

REVIEW OF TAXPAYER PRIVACY ISSUES

United States. Congress. House. Committee on Ways and Means. Subcommittee on Oversight.

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

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COMMITTEE ON WAYS AND MEANS

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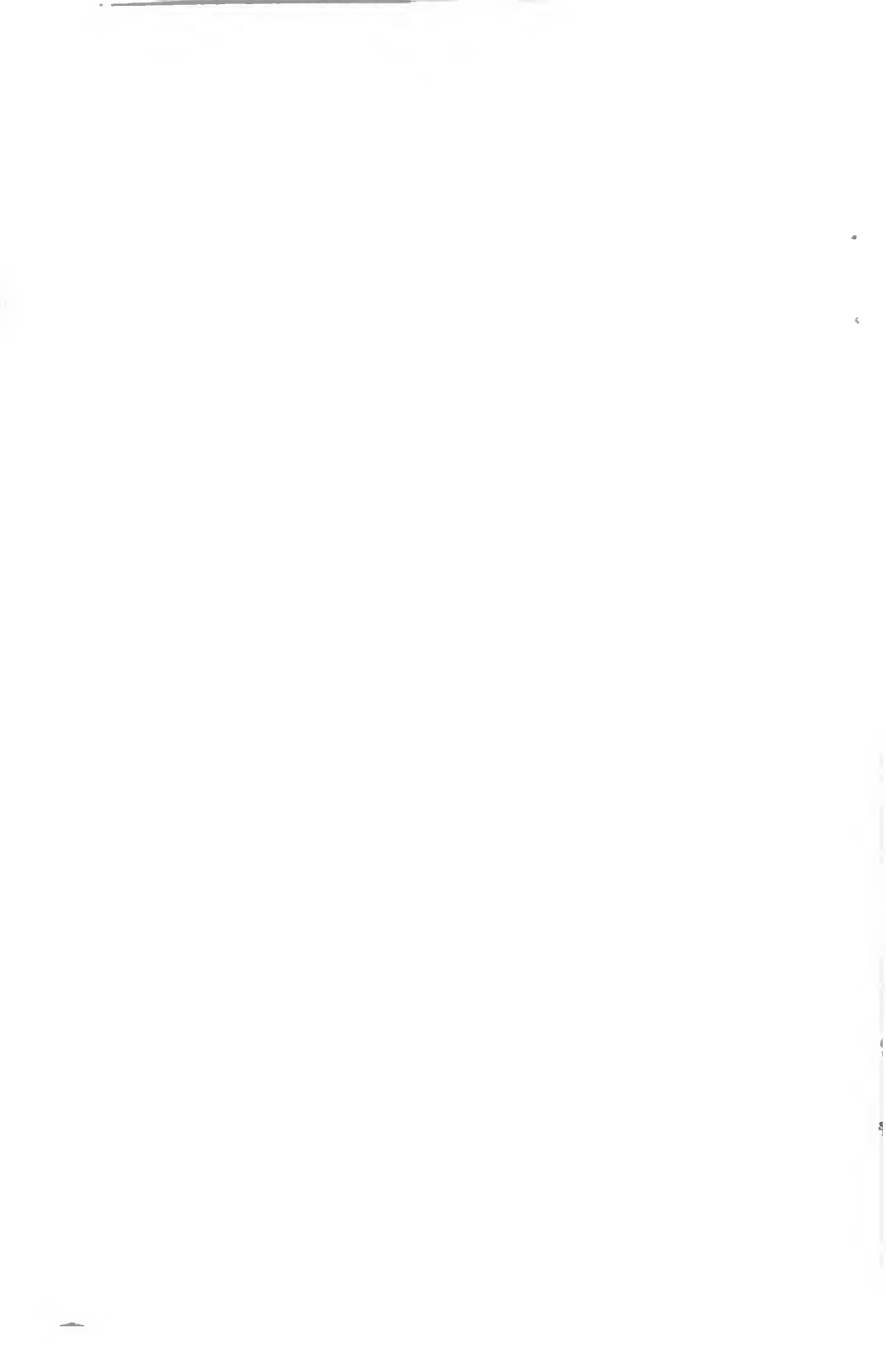
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REVIEW OF TAXPAYER PRIVACY ISSUES

WEDNESDAY, JULY 30, 1980

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, D.C.

