economic Analysis in the Department of Commerce, the Federal Trade Commission, and the Department of the Treasury.[198] The Department of Agriculture was added in 1998, as a result of the transfer of responsibility for the census of agriculture from the Bureau of the Census to the Department of Agriculture.[199] However, disclosures to the Federal Trade Commission have been discontinued because responsibility for the survey for which such disclosures were permitted has been transferred to the Bureau of the Census.
- Second, disclosures are authorized only for specified purposes. For example, disclosures to the Bureau of the Census are allowed "for the purpose of, but only to the extent necessary in, the structuring of censuses … and conducting related statistical activities authorized by law" (section 6103(j)(1)).
- Third, disclosures are allowed only to "officers and employees" of the authorized agency. A further stipulation for the Departments of Agriculture and Treasury is that the "official duties" of these officers and employees must require access to the tax return information.
- Fourth, disclosures must be prescribed by Treasury regulations (except in the case of disclosures to the Department of the Treasury).
- Fifth, the disclosure must be requested in writing by the Secretary of the Department, or, in the case of the Department of the Treasury, the head of the requesting office or bureau.
- Sixth, recipient agencies may not redisclose the tax return information in identifiable form, except to the taxpayer.

In addition, statistical agencies must follow the procedures and recordkeeping requirements of section 6103(p). IRS periodically conducts safeguard reviews of statistical agencies to ensure that the requirements of sections 6103(j) and 6103(p) are being met, and, if not, that remedial actions are taken to bring the agency into compliance with them.

2. Expanding the Number of Covered Agencies

As part of its program for strengthening the Federal statistical system, the Administration has supported legislation that would permit the limited sharing of confidential data among selected statistical agencies solely for statistical purposes. In conjunction with such legislation, the Administration has proposed companion legislation that would expand the number of agencies covered under section 6103(j).[200] The purpose of the proposal is to reduce the respondent burden on individuals and on businesses covered by Federal statistical censuses and surveys, and to eliminate duplicative work and increase efficiency among the Federal statistical agencies. In addition to expanding disclosure authority to additional statistical agencies, the proposal would allow, pursuant to prior Treasury approval, the sharing of tax information among

[198] Most disclosures to Treasury's Office of Tax Policy are made for purposes of tax administration, which is covered by section 6103(h).

[199] The transfer was made by the Census of Agriculture Act of 1997, Pub. L. 105-113.

[200] Such legislation, with an interpretative commentary, was first transmitted to the Congress by Assistant Secretary of the Treasury for Tax Policy Leslie Samuels on June 3, 1996.

these agencies for the purpose of, but only to the extent necessary to construct sampling frames for censuses and surveys and for related statistical purposes authorized by law. The tax information permitted to be disclosed would include identification information (names, addresses, and taxpayer identification numbers) and classifications of other return information in categorical, rather than exact, form.

Under the proposal, disclosures of business-related return information to the Bureau of the Census, return information from the returns of corporations to the Bureau of Economic Analysis, and agricultural business related return information to the National Agricultural Statistics Service would continue as under the current statute. Return information related to individuals disclosable to these three agencies and return information related to individuals and businesses disclosable to other statistical agencies for the purpose of constructing sampling frames for censuses and surveys would be covered by a new subsection that would establish uniform criteria for such disclosures. The list of statistical agencies would be those designated in the companion data sharing legislation, and the Division of Research and Statistics of the Board of Governors of the Federal Reserve System.

Recommendation: The disclosure authority of section 6103(j) should be expanded to additional specified statistical agencies, and such agencies should be permitted, upon prior Treasury approval, to share IRS data with each other.

3. Disclosures to the Federal Trade Commission

The JCT staff recommended repealing section 6103(j)(2), regarding disclosures to the Federal Trade Commission ("FTC") for statistical purposes, because the FTC no longer needs the information. Treasury agrees.

VII. FOIA and Disclosure Issues With Respect to IRS Documents

A. Agency Working Law – FOIA and Section 6110

1. In General

As discussed above, the FOIA generally requires Federal agencies to make their records available to the public except to the extent such records, or segregable portions thereof, fall within one of nine exemptions or three special law enforcement exclusions to its general disclosure requirements. The basic purpose of the FOIA is to "ensure an informed citizenry, vital to the functioning of a democratic society, needed to check against corruption and to hold the governors accountable to the governed."[201] In providing for exemption to the general disclosure requirements of the FOIA, however, Congress recognized that release of some kinds of records would not serve the basic purpose of the FOIA or would do harm to other important interests, such as privacy, security, and the effective and efficient operation of government. Both FOIA and section 6110 reflect Congress's attempt to properly balance these competing interests - taxpayer privacy, an informed citizenry and government accountability, and government efficiency.

The FOIA, in effect, places an affirmative obligation upon Federal agencies to make available for public inspection the "working law" of the agency.[202] The concept of agency

[201] *NLRB v. Robbins Tire & Rubber Co.*, *supra* note 54, at 242.

[202] *See* 5 U.S.C. § 552(a)(2).

working law has developed in the case law: "It is well established that information which either creates or provides a way of determining the extent of substantive rights and liabilities constitutes a form of law that cannot be withheld from the public."[203] Under current law, as discussed below, certain information that has been deemed by the courts to "create or provide a way of determining the extent of substantive rights and liabilities" of taxpayers under the FOIA must be disclosed under the procedures and protections established by section 6110.

2. Case Law Regarding IRS Working Law

In *Tax Analysts & Advocates v. IRS*,[204] the United States Court of Appeals for the District of Columbia Circuit was first confronted with the question of how to balance the competing interests described above. The lower court had held PLRs and TAMs to be "interpretations …adopted by the agency" and therefore expressly required to be disclosed under FOIA (a)(2) because they provided a research tool for the agency and were relied upon by the agency as precedent.[205]

At the time, section 6103(a)(1) provided that "returns made with respect to taxes . . . upon which the tax has been determined by the Secretary or his delegate shall constitute public records; but, except as hereinafter provided . . . they shall be open to inspection only by order of the President and under rules and regulations prescribed by the Secretary or his delegate and approved by the President."[206] Thus, presented with the question of whether 5 U.S.C. §552(b)(3) in conjunction with section 6103, exempted these documents from disclosure, the D.C. Circuit held that PLRs, insofar as they were

> generated by the voluntary request of a taxpayer for tax advice from the IRS are beyond the scope of that which the Congress sought to protect under section 6103, that is, 'returns' filed under compulsion of law which contain information necessary to determine federal tax liability.[207]

By contrast, TAMs were held to be exempt in their entirety because they responded to an inquiry by a District Director regarding the "treatment of a specific set of facts relating to a tax return 'filed by a named taxpayer involving either an audit or in connection with the taxpayer's claim for refund or credit of taxes'" and thus "deal directly with information contained in

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[203] *Tax Analysts & Advocates v. IRS*, 505 F.2d 350, 353 (D.C. Cir. 1974), citing *Sterling Drug, Inc. v. FTC*, 450 F.2d 698 (D.C. Cir. 1971) [hereinafter *Tax Analysts I*].

[204] *Tax Analysts I*.

[205] *Tax Analysts & Advocates v. IRS*, 362 F. Supp. 1298 (D.D.C. 1973), *modified by Tax Analysts I*.

[206] Although there was no concept of "return information" in the Code at the time, Treasury Regulations defined "return" to include "(a) Information returns, schedules, lists and other written statements filed by or on behalf of the taxpayer with the Internal Revenue Service which are designed to be supplemental to or become a part of the return, and (b) Other records, reports, information received orally or in writing, factual data, documents, papers, abstracts, memoranda, or evidence taken, or any portion thereof, relating to the items included under (a) of this subdivision." Treas. Reg. § 301.6103(a)-1(a)(3) (Feb. 8, 1972).

[207] *Tax Analysts I* at 355.

'returns made with respect to taxes' and are part of the process by which tax determinations are made."[208] In *Freuhauf Corp. v. IRS*, however, the Sixth Circuit, reached the opposite result with respect to "'those portions of responses to Technical Advice requests that are or were intended for issuance to taxpayers.'"[209]

Largely in response to these cases, Congress enacted section 6110 as part of the Tax Reform Act of 1976's overhaul of taxpayer confidentiality provisions. Section 6110 requires that a "written determination" and any background document related thereto must be open to public inspection. As explained by the JCT staff, "Only in this way can all taxpayers be assured of access to the ruling positions of the IRS. Also, this tends to increase the public's confidence that the tax system operates fairly and in an even-handed manner with respect to all taxpayers."[210] Explaining the concerns about the secrecy surrounding the ruling process, the JCT staff stated:

> [T]he private ruling system developed into a body of law known only to a few members of the tax profession. For example, an accounting or law firm with offices in Washington could have a library of all the private ruling letters issued to its clients. Such a firm was in a position to advise other clients as to the current IRS ruling position because of its special access to these rules of law. This, in turn, tended to reduce public confidence in the tax laws. Additionally, the secrecy surrounding letter rulings generated suspicion that the tax laws were not being applied on an even-handed basis.[211]

In addition to these concerns about "secret law," Congress also sought to address certain issues left unresolved by the cases and/or IRS procedures. These issues included "the parts of a ruling file that should be published, whether private rulings should be available as 'precedent' for other taxpayers, what procedures should be established to allow taxpayers to claim that protected material should not be disclosed, etc."[212] In enacting section 6110, Congress thus sought to ensure that the public's right to know was sufficiently balanced with taxpayers' rights of privacy.