The subcommittee met at 6 p.m., pursuant to notice, in room H-137, the Capitol, Hon. Sam M. Gibbons (chairman of the subcommittee) presiding.

[Press release announcing the hearing follows:]

[Press release of July 25, 1980]

WAYS AND MEANS OVERSIGHT PANEL TO REVIEW TAXPAYER PRIVACY ISSUES

The House Ways and Means Oversight Subcommittee wants to know whether Congress should now relax the safeguards it placed in the law four years ago to insure the privacy of tax returns and taxpayer's bank records.

Chairman Sam M. Gibbons (D-Fla.) announced today that the Subcommittee will consider this issue at a hearing to be held next Wednesday, July 30, 1980, beginning at 6:00 p.m., in Room H-137 of the Capitol.

Before Congress enacted the Tax Reform Act of 1976, the Internal Revenue Code provided that tax returns were public records disclosable in accordance with regulations approved by the President. In addition, the IRS could, prior to the 1976 Act, obtain information about a taxpayer from a third party, such as a bank, by issuing an administrative summons, without giving the taxpayer notice that it was seeking such information.

Now, under the 1976 Act, the IRS may disclose tax returns or certain related information to another Federal agency only by court order. The Act also enables a taxpayer to force the IRS to get a court order to enforce an administrative summons for third-party information about the taxpayer's finances.

Earlier this year legislation was introduced in both houses of Congress to relax these and other restrictions in the 1976 law. The sponsors claim that present rules have hampered IRS cooperation with Federal law enforcement agencies in investigating and prosecuting narcotics traffickers and organized crime figures. Others claim that taxpayer privacy would suffer if present safeguards are relaxed.

"We want to hear all viewpoints," Gibbons said concerning next Wednesday's hearing. In addition to Congressional proponents and critics of the legislation to relax restrictions, witnesses will include two panels: one consisting of Commissioner of Internal Revenue Jerome Kurtz, Assistant Attorney General (Tax Division) M. Carr Ferguson and Deputy Assistant Attorney General (Criminal Division) Irvin B. Nathan; and another panel consisting of representatives of the American Bar Association and the American Civil Liberties Union.

Mr. GIBBONS. The subcommittee will be in order.

As a part of my opening statement, I want to state that we will not make evening sessions a regular practice, but I am sure that all of you know the reason for this hearing and late hour for it.

The reason for the late hour is, of course, that the Ways and Means Committee is just clogged with hearings and we want to make sure we get to this very important issue that Senator Nunn has raised for us.

When the Tax Reform Act of 1976 was passed, Congress wrote in several provisions designed to enhance the privacy of taxpayer information.

One provision bars the Internal Revenue Service from turning over a tax return or information supplied the IRS by a taxpayer to another Federal agency except by court order. Another provision states that information gathered by the IRS without the aid of the taxpayer could be turned over only by written request of the head of a Federal agency.

These provisions are reinforced by others which subject IRS employees to criminal and civil penalties for unauthorized disclosures of tax information.

Still another provision of the 1976 act dealt with what is known as the IRS third-party administrative summons. Before the 1976 act the IRS could issue an administrative summons to a third party, such as a bank, and get a taxpayer's financial records without notifying the taxpayer. Now not only must the IRS notify the taxpayer but also the taxpayer can automatically stay the summons and make the IRS get a court order to enforce it.

More than 3 years of experience under these provisions has given rise to complaints—mainly from the Federal law enforcement community—that the 1976 pendulum swung too far. The critics claim that the present rules inhibit Federal investigations and prosecutions of narcotics traffickers and organized crime figures to such an extent that all of American society suffers. Others contend, however, that individual privacy would suffer more if these rules were relaxed.

And I understand the IRS and Justice have pinpointed other problems which may require changes in the law to overcome. We expect to hear about these in greater detail from our panel of administration witnesses later this evening.

Senator Nunn and others introduced legislation in the Senate and I followed their lead in the House. Since that time, the IRS and the Justice Department have gotten together in a series of meetings, I understand, and have worked out some of their differences.

Well, we are going to hear from a number of different witnesses today, representing various points of view, and we will start with you, Senator Nunn, since you are the pioneer in this field.

STATEMENT OF HON. SAM NUNN, A U.S. SENATOR FROM THE STATE OF GEORGIA

Senator NUNN. Thank you. I