Another element of the Tax Reform Act of 1976 that would shape future litigation in this area was the addition of the concept of "return information" to the protections of section 6103. New section 6103(b)(2)(A) expansively defined return information to include the following:

- a taxpayer's identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments,

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[208] *Id.*

[209] 522 F.2d 284 (6th Cir. 1975), *vacated*, *Internal Revenue Service v. Fruehauf Corp.*, 429 U.S. 1085 (1977), *on remand*, *Fruehauf Corp. v. Internal Revenue Service*, 566 F.2d 574 (6th Cir. 1977).

[210] Staff of the Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1976*, *supra* note 37, at 304.

[211] *Id.* at 303.

[212] *Id.*

- whether the taxpayer's return was, is being, or will be examined or subject to other investigation or processing, or
- any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense.

As courts would later observe, the 1976 revision of section 6103 defined "return information in the broadest way."[213] Thus, dissatisfied with the courts' inability under the FOIA to protect sufficiently taxpayers' privacy interests in PLRs and TAMs[214] while at the same time facilitating an informed citizenry and government accountability, Congress created in the Code – in the phrase "return information" – a new concept that swept up PLRs and TAMs in their entirety and, at the same time, embraced the courts' conclusion that PLRs and TAMs should be made public under FOIA in section 6110. [215]

Almost a decade later, the D.C. Circuit was again faced with the issue of what constitutes the IRS's "working law," and, more specifically, with the question of the scope of the deliberative process privilege under FOIA(b)(5) as applied to certain documents. In *Taxation with Representation Fund (TWRF) v. IRS*,[216] the D.C. Circuit held that General Counsel Memoranda ("GCMs") reconciled with the IRS Assistant Commissioner (Technical), Action on Decision documents ("AODs") issued with respect to nonappealed cases, and Technical Memoranda ("TMs") approved by the Treasury Assistant Secretary (Tax Policy) were required to be disclosed under FOIA (a)(2).[217] Preliminarily, the court suggested that it agreed with the

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[213] *United States v. Barrett*, 837 F.2d 1341 (5th Cir. 1988), *cert. denied,* 492 U.S. 926, *reh'g denied,* 493 U.S. 883 (1989).

[214] The FOIA provided inadequate protections for taxpayer privacy. Under FOIA(a)(2), Federal agencies are authorized to delete identifying details when making available or publishing an opinion, statement of policy, interpretation or staff manual or instruction in order to prevent a clearly unwarranted invasion of *personal* privacy." Because the FOIA's privacy protections do not reach nonindividuals, e.g., corporations, trusts, estates, and partnerships, the FOIA would not adequately protect *all* taxpayer privacy interests.

[215] Section 6103(b)(2)(B) includes within the term "return information" any material redacted from a written determination or background file under section 6110.

[216] 646 F.2d 666 (D.C. Cir. 1981) [hereinafter *Tax Analysts II*].

[217] In *Tax Analysts II*, the D.C. Circuit was not asked to determine how to reconcile FOIA (a)(2) and section 6103. The IRS did not argue that GCMs and AODs consisted of return information in their entirety. Rather, the IRS argued that these documents contained discrete items of return information, the redaction of which was required by FOIA exemption 3 in conjunction with section 6103(a). When this case was being litigated, the district court, in *Neufeld v. IRS*, 1 Government Disclosure Service para. 79,118 (D.D.C. 1979), *aff'd in part & rev'd in part*, 646 F.2d 661 (D.C. Cir. 1981), had followed the Ninth Circuit's interpretation of section 6103(b)(2), which protected only return information that, directly or indirectly, identified a taxpayer. Given this standard, the IRS would have been unable to argue, for those GCMs written with respect to

IRS that each of the three documents, at the time they were written, were exempt from disclosure under FOIA (b)(5)'s deliberative process privilege. However, having found that the documents were (1) reconciled with the views of the final agency decision-maker, (2) used by case agents in their dealings with other taxpayers; and/or (3) used internally as precedent, the court in *Tax Analysts II* held that the actions of decision-makers concerning, and agency personnel uses of, these documents subsequent to their issuance made these documents informally adopted interpretations of law disclosable under FOIA (a)(2).

A decade later, in *Tax Analysts v. IRS*,[218] the D.C. Circuit addressed whether Field Service Advice Memoranda ("FSAs") fell within FOIA (b)(5)'s deliberative process privilege or constituted interpretations of law adopted by the IRS that had to be disclosed under FOIA (a)(2). Even though FSAs were not reconciled with the views of the final agency decision-maker, were not used by case agents in their dealings with other taxpayers, and were not used internally as precedent – the reasons that GCMs, AODs, and TMs had been held to be (a)(2) materials – the D.C. Circuit determined that because FSAs were (1) statements of the national office of Chief Counsel authorities on particular taxpayer matters, (2) written in the national office to obtain uniformity on significant legal issues, and (3) used by case agents in their dealings with the taxpayers with respect to whom the FSAs were written, they were informally binding upon recipients and thus constituted interpretations adopted by the IRS within the meaning of FOIA (a)(2) and were not exempt in their entirety from disclosure by FOIA(b)(5).

Drawing parallels between TAMs and FSAs, the *Tax Analysts III* panel also determined that the legal analysis portions of these counsel-generated memoranda were not return information within the meaning of section 6103(b)(2) and thus were subject to disclosure. In Treasury's view, the court failed to appreciate that TAMs and PLRs were swept up, in their entirety, into the all-encompassing definition of return information and hence the general confidentiality rule of section 6103 that Congress created in 1976, but were then subject to public inspection only by virtue of the simultaneous enactment of section 6110 and that only Congress could have mandated this result. The court in *Tax Analysts III* could not order the disclosure of taxpayer-specific FSAs determined to be FOIA (a)(2) material (consistent with *Tax Analysts I*) if it determined that the FSAs constituted return information in their entirety. In order to effectuate the result of having what it found to be "working law" available to the public, the court narrowed the definition of return information. Subsequently, in RRA 1998, just as it had in 1976, Congress legislated a result consistent with this court-ordered FOIA disclosure, adding "Chief Counsel Advice" to the list of written determinations subject to disclosure under section 6110.

3. TBOR 2000 Expansion of Section 6110

TBOR 2000 expands upon RRA 1998's view that there are additional types of documents that constitute the working law of the IRS. Specifically, section 202 of TBOR 2000 would define written determinations within section 6110(b) to include not only advice issued by the national office component of Chief Counsel to field or service center employees of the IRS or

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PLRs and AODs, that the documents consisted of return information in their entirety. Subsequently, the standard embraced by the D.C. Circuit in *Neufeld* just days before its decision in *TWRF* was rejected by the Supreme Court in *Church of Scientology of Ca. v. IRS*, 484 U.S. 9 (1987).

[218] 117 F.3d 607 (D.C. Cir. 1997) [hereinafter *Tax Analysts III*].

regional or district employees of Chief Counsel, but also would expand the definition to encompass all “official advice” issued by any component of either Chief Counsel or the IRS to any employee of either Chief Counsel or the IRS. As with the current provision regarding Chief Counsel advice, such official advice would have to convey (1) a legal interpretation of a revenue provision, (2) IRS or Office of Chief Counsel position or policy concerning a revenue provision, or (3) legal interpretation of state law, foreign law, or other Federal law relating to the assessment or collection of any liability under a revenue provision.

The principal defect of section 202 of TBOR 2000 is that it does not define “official” advice. Moreover, it potentially opens up a wide range of privileged documents to affirmative disclosure. For example, whereas present-law section 6110 applies to documents that have been explicitly found by courts not to be subject in their entirety to the deliberative process privilege, TBOR 2000 does nothing (short of language in the legislative history) to confine “official” advice to documents analogous to documents currently included in section 6110, i.e., final statements of policy or legal interpretations adopted by authoritative components of the IRS. TBOR 2000 appears to endorse the notion that every interpretation of the tax law written within the Office of Chief Counsel and IRS is agency working law that must be disclosed regardless of its finality or authority within the agency. Treasury believes this goes too far. In Treasury’s view, legal analysis of tax issues contained in documents written by the Office of Chief Counsel or IRS should not automatically be equated with agency working law and should enjoy the protection of the deliberative process privilege where appropriate.

These points are elaborated upon below in the discussion of two specific categories of documents addressed by the report language for TBOR 2000.

a) Intra-National Office Counsel Documents and National Office Counsel Documents to Program Managers

TBOR 2000 reflects the view that documents written by any national Office of Chief Counsel component, either to another component of the national Office of Chief Counsel or to its IRS headquarters “client” should be available for public inspection once the policy or program matter to which the document relates is final. Memoranda between component offices of the Office of Chief Counsel typically arise in the context of drafting TAMs, PLRs, FSAs, rulings, regulations, or brief review. These documents are predecisional in that they are generated before the Office of Chief Counsel decision as to how to address issues, and what positions to take, if any, in the TAMs, PLRs, FSAs, revenue rulings, regulations, or briefs. Furthermore, they are deliberative. They represent the give-and-take between various components of the Office of Chief Counsel, which will speak with one voice once a TAM, PLR, FSA, revenue ruling, regulation, or brief is finalized and issued (or filed). As the Supreme Court noted in *NLRB v. Sears, Roebuck & Co.,* “the public is only marginally concerned with reasons supporting a policy which an agency has rejected, or with reasons which might have supplied, but did not supply, the basis for a policy which was actually adopted on a different ground.”[219] The legislative history to the enactment of section 6110 makes clear that Congress excluded from the category of “background file documents” that were to be made available to the public upon request, internally generated documents written during the drafting of PLRs and TAMs:

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[219] 421 U.S. 132, 152 (1975).

> Moreover, internal memoranda within the Internal Revenue Service relating to a particular written determination, or the question involved therein, which relate to development of the Service's legal position on the question involved, should not be a part of the background file (and for this purpose Chief Counsel should be considered part of the Internal Revenue Service).[220]

A similar analysis applies to memoranda between Counsel and IRS program managers and executives, such as legal advice on tax forms and publications, Appeals Settlement Guidelines, Industry Specialization Program papers ("ISPs"), Market Segment Specialization Program papers ("MSSPs"), and other policy and program initiatives. These documents are predecisional because they are generated before the adoption of a policy by the program managers and executives as to how they will run their programs or what papers, forms, or publications should conclude. Furthermore, they are deliberative in that they reflect give-and-take as to how programs should be run, what they should include, and assessments of competing policy and administrative values that may be factored into the decision-making process.

As with intra-counsel memoranda, the public arguably has little interest in learning what might have been done, but was not. The public's interest in ascertaining government positions and facilitating government accountability is met by the publication of the documents and creation of programs that culminate from these deliberations, e.g., tax forms and publications, Internal Revenue Manual and other instructions to staff, policy statements, position papers (ISPs, MSSPs), settlement guidelines, etc. Just as the documents reflecting the internal deliberations preceding the issuance of regulations and other forms of published guidance have been found by the courts to be predecisional and deliberative and therefore exempt from disclosure by FOIA (b)(5), so, too, are these intra-counsel and counsel to program manager internal memoranda.[221]

While there is little public interest served by these documents' publication, there are substantial governmental interests weighing against their disclosure – in ensuring government efficiency, tax compliance and uniform tax enforcement, and in obtaining candor in furtherance of the full consideration and development of sound tax administration policy and practice.

The costs of increased disclosure include costs to the quality of the decision-making processes of the agency as a result of both the chilling effect such disclosure would have on the deliberative process and the diversion of limited agency resources to the mechanics of public inspection. There will be less guidance produced and in a less timely fashion because of the greater effort required – thoroughness of research, degree of editing, levels of review. In addition, taxpayers may inappropriately rely on or cite to predecisional documents that do not ultimately reflect the IRS's official position on a matter – potentially leading to the creation of a body of "bad law." Moreover, discrepancies among or errors in predecisional documents will create confusion for taxpayers. Finally, without assurances of confidentiality, taxpayers may be less likely to seek guidance or to participate in the IRS dispute resolution procedures.

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[220] Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1976*, *supra* note 37, at 306.

[221] *See*, *e.g., Arthur Andersen & Co. v. IRS*, 679 F.2d 254 (D.C. Cir. 1982); *Pies v. IRS,* 668 F.2d 1350 (D.C. Cir. 1981).

b) District Counsel Advice to Local Client Offices

The TBOR 2000 report language also suggests that advice flowing from district counsel to IRS district personnel should be disclosed affirmatively, as is Chief Counsel Advice presently. To simply equate any memoranda written by a lawyer with working law ignores the carefully drawn lines in FOIA law between deliberative or attorney-client communications, which are privileged under FOIA exemption 5, and interpretations of law adopted by the agency, which must be affirmatively disclosed.

TBOR 2000 would mandate widespread public dissemination to address what appears to be a concern with a perceived lack of communication between IRS agents and taxpayers or their representatives, and consistency of treatment among taxpayers. Although these should be important goals of the IRS, the TBOR 2000 approach effectively substitutes public disclosure for IRS management oversight of its examination and other enforcement actions and loses sight of the purposes of FOIA and section 6110.

The interest of taxpayers in understanding the bases for their own tax treatment is adequately protected by current law. Both FOIA and section 6103(e) authorize disclosure to taxpayers and their representatives; to the extent an advisory document informs case agents in their dealings with the taxpayers, the case agent may communicate the position and legal arguments in support of that position, and may even disclose the advisory document (upon approval). Because the matters upon which local counsel offices opine are those for which established IRS position exists, there is no public interest served by widespread disclosure of such documents, and the effect of mandatory disclosure is likely to have a chilling effect on such communications. To the extent there are inconsistencies, publication of these documents will only create confusion as to what the IRS's official position really is. The public's interest in ensuring uniformity and consistency among agency positions is served at the national level, not the local level. Particular taxpayers' more parochial and particularized interests can (and should) be served by means other than further expanding section 6110.

Requiring the affirmative disclosure of district counsel advice would impose significant administrative burdens on the IRS. Between calendar years 1992-1998, 223,592 advisory opinion files were opened in district counsel offices nationwide – almost 32,000 possible district counsel advice documents annually.

4. Section 6110 and the Reorganized IRS

The discussion above indicates that as currently structured, section 6110 requires the disclosure of final determinations by IRS decision-makers. With respect to Chief Counsel Advice, section 6110 accomplishes this by limiting disclosure to documents issued by the National Office of Chief Counsel to the field. Treasury submits that TBOR 2000 departs from these principles and requires the disclosure of documents that are neither final nor authoritative. In addition, given the recent reorganization of the IRS, Treasury should be given the opportunity to determine whether it should issue regulations, as authorized by section 6110(i)(2), to expand the documents that should be considered "Chief Counsel Advice" based on these principles.

Recommendation: Section 202 of TBOR 2000, which would place an affirmative obligation on the IRS to disclose all "Official Advice" under section 6110 should not be enacted, because it requires the disclosure of documents that are neither final nor authoritative and are protected by the deliberative process privilege and thus will create confusion as to the law.

B. Closing Agreements

When section 6110 was enacted, Congress stated that closing agreements were not considered to be written determinations subject to disclosure under section 6110:

> [T]he Act does not require public disclosure of a closing agreement entered into between the IRS and a taxpayer which finally determines the taxpayer's tax liability with respect to a taxable year…. The Congress understands that a closing agreement is generally the result of a negotiated settlement and, as such, does not necessarily represent the IRS view of the law.[222]

Congress also cautioned, however:

> The Congress intends, however, that the closing agreement exception is not to be used as a means of avoiding public disclosure of determinations which under prior practice, would be issued in a form which would be open to public inspection under [section 6110].[223]

Closing agreements fall within the definition of "return information" in the Code because they consist of "data received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to … the determination of the existence, or possible existence, of liability (or the amount thereof) … for any tax…."[224] As one court observed, although closing agreements "generally set out the terms of the negotiated settlement between the taxpayer and the IRS, they are not intended to provide analysis, interpret the law, or apply the law to a particular set of facts."[225]

The principle that closing agreements, at least of taxable entities, are confidential return information and should not be subject to disclosure has been relatively undisputed. In recent years, however, two FOIA suits have disputed this principle with respect to tax-exempt entities, apparently due to a perception that the IRS has adopted the practice of resolving disputes with churches and other entities about exempt status through the (confidential) closing agreement process rather than through the (public) application for exempt status process.[226] To date, the courts have affirmed Treasury's view that closing agreements constitute return information.[227]

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[222] Staff of the Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1976*, *supra* note 37, at 304-05; *see* H. Rep. No. 658, 94th Cong., 1st Sess. 316 (1975); S. Rep. No. 94-938, *supra* note 35, at 306-07.

[223] *Id.* at 305.

[224] Section 6103(b)(2)(A); *see Tax Analysts v. IRS*, 53 F. Supp. 2d 449 (D.D.C. 1999).

[225] *Id.* at 450 n.2.

[226] David L. Lupi-Sher, *Support for Confidential PFAs May Signal a Change in Disclosure Wars*, 87 Tax Notes 176, 178 (April 10, 2000).

[227] *Tax Analysts v. IRS*, 53 F.Supp. 2d 449 (D.D.C. 1999) (closing agreements contain "determination[s] of the existence … of liability" and thus constitute return information within the meaning of section 6103(b)(2)(A)); *see generally Tax Analysts v. IRS*, 1999 U.S. Dist. LEXIS 16733 (D.D.C. Aug. 6, 1999), *vacated*, No. 99-5284 (D.C. Cir. June 13, 1999).

The JCT staff recommended that closing agreements of tax-exempt entities should be disclosed in order to assist in the public oversight of such organizations,[228] but did not recommend that closing agreements of taxable entities should be disclosed. As explained in their study:

> In general, the Joint Committee staff does not believe that closing agreements are an effective means to provide guidance to taxpayers regarding the law. Such agreements are negotiated, and may not represent the IRS view of the law. Further, because such agreements may be fact specific and may not contain all relevant information, they may be misleading if relied upon by others.[229]

<u>Recommendation</u>: Section 6103(b)(2)(C) and section 6110(b)(1) should be amended to clarify that closing agreements, taxpayer-specific competent authority agreements, and any other negotiated agreement between the IRS and taxpayers or the IRS and another party concerning a taxpayer (and any background information related to such agreement) constitute confidential return information in their entirety and do not constitute written determinations subject to disclosure under section 6110.

C. Pre-Filing Agreements

On February 11, 2000, the IRS announced a pilot program for "pre-filing agreements" ("PFAs"), under which large businesses may request an examination and resolution of specific issues relating to tax returns that they expect to file between September and December of 2000.[230] The Notice indicates that "the program is intended to reduce the costs, burden and delays encountered in post-filing examinations."

The Notice states that PFAs are closing agreements under section 7121 of the Code. The Notice makes clear that PFAs are not intended to interpret the law, but rather, are intended to resolve factual issues:

> The program is intended to reach agreement on factual issues and apply settled legal principles to those facts…. Questions concerning the correct interpretation of legal rules the interpretation of which is not well settled are more properly presented in requests for private letter rulings…. Moreover, the program is not available to settle disagreements between the taxpayer and the IRS over the correct interpretation of the tax laws (except as authorized under Delegation Order No. 236 or 247 regarding settlement guidelines).[231]

The notice goes on to provide examples of the types of factual issues that may lend themselves to resolution in a PFA.

PFAs thus, like closing agreements, will be negotiated agreements with respect to the determination of a taxpayer's liability – the only distinction being that the audit is conducted and completed prior to filing the taxpayer's return.

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[228] This issue will be addressed in Volume II of this study.

[229] JCT Study (Vol. II) at 85 n.186.

[230] Notice 2000-12, 2000-9 I.R.B. 727.

[231] *Id.*

Taxpayers and tax practitioners have uniformly sought assurances that PFAs will be kept confidential, suggesting that, as with Advance Pricing Agreements ("APAs"), the success of the program hinges on the protection of taxpayer privacy.[232] Similar to the debate surrounding the disclosure of APAs, however, some have argued that PFAs will more resemble rulings than closing agreements and thus should be disclosed.[233]

With respect to APAs, a compromise was reached that attempts to balance taxpayer privacy and the public's right to have information about APAs that are being executed and any general principles that may be emerging from those agreements. The compromise requires Treasury to issue a report each year containing certain statistical and summary information regarding APAs executed during the year.[234] The first such report (covering APAs issued since the inception of the program in 1990 through 1999) was issued on March 30, 1999.

Treasury recognizes that care must be taken to ensure that the various alternative dispute resolution techniques are not used to supplant the traditional ruling process whereby "guidance" ultimately is published. As Notice 2000-12 makes clear, issues of legal interpretation must still be submitted for resolution by the ruling process.

Treasury and the IRS will implement procedures to monitor the PFA program to ensure that issues of legal interpretation are not resolved in the PFA process, but, rather, are referred to the ruling process. At least in the initial years of the program, a report similar to the APA report should be prepared so that the public can be aware of the types of issues that are being resolved through the PFA program.

Recommendation: Section 6103(b)(2)(C) and section 6110(b)(1) should be amended to clarify that pre-filing agreements (and any background information related to such agreements) constitute confidential return information in their entirety and do not constitute written determinations subject to disclosure under section 6110. In the initial years of the program, IRS should be authorized to issue a report describing the number of pre-filing agreements executed and the types of issues resolved therein.

D. Information Exchanged Under Bilateral Tax Conventions and Other Agreements and Competent Authority Agreements

In most international income tax conventions to which the United States is a party, the Secretary of the Treasury, or his delegate, is designated to act as the "Competent Authority" for

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[232] *See, e.g.*, Letter from Charles W. Shewbridge, III, Tax Executives Institute, Inc., to The Honorable Bill Archer, Chairman, Committee on Ways and Means, U.S. House of Representatives, 2000 TNT 52-9 (March 15, 2000). ("If the PFA program is to succeed, it is important for taxpayers to know – before the process begins – that the sensitive information submitted to the IRS will remain confidential, just as it would were the information provided to the IRS in the course of the examination.")

[233] *See* Lupi-Sher, *supra* note 226; "Tax Analysts Urges IRS to Delete Secrecy Provisions of PFA Program," Tax Notes Today, 2000 TNT 72-45 (April 13, 2000).

[234] Pub. L. 106-170, § 521(b-c).

the United States.[235] Under the terms of these various conventions, the U.S. Competent Authority is generally authorized to carry out two principal functions:

1) to engage in the exchange of information with the competent authority of the other contracting state for purposes of carrying out the provisions of the convention or of the domestic laws of the contracting states concerning taxes covered by the convention;[236] and

2) to conduct a "Mutual Agreement Procedure" involving negotiation and agreement with the competent authority of the other contracting state whereby (i) specific cases potentially involving taxation of a resident of one of the contracting states not in accordance with the provisions of the convention can be resolved, or (ii) any difficulties or doubts arising as to the general interpretation, application, or implementation of the convention can be eliminated.[237]

Recently, the conduct of each of these two Competent Authority functions has given rise to disclosure issues under the FOIA.

1. Information Exchanged Under Bilateral Tax Conventions and Other Agreements

Each bilateral tax convention, or other agreement containing a tax information exchange provision, specifies the purposes for which information may be exchanged by the competent authorities.[238] A few treaties permit the exchange of information only for narrow purposes, such as to prevent tax fraud or for use in a criminal investigation or prosecution. The exchange of information provisions of most treaties, however, have a broad scope, permitting information to be exchanged in a wide variety of circumstances, including at the request of one country investigating the tax affairs of a particular taxpayer, in a Mutual Agreement Procedure initiated to resolve a particular taxpayer matter, during simultaneous taxpayer examinations carried out

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[235] *See, e.g.*, Article 3, paragraph 1(e), 1996 U.S. Model Income Tax Convention ("U.S. Model Convention").

[236] *See* Article 26 of the U.S. Model Convention.

[237] *See* Article 25 of the U.S. Model Convention.

[238] In addition to income tax conventions, the United States has entered into a number of other bilateral agreements providing for the exchange of tax information with other countries. For example, the United States has entered into agreements with many of the U.S. possessions, 14 tax information exchange agreements, and various mutual legal assistance treaties that include tax information in criminal investigations. The United States also is a signatory to the Convention on Mutual Administrative Assistance in Tax Matters (a multilateral agreement developed by the Council of Europe and the Organization for Economic Co-operation and Development). While the JCT Study made recommendations specifically applying to tax conventions and tax information exchange agreements, the study stated that the staff "anticipates that other similar agreements exist which should also receive protection from disclosure" and requested that Treasury "submit a list and description [of agreements similar to tax treaties and tax information exchange agreements] which should be considered for protection from disclosure." That list is included as Appendix C attached hereto. All such agreements are referred to hereinafter as "treaties."

under the treaty, in competent authority consultations on the general meaning of a treaty provision, and in general discussions on matters of importance to the respective tax administrations of the treaty partners. Thus, the information exchanged pursuant to these provisions consists of both taxpayer-specific factual information and non-taxpayer-specific information regarding the practices, procedures, or policies of a country on a tax matter.[239] In its treaty negotiations, the United States generally pursues the broadest possible scope for the exchange of information provisions.

Tax treaties often contain some general limitations on the obligations of the contracting countries to supply information under the treaty. For example, as is reflected in Article 26 of the U.S. Model Convention, most treaties specifically provide that a country is not required to carry out administrative measures at variance with the laws and administrative practice of either country (including the income tax treaty of which the article is a part), to supply information that is not obtainable under the laws or in the normal course of the administration of either country, or to supply information that would disclose any trade, business, industrial, commercial, or professional secret or trade process, or information the disclosure of which would be contrary to public policy.

Information exchanged under the exchange of information provisions of a treaty is typically subject to non-disclosure clauses in those provisions. As is reflected in Article 26 of the U.S. Model Convention, many treaties require the country receiving information under the treaty to treat that information as secret in the same manner as information obtained under its domestic laws. In addition, these treaties provide that disclosure of the information is not permitted other than to persons or authorities (including courts and administrative bodies) involved in the administration, assessment, collection or enforcement of taxes to which the treaty applies.

Notwithstanding these treaty non-disclosure provisions, public disclosure of information exchanged between the United States and a treaty partner pursuant to a tax treaty has recently been sought on several occasions. In 1996, the Bureau of National Affairs brought a lawsuit against the IRS seeking the public disclosure of all completed APAs. Most APAs are based on one or more negotiated agreements between the U.S. Competent Authority and a foreign country entered into under the mutual agreement article of an income tax treaty. Thus, these APAs reflect information protected by the non-disclosure provisions of the treaty in that they contain information provided by, or agreed to, by the treaty partner. Prior to final judicial resolution of this issue, however, Congress passed section 521 of Pub. L. 106-170, the Ticket to Work and Work Incentives Improvement Act of 1999, which provides that APAs are return information in their entirety under section 6103 and that neither APAs nor their background files are to be considered written determinations subject to disclosure under section 6110. As discussed above, the Act also required the Secretary to issue an annual report with respect to APAs. Thus, any

[239] In the United States, disclosure of returns or return information to foreign tax authorities generally is prohibited under section 6103. However, section 6103(k)(4) permits disclosure to the competent authority of a foreign government that has an income tax or gift and estate tax treaty (or other treaty or bilateral agreement relating to the exchange of tax information) with the United States, but only to the extent provided in, and subject to the terms and conditions of, such treaty or bilateral agreement.

information exchanged between the United States and a treaty partner in the context of an APA case will be protected from disclosure under section 6103, regardless of the application of treaty non-disclosure protection.

Also in 1996, Tax Analysts filed a FOIA request for all IRS records relating to the Pacific Association of Tax Administrators ("PATA"), its meetings, deliberations, decisions, and staffing. PATA is an association of the competent authorities from the United States, Australia, Canada, and Japan formed to meet periodically to discuss and exchange information on tax matters of common interest. In 1998, Tax Analysts filed an identical FOIA request for all IRS records relating to the Group of Four ("G-4"). The G-4 is an association of the competent authorities and tax policy officials from the United States, Germany, France, and the United Kingdom formed to meet periodically to discuss and exchange information on tax matters of common interest. In February 1999, Tax Analysts filed a suit in the United States District Court for the District of Columbia requesting access to all records responsive to its FOIA requests for PATA and G-4 documents. In accordance with a processing schedule stipulated by the parties and approved by the court, the IRS released several boxes of PATA documents to Tax Analysts in October and November of 1999. Documents were withheld or redactions were made from released documents to the extent such documents contained or reflected information received from a PATA treaty partner. In the coming months, the IRS will make similar releases of G-4 documents in accordance with the processing schedule. The government's production of PATA and G-4 documents, in terms of the documents that will be, or have been, produced and the redactions that will be, or have been, made from those documents, is designed to protect the information received from the treaty partners contributing to those documents.

Lastly, protection to be afforded to information received from a treaty partner is being challenged by Tax Analysts in the case involving the disclosure of FSAs referred to and discussed above as *Tax Analysts III*. Currently, this case is again before the District Court for the District of Columbia and the issue is whether or not the IRS is justified in making redactions of information received from a treaty partner in the FSAs at issue. Briefs on this issue were filed in January of 1999, and a decision on this issue is pending.[240]

Each of these cases raises the issue of whether information exchanged with a treaty partner pursuant to an exchange of information provision of the applicable treaty is exempted from public disclosure under the FOIA due to the non-disclosure provisions of the applicable treaties. Because taxpayer-specific return information[241] in the hands of the IRS is protected from disclosure by section 6103(a), which, as discussed above, is an exemption 3 statute, any such return information received by the U.S. Competent Authority from a treaty partner is clearly exempt from disclosure under the FOIA. Some have questioned, however, whether non-taxpayer-specific information exchanged with a treaty partner, which is protected by the terms of the treaty, is afforded protection from public disclosure under FOIA exemption 3.

In the current *Tax Analysts III* proceeding before the District Court for the District of Columbia, Tax Analysts has argued that exemption 3 is not applicable to information protected

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[240] *Tax Analysts v. IRS*, No. 94-cv-923 (GK) (D.D.C.), 1999 U.S. Dist. LEXIS 14950.

[241] Under section 6103(b)(2)(A), return information includes any information on income or deductions or other data received by the Secretary with respect to the determination of the tax liability of any person.

by a treaty because a treaty cannot be considered a statute for that purpose. But, as the government argued in response, the Supremacy Clause of the United States Constitution provides that United States treaties are "the supreme law of the land:"

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme law of the land; and Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.[242]

Thus, the Constitution places treaties on equal footing with statutes. Moreover, the Supreme Court has held, throughout the history of U.S. jurisprudence, that a treaty is "equivalent to an act of the legislature."[243]

Due to the challenge in *Tax Analysts III*, the JCT Study recommended that it should be clarified that tax treaties qualify as statutes for purposes of exemption 3. This recommendation was made specifically for Senate-ratified tax conventions and for tax information exchange agreements, but the JCT Study stated that it anticipates that other similar agreements should be similarly treated for this purpose. Treasury agrees with this recommendation and generally agrees with the analysis and conclusions contained at pages 201-04 of the JCT Study. In addition, the potential public disclosure in the United States of information exchanged between the U.S. Competent Authority and its treaty partners has raised critical foreign relations concerns. The Commentary to the OECD Model Tax Convention, to which the United States is a signatory, reflects this concern in noting that "[r]eciprocal assistance between tax administrations is feasible only if each administration is assured that the other administration will treat with proper confidence the information which it will receive in the course of their co-operation."[244] There is a strong expectation between OECD member countries entering into

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[242] U.S. Const. Art. VI. Cl. 2.

[243] *Foster & Elam v. Neilson*, 27 U.S. 253, 314 (1829). The Supreme Court has reaffirmed this principle on several occasions. *See Head Money Cases*, 112 U.S. 580, 598,99 (1884) ("[a] treaty, then, is a law of the land as an act of Congress is . . ."); *Whitney v. Robertson*, 124 U.S. 190, 194 (1888) ("[b]y the Constitution a treaty is placed on the same footing, and made of like obligation, with an act of legislation"); *De Lima v. Bidwell*, 182 U.S. 1, 195 (1901) ("[i]t will be observed that no distinction is made as to the question of supremacy between laws and treaties, except that both are controlled by the Constitution"); *Reid v. Covert*, 354 U.S. 1, 18 (1957) ("[t]his Court has also repeatedly taken the position that an Act of Congress, which must comply with the Constitution, is on a full parity with a treaty. . . ").

Under the FOIA, one court has indicated, in dictum, that the constitutional ratification procedure applicable to treaties may be relevant to exemption 3. *Public Citizen v. Office of the United States Trade Representative*, 804 F. Supp. 385, 388 (D.D.C. 1992). In *Public Citizens*, the court held that exemption 3 does not cover materials related to an international trade agreement of the United States. The court distinguished the agreement from "Senate-ratified treaties, and [the agreement] therefore do[es] not have the status of statutory law." 804 F.Supp. at 388 (citing *Foster & Elam*, 27 U.S. at 314).

[244] Commentary on the OECD Model Tax Convention on Income and Capital, Article 26, para. 11 (1998).

bilateral treaty relationships that interactions will be kept confidential and that assistance will be provided only if information exchanged in the assistance process will be provided only to those persons who *need* access for tax administration purposes.

2. Competent Authority Agreements

As described above, the U.S. Competent Authority is charged with conducting a "Mutual Agreement Procedure" involving negotiation and agreement with the competent authority of the other contracting state whereby (i) specific cases potentially involving taxation of a resident of one of the contracting states not in accordance with the provisions of the convention can be resolved, or (ii) any difficulties or doubts arising as to the general interpretation, application, or implementation of the convention can be eliminated.

The Mutual Agreement Procedure often results in the production of written documents memorializing the outcome of mutual agreement negotiations. These documents are referred to as "competent authority agreements" and can be of two types: (1) taxpayer-specific agreements, which generally are negotiated settlements to eliminate the double taxation of a taxpayer arising through the application of two non-harmonious tax regimes to the same transaction and (2) non-taxpayer-specific agreements, which generally are negotiated to provide a mutual understanding on the interpretation, application, or implementation of the treaty. The vast majority of competent authority agreements are of the first type, and most of these agreements involve matters of cross-border transfer pricing.

Since the JCT Study was issued, Tax Analysts has begun to pursue the public disclosure of all competent authority agreements under the FOIA. The IRS is in the early stages of formulating its response to this FOIA request. Because Tax Analysts chose to make its request public, however, there has been already an extensive amount of concern expressed about this issue by treaty partners, trade associations, and taxpayers.[245]

In discussions with the United States, treaty partners have already expressed serious concerns regarding the FOIA request for competent authority agreements. Based on these discussions, and on similar discussions concerning the APA proceedings of last year and the recent FOIA requests for information relating to PATA and G-4, Treasury is concerned that the possibility of public disclosure, if not promptly resolved, will impact the treaty-based negotiation process, such that it will become more difficult, and potentially impossible, to resolve matters of double taxation and treaty interpretation with our treaty partners.

Taxpayers and trade associations too are concerned because they believe the factual information exchanged in the competent authority dispute resolution process is often highly sensitive and revelatory of confidential business matters. This concern was one of the principal

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[245] *See, e.g.*, Letter from Robert E. Ackerman and Michael F. Patton, Ernst & Young, LLP, to Jonathan Talisman, Acting Assistant Secretary (Tax Policy), U.S. Treasury Department, and Charles O. Rossotti, Commissioner of the Internal Revenue Service (May 22, 2000), 2000 TNT 121-20; Letter from Charles W. Shewbridge, III, International President, Tax Executives Institute, Inc., to Jonathan Talisman, Acting Assistant Secretary (Tax Policy), U.S. Treasury Department, and Charles O. Rossotti, Commissioner of the Internal Revenue Service (June 7, 2000), *available on* LEXIS at 2000 TNT 114-12.

motivations for Congress's enactment of the legislation protecting APAs and any background information related to such agreements from any form of public disclosure, even on a redacted basis under section 6110. The subject of many competent authority agreements, cross-border transfer pricing, is the same as the subject addressed in APAs.

Clarifying that a tax treaty qualifies as a statute for FOIA exemption 3 purposes would provide some assurance that confidential information provided by a treaty partner and incorporated into a competent authority agreement would not be publicly disclosed. Nevertheless, as was the case with APAs, the potential public disclosure of any part of a taxpayer-specific competent authority agreement, even after redactions, will leave both taxpayers and treaty partners with significant concerns about the utility of the Mutual Agreement Procedure. Accordingly, as indicated above, Treasury recommends that it also be provided that taxpayer-specific competent authority agreements, like closing agreements, pre-filing agreements, and other negotiated agreements between the IRS and taxpayers or the IRS and another party (such as a treaty partner) concerning a taxpayer, constitute return information in their entirety for purposes of section 6103 and do not constitute written determinations subject to disclosure under section 6110.

Recommendation: It should be clarified that any information expressly protected under a non-disclosure provision of a tax treaty (including any agreement listed in Appendix C) is protected from public disclosure pursuant to FOIA exemption 3 and/or section 6110(c)(3). This could be accomplished through a Title 26 statutory provision specifically affording confidentiality to information expressly protected from disclosure by a tax treaty. This provision, among other things, would assure confidentiality of both taxpayer-specific and non-taxpayer specific competent authority agreements. In addition, as recommended above, section 6103(b)(2)(C) and section 6110(b)(1) should be amended to clarify that any taxpayer-specific competent authority agreement and any background information related to such agreement constitutes return information in its entirety and does not constitute a written determination subject to disclosure under section 6110.

VIII. Unauthorized Disclosures

A. Reports to Congress

Section 6103(p)(3)(C) requires the Secretary to furnish a report to the Joint Committee on Taxation within 90 days of the close of each calendar year for disclosure to the public, which describes for certain types of disclosures, the number of requests for disclosure, disclosures made, taxpayers with respect to whom such disclosures were made, and the purposes for which such disclosures were made. The disclosures required to be included in such reports include disclosures to state tax officials and state and local law enforcement agencies (section 6103(d)), disclosures to Federal or state law enforcement agencies in cases of imminent death or physical injury (section 6103(i)(3)(B)(i)), disclosures to Federal, state, or local child support agencies (section 6103(l)(6)), and disclosures to the GAO.

Under section 209(b) of TBOR 2000, the section 6103(p)(3)(C) report from the IRS would be expanded to include information regarding unauthorized disclosure and inspection of returns and return information, including the number, status, and results of administrative investigations, civil lawsuits under section 7431 (including settlement amounts and damages), and criminal prosecutions. Treasury supports this proposal in principle, but would point out that such data is maintained by TIGTA, not by IRS.

B. Civil Damages for Unauthorized Inspection or Disclosure

1. Taxpayer Notification

Section 7431(e) requires the IRS to notify a taxpayer that the taxpayer's return or return information has been unlawfully inspected or disclosed upon indictment of the alleged wrongdoer. Not all substantiated unlawful access or disclosure cases, however, are prosecuted. JCT staff recommended that an additional trigger for taxpayer notification should be TIGTA's administrative determination that unlawful access or disclosure has occurred. Treasury concurs with JCT staff's view that taxpayer notification may be appropriate in circumstances other than indictment. However, Treasury does not agree that TIGTA's referral of the case for prosecution is the appropriate trigger. In cases where an indictment was not obtained (for whatever reason, including failure of a grand jury to find sufficient evidence for such indictment), this provision would require notification of the taxpayer prior to any administrative review or determination by the IRS. Treasury believes that the appropriate notification is when the IRS administratively determines that an employee has unlawfully accessed or disclosed returns or return information. This is the point in the administrative process most analogous to an indictment.

Recommendation: Section 209(a) of TBOR 2000, regarding administrative determinations of browsing, should not be adopted, but, rather, section 7431 should be amended to provide that taxpayers shall be notified at the earlier of indictment or whenever the IRS proposes an administrative determination as to disciplinary or adverse action against an employee arising from the employee's unauthorized inspection or disclosure of a taxpayer's return or return information.

2. Burden of Proof

There is a split among the United States Courts of Appeal whether the language of section 7431(g) – "no liability shall arise…from a good faith, but erroneous, interpretation of [section 6103]" – requires the taxpayer plaintiff to prove "bad faith" on the part of the disclosing party to succeed under section 7431. The Sixth Circuit, in *Davidson v. Brady*,[246] held that the plaintiff in an unauthorized disclosure action must plead bad faith on the part of the defendants. The court stated that, "[w]hile common law good faith immunity is generally treated as an affirmative defense …, the affirmative statement by Congress that 'no liability shall arise' if good faith is present makes bad faith an element of a section 7217 cause of action."[247] The court drew parallels between the good faith safe harbor in section 7217[248] and the immunity defense

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[246] 732 F.2d 552 (6th Cir. 1984).

[247] *Id.* at 553 (citations omitted).

[248] The civil damage provision originally permitted the taxpayer to bring an action against the Federal employee who made the disclosure. In 1982, Congress changed the law by repealing section 7217 and enacting 7431, which authorized civil damage actions against the United States arising from unauthorized disclosures made by Federal employees.

provided to government officials performing discretionary functions, citing to *Harlow v. Fitzgerald*.[249]

Subsequently, three other circuit courts of appeals have apparently disagreed with the Sixth Circuit.[250] Moreover, the Government has routinely accepted the burden of pleading and proving good faith in unauthorized disclosure cases. This result is the most sensible one, since the Government is the party in possession of the facts necessary to prove good faith. Placing the burden of proof on the taxpayer, in addition to forcing the plaintiff to prove a negative, could subject the Government to burdensome discovery requests, and, ultimately, delay the prompt adjudication of these cases. Treasury agrees that the burden of proving that an employee's unauthorized disclosure or inspection of tax information was a result of a good faith, but erroneous, interpretation of section 6103 should rest with the Government. In light of the split among the circuits, this should be clarified.

Another question that arises is whether the good faith defense applies to factual mistakes as well as to erroneous interpretations of section 6103. Section 7431 should be amended to explicitly provide such a defense.

Recommendation: Section 7431 should be amended to clarify that the burden of proving that an employee's unauthorized disclosure of tax information was a result of a good faith, but erroneous, interpretation of section 6103 rests with the Government. In addition, section 7431 should be amended to provide that the good faith defense also applies to factual mistakes.

3. Exhaustion of Administrative Remedies

Under sections 7432 and 7433 of the Code, civil damages for failures to release liens and for certain unauthorized collection actions, respectively, cannot be awarded unless the court determines that the plaintiff has exhausted the administrative remedies available to the plaintiff within the IRS. This administrative remedy prerequisite serves dual purposes. First, it obligates taxpayers to bring the alleged improper actions to the attention of the IRS and affords the IRS the opportunity to address (and resolve) these improper actions. Second, it saves costs – in terms of time and money – to both the wronged taxpayer and taxpayers generally, by permitting improper actions to be promptly redressed without the need for the courts. These sections also provide that any claims payable under this authority are payable out of the United States Judgment Fund

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[249] 457 U.S. 800, 818 (1982) (holding that governmental officials act in good faith when "their conduct does not violate clearly established statutory or constitutional rights of which a reasonable person would have known").

[250] *McDonald v. United States,* 102 F.2d 1009 (9th Cir. 1996); *Hrubec v. National Railroad Passenger Corp.*, 981 F.2d 962, 964 (7th Cir. 1992) (*dicta*); *Flippo v. United States*, 670 F. Supp. 638, 643 (W.D. N.C. 1987), *aff'd,* 849 F.2d 604 (4th Cir. 1988) (Fourth Circuit affirmed, without opinion a decision of the district court holding that good faith was a defense available to the United States); *Sinicki v. United States Dep't of Treasury*, 1998 U.S. Dist. LEXIS 2015 (S.D.N.Y. 1998); *Sharer v. United States*, 83 A.F.T.R.2d 1331 (E.D. Ca. Feb. 10, 1999). *But see Fostvedt v. United States*, 824 F. Supp. 978, 984-5 (D. Colo. 1993), *aff'd without opinion*, 16 F.3d 416 (10th Cir. 1994) (although disclosure was authorized, court also noted that plaintiff failed to allege facts supporting the bad faith element of the action).

(31 U.S.C. § 1304), and not the IRS's own appropriations. This ensures that the administrative resolution of claims is not affected by the impact of such resolution on the IRS's budget.

These reasons are equally compelling with respect to section 7431. Taxpayers should be required first to pursue administrative claims for alleged unauthorized inspections or disclosures of tax information prior to pursuing civil damage actions in the courts. Although the IRS has been able to address particular claims brought to its attention through other authority in the United States Code, it is appropriate that this authority be explicitly provided for in section 7431, as it is in sections 7432 and 7433.

Recommendation: Section 7431 should be amended to require exhaustion of administrative remedies prior to awarding damages under that section and to provide that any claims payable under this authority are payable out of the U.S. Judgment Fund.

IX. Miscellaneous Recommendations

A. Disclosure to Former Spouse Upon Oral Request

Section 6103(e)(1)(B) permits, upon written request, the inspection or disclosure of a joint return to either of the individuals with respect to whom the return is filed. Section 6103(e)(7) permits the inspection or disclosure of return information to the same individuals if the Secretary determines that such disclosure would not seriously impair Federal tax administration. Requests for such disclosures need not be in writing. In response to concerns that former spouses were not able to obtain information regarding collection activities relating to a joint return,[251] TBOR 2 added section 6103(e)(8), which permits, upon written request, disclosures to former spouses or spouses no longer residing in the same household of the fact and nature of collection activities and the amount collected from the other spouse or former spouse.

Under TBOR 2000, the requirement that section 6103(e)(8) requests be in writing would be eliminated. Treasury supports this proposal. There is no policy reason to require disclosures under section 6103(e)(8) to be in writing when there is no similar requirement for disclosures under section 6103(e)(7). In order to meet TIGTA's reporting requirement, however, it appears that IRS will have to keep records of telephone calls and other oral communications. Consideration should be given to eliminating this reporting requirement.

Recommendation: Treasury supports section 203 of TBOR 2000, which would permit disclosures to former spouses with respect to a joint return upon oral request, but consideration should be given to phasing out the TIGTA reporting requirement.

B. Disclosure of Taxpayer Identity for Refund Purposes

Section 6103(m) permits the Secretary to disclose taxpayer identity information to the "press and other media" for purposes of notifying persons entitled to tax refunds when the Secretary, after reasonable effort and lapse of time, has been unable to locate such persons. The IRS has interpreted this not to include the Internet, because the First Circuit determined that "press and other media" means traditional press and media,[252] and the Internet did not exist when the statute was enacted.

[251] Technically, such disclosures have always been authorized by section 6103(e)(1)(B).

[252] *Aronson v. IRS*, 973 F.2d 962 (1st Cir. 1992).

The Taxpayer Advocate recommended amending section 6103(m)(1) to read, “The Secretary may make public taxpayer identifying information for purposes of notifying persons entitled to tax refunds when the Secretary, after reasonable effort and lapse of time, has been unable to locate such persons.”[253] TBOR 2000 would amend this provision to include “any other means of mass communication.” Treasury supports this proposed change.

Recommendation: Treasury supports section 210 of TBOR 2000, which would permit use of the Internet to locate individuals entitled to refunds.

C. Refund Offset Disclosures

The JCT staff recommended repealing section 6103(m)(2). This apparently was based on a perception that the merger of the refund offset program into the Treasury Offset Program obviated the need for disclosures of IRS mailing address information for pre-offset notification. Contrary to what the JCT staff reported, it is Treasury’s understanding that section 6103(m)(2) disclosures are made regularly. Accordingly, Treasury does not recommend repealing this section.

Recommendation: Treasury does not agree with the JCT staff’s recommendation to repeal section 6103(m)(2), which relates to disclosures for purposes of the refund offset program.

[253] IRS National Taxpayer Advocate’s Annual Report to Congress for Fiscal Year 1999 (Jan. 4, 2000), Proposal no. 35.

Appendix A

FEDERAL REGISTER
Vol. 64, No. 195

Notices

DEPARTMENT OF THE TREASURY

Solicitation for Comment in Connection With a Study Being Conducted by the Department of the Treasury Relating to the Scope and Use of Provisions Regarding Taxpayer Confidentiality

64 FR 54960

DATE: Friday, October 8, 1999

ACTION: Solicitation for comment.

SUMMARY: This is a solicitation for public comment in connection with a study being conducted by the Department of the Treasury relating to the scope and use of provisions regarding taxpayer confidentiality. This study is required by section 3802 of the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105-206, 112 Stat. 782).

DATES: Written comments must be submitted by November 15, 1999.

ADDRESSES: Send comments to: Elizabeth P. Askey, Office of Tax Legislative Counsel, Department of the Treasury, 1500 Pennsylvania Avenue, NW, Room 1321A, Washington, DC 20220. Comments may also be submitted to: taxpolicy@do.treas.gov -the subject line should contain the phrase "Confidentiality Study." All comments will be available for public inspection and copying.

FOR FURTHER INFORMATION CONTACT: Elizabeth Askey at 202-622-0224 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 6103 of the Internal Revenue Code (Code) prohibits the disclosure of tax returns or returns information except as otherwise authorized by the Code. Permitted disclosures include:

(1) Disclosures to a taxpayer or the taxpayer's designee pursuant to the taxpayer's consent;

(2) Disclosures for purposes of tax administration (including state tax administration);

(3) Disclosures to federal state, or local governmental agencies for nontax purposes such as child support enforcement and verifying taxpayers' eligibility for certain designated needs based programs, including food stamps, and certain Social Security benefits; and

(4) Disclosures for nontax law enforcement purposes. Permitted disclosures generally are subject to strict procedural safeguards. Unauthorized disclosure or inspection of returns and return information may result in civil damages against the United States and/or criminal penalties against individuals who unlawfully disclose or inspect tax information.

Section 6104 makes available to the public certain tax information related to tax-exempt organizations and certain other entities. In the case of any tax exempt organization, section 6104 generally provides that the organization's application for tax exemption and supporting documents, IRS determination letter, and annual information returns filed under section 6033 are available for public inspection at certain IRS offices and at the organization's principal office (and certain regional and district offices). In addition, copies of such documents are generally available upon request made to the organization or the IRS. Section 6104 also authorizes the Secretary to disclose to certain state officials charged with overseeing charitable organizations described in section 501(c)(3) information relating to any organization's failure to qualify for, or subsequent loss of, section 501(c)(3) status, or the mailing of certain notices of tax deficiency.

Section 3802 of the IRS Restructuring and Reform Act of 1998 requires the Secretary of the Treasury to study the scope and use of provisions regarding taxpayer confidentiality Specifically, the study is to examine:

1. The present protections for taxpayer privacy,

2. Any need for third parties to use tax reform information,

3. Whether greater levels of voluntary compliance may be achieved by allowing the public to know who is legally required to file tax returns, but does not file tax returns,

4. The interrelationship of the taxpayer confidentiality provisions in the Internal Revenue Code of 1986 with provisions in other Federal law, including *5 U.S.C. 552a* (commonly known as the Freedom of Information Act),

5. The impact on taxpayer privacy of the sharing of incoming tax return information for purposes of enforcement of state and local tax laws other than income tax laws, including the impact on the taxpayer privacy intended to be protected at the Federal, state, and local levels under Public Law 105-35, the Taxpayer Browsing Protection Act of 1997, and,

6. Whether the public interest would be served by greater disclosure of information relating to tax-exempt organizations described in section 501 of the Internal Revenue Code of 1986.

Request for Public Comment

The Department of the Treasury invites comments relative to the six topics described. In particular, the Department of the Treasury invites comments with respect to the following:

1. How is the privacy protection provided by section 6103 beneficial to taxpayers?

2. How is the section 6103 statutory scheme burdensome for taxpayers? Does section 6103 affect the IRS's ability to deliver quality customer service and, if so, in what ways?

3. Is the statutory structure and/or administration of section 6103 consistent, simple, administrable, and fair? What changes, if any, should be made to the content and/or administration of section 6103?

4. What is the relationship between taxpayer confidentiality as provided by [*54961] section 6103 and compliance with the internal revenue laws? What effect, if any, might publishing the names of nonfilers have on compliance with the internal revenue laws? What effect, if any, might broadening the scope of permissible disclosures have on compliance with the internal revenue laws?

5. What impact has technology had on the protection of taxpayer privacy and what, if any, additional safeguards may be necessary as a result? As the IRS moves toward electronic filing and maintenance of tax records, what, if any, changes should be made to the confidentiality rules under section 6103?

6. What impact have taxpayer privacy protections had on the ability of federal, state, and local agencies to receive information critical to their operation, particularly information not easily obtainable from other sources?

7. Should tax information be used for nontax purposes? If so, what factors should influence whether agencies and others should be permitted direct access under section 6103 to taxpayer information for nontax purposes? What factors should influence whether agencies and others should be allowed to obtain such information by consent from the taxpayer, for example, as a condition to approval of mortgages or other loans, or for obtaining government benefits? Should there be any conditions or restrictions on the recipient's use of tax information obtained by consent?

8. What factors should influence whether federal, state, or local agencies that receive tax information to carry out particular programs, and who use private contractors for data processing and other services, should be permitted to disclose tax information to those contractors for the purpose of performing those programs?

9. What changes, if any, should be made to either the safeguard program or the consent process?

10. What, if any, additional restrictions should be placed on the ability of those who receive tax information to redisclose the information to other parties? What means should be used to implement any such redisclosure protections?

11. How can taxpayer privacy concerns and a desire for more information-sharing within government be balanced?

12. Would the public interest be served by allowing greater sharing of information between the IRS and other federal and state agencies for joint investigations relating to the enforcement of federal and state laws affecting tax-exempt organizations? What restrictions, if any, should be imposed on use of the information by those agencies?

13. Do the public inspection provisions of section 6104 and section 6110 provide adequate disclosure of IRS determinations affecting tax-exempt organizations? If not, what additional information should be made available?

14. Is the information currently reported by tax-exempt organizations to the IRS adequate to ensure effective oversight? If not, what additional information should be reported? Should there be more detailed disclosure regarding transactions between tax-exempt organizations and their subsidiaries or other affiliates?

Joseph Mikrut,

Tax Legislative Counsel.

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224
March 7, 1994

SISTANT COMMISSIONER
(EXAMINATION)

MEMORANDUM FOR CHIEF COMPLIANCE OFFICER CP

FROM: John J. Monaco
Assistant Commissioner (Examination) CP:EX

SUBJECT: Criteria for Disclosures for Non-Tax Purposes

Attached is the proposed threshold criteria which you requested for use in evaluating the merits of legislative proposals made by other agencies who seek disclosure of tax information for the purpose of furthering their programs or initiatives.

The criteria were developed by an ad hoc work group consisting of representatives of the Office of Disclosure, Legislative Affairs, Office of Privacy, and Disclosure Litigation. As explained in the Memorandum for Deputy Commissioner, some criteria would be addressed by the other agency; some by the Service; and some by both. The criteria are accompanied by guidelines for their application.

Attachment

MEMORANDUM FOR DEPUTY COMMISSIONER C:D

FROM: Phil Brand /s/ Philip G. Brand
Chief Compliance Officer CP

SUBJECT: Criteria for Disclosures for Non-Tax Purposes

The Internal Revenue Service (Service) continues to oppose the disclosure of tax information for non-tax purposes, but recognizes the reality that legislative proposals for additional disclosures will continue to be made by other agencies seeking to use tax information to strengthen an existing program or implement a new initiative. Therefore, these proposals should be examined against specific criteria in order to analyze the merits of the proposals on a consistent basis. This will allow the Service to determine the extent of its support for, or opposition to, the proposals, and to facilitate constructive criticism as warranted.

Certain criteria would comprise a threshold for the Service to even consider the possibility of support for legislation; other criteria would be weighed in the decision making process. Although some criteria would be explored solely by the Service, the burden of developing the case for disclosure and providing protection for the data should fall to the agency that desires our information. Accordingly, it should be made known that certain information must first be developed by agencies seeking the Service's support for disclosure legislation. Guidelines to be provided to the agencies are described in Attachment 1. Proposed criteria to be applied are as follows:

Criteria to be Addressed by the Requestor

1. There is a clear and complete description of the purpose for the disclosure and the use of the tax data in serving that purpose.

2. The information sought is otherwise unavailable.

3. The information sought is the minimum data needed to achieve the purpose of the disclosure.

4. There are substantial benefits to be derived.

Criteria to be Addressed by the Requestor and the Service

5. The costs of implementation would not create a burden for the Service.

6. The legislation would provide for the safeguarding of the return information and the nature of the proposal would allow for a manageable oversight of the safeguards.

7. Other than Section 6103 of the Internal Revenue Code, there are no statutory impediments to implementation of the proposed legislation.

Criteria to be Addressed by the Service

8. The infringement of taxpayer privacy would be perceived as necessary and tolerable and not in conflict with the Service's privacy policies and principles.

9. Support for the proposal would not subsequently jeopardize Service opposition to expansion of disclosure under the Code.

10. The proposal does not pose a serious threat to voluntary compliance or otherwise adversely impact tax administration.

An expansion of the issues to be considered for the individual criteria are presented in Attachment 2.

Attachments 2

Attachment 1

CRITERIA GUIDELINES FOR AGENCIES SEEKING THE SERVICE'S SUPPORT FOR PROPOSED DISCLOSURE LEGISLATION

There is a clear and complete description of the purpose for the disclosure and the use of the tax data in serving that purpose.

Provide a detailed description of how the tax information will be used to further your mission and provide the statutory authority for the activity. Describe the affected agency program and how the disclosure of tax information will be integrated into that program. For example, if the information will be used in making a benefit determination under a needs-based benefit program, describe the program and the relevance of the information to the determination. Indicate the types of individuals whose information will be disclosed and the number of individuals affected. Indicate whether and to what extent the disclosure will intrude on taxpayer privacy.

In addition, to the extent possible, detail operational aspects relating to use of the information. Track the anticipated path of the information from its receipt by your agency to its storage or return to the Service. For example, how will your agency access the information? Will the information be online or will there be single or multiple computer matches, or both? Will the information be used in administrative or judicial proceedings? Indicate all persons who will have access to the information, such as classes of agency employees, contractors, agents, agency counsel, outside counsel, or other agencies, such as the Department of Justice. Indicate in what media the information will be used and how it will be stored, and whether or not the information will be returned to the Service after use.

The information sought is otherwise unavailable.

Explain how all other avenues for the information have been exhausted. Demonstrate that the information, for all practical purposes, cannot reasonably be otherwise obtained rather than it merely being inconvenient to use other alternatives.

The information sought is the minimum data needed to achieve the purpose of the disclosure.

For each of the discrete elements of information sought, explain specifically why it is necessary and how it would be used. What would be the minimum information that is required to meet the stated need.

There are substantial benefits to be derived.

Explain what provision, if any, exists for periodic reevaluation of benefits. Does the proposal contain a "sunset" provision?

For disclosures based on monetary benefit: Specific and significant savings to the government must be established. A cost-benefit analysis should be conducted and submitted which would present a strong "business case" for the proposal. The submission must be more concrete than a mere estimate of "potential" benefits. Explain how critical the disclosures are to the effectiveness of the program.

For disclosures based on a perceived benefit to society: Explain how the disclosures would result in a significant and tangible benefit to a substantial portion of the population. Provide any research or studies conducted to support this conclusion. If there is known opposition to the proposal present a case to outweigh the arguments against disclosure.

The costs of implementation would not create a burden for the Service.

Explain how the cost to the Service to administer the new program (and related safeguard oversight) would be reimbursed or otherwise recovered.

The legislation would provide for the safeguarding of the return information.

Provide assurance that under the proposed legislation the agency will be responsible for the protection of the return information disclosed. If the proposal permits disclosure or redisclosure of the tax data to other than the requestor, would the safeguard provisions of Internal Revenue Code section 6103(p)(4) be applicable to all recipients of data? Does the proposed legislation provide that the existing penalty provisions in the Internal Revenue Code for unauthorized disclosure of return information would apply to all recipients?

Other than Section 6103 of the Internal Revenue Code, there are no statutory impediments to implementation of the proposed legislation.

State whether or not the proposal will require additional, related legislation to accomplish the desired result. Confirm that the proposal does not conflict with existing regulations, rules, or statutes other than Section 6103 of the Internal Revenue Code.

CRITERIA ISSUES REGARDING REQUESTS FOR THE SERVICE'S SUPPORT FOR PROPOSED DISCLOSURE LEGISLATION

In addition to analyzing the data submitted by the requesting agency in support of its proposal, the following issues should be considered in the process of evaluating the merits of any new disclosure proposal for purposes of determining whether the Service should support the initiative.

The costs of implementation would not create a burden for the Service.

What would be the cost to the Service to administer the new program (and related safeguard oversight)? Would the cost be recovered? Would the implementation delay or impair any of our activities (such as information processing)? Would (or should) the disclosures be subject to the recordkeeping and reporting requirements of the Internal Revenue Code, Section 6103(p)(3)?

The legislation would provide for the Safeguarding of the return information and the nature of the proposal would allow for a manageable oversight of the safeguards.

Will the Service be able to ensure the protection of the return information under the proposed legislation? Does the legislation permit disclosure or redisclosure of the tax information to contractors or other entities besides the requestor? Is such expansion of access necessary? Is the extent of the dispersal of return information such that oversight of safeguards would be unmanageable? Would the safeguard provisions of the Internal Revenue Code, Section 6103(p)(4) be applicable to *all* recipients of the data? Would the penalty provisions in the Code for unauthorized disclosure apply to *all* recipients?

Other than Section 6103 of the Internal Revenue Code, there are no statutory impediments to implementation of the proposed legislation.

Does the proposed legislation conflict with existing privacy, confidentiality, or other statutes? Is additional legislation required to accomplish the desired result?

The infringement of taxpayer privacy would be perceived as necessary and tolerable and not in conflict with the Service's privacy policies and principles.

Does the proposal involve disclosure of information on a great many taxpayers to identify abuse by (or a characteristic

of) just a few? How intrusive to taxpayer privacy would the legislation be? Are there fundamental concerns with respect to privacy issues (e.g., linkage of records, centralization, derivation of new data, retention of data, oversight of users, etc.)? Can we expect the additional loss of privacy to be perceived as a necessary and tolerable "cost" in order to accomplish the goals of the proposal? Would our support of the proposal imply that taxpayer privacy/confidentiality is for sale?

<u>Support for the proposal would not subsequently jeopardize the Service's opposition to expansion of disclosure under the Code.</u>

Would support for the proposal compromise our position of opposition to the proliferation of disclosure of tax information for nontax purposes to such extent that subsequent objection to additional legislation is jeopardized?

<u>The proposal does not pose a serious threat to voluntary compliance or otherwise adversely impact on tax administration.</u>

Cumulative effect of disclosures for nontax purposes: What impact would the additional erosion of confidentiality under the proposed legislation have on taxpayers' continued compliance with our voluntary assessment system?

What effect would the proposal have on the Service's policies and initiatives?

Appendix C

Tax Agreements between the IRS and U.S. Possessions

Tax Implementation Agreement Between the United States of America and the Virgin Islands, effective February 24, 1987

Tax Implementation Agreement Between the United States of America and American Samoa, effective January 1, 1988

Tax Implementation Agreement Between the United States of America and Guam, effective April 5, 1989

Tax Coordination Agreement Between the United States of America and the Commonwealth of Puerto Rico, effective May 26, 1989

Tax Information Exchange Agreements

Barbados, effective November 3, 1984

Bermuda, effective December 2, 1988

Costa Rica, effective February 12, 1991

Dominica, effective May 8, 1988

Dominican Republic, effective October 12, 1989

Grenada, effective July 13, 1987

Guyana, effective August 27, 1992

Honduras, effective October 11, 1991

Jamaica, effective December 18, 1986

Marshall Island, effective March 14, 1991

Mexico, effective January 18, 1990

Peru, effective March 31, 1993

St. Lucia, effective April 22, 1991

Trinidad & Tobago, effective February 9, 1990

Multilateral Convention

Convention on Mutual Administrative Assistance in Tax Matters (developed by the Council of Europe and the Organization for Economic Co-operation and Development), effective April 1, 1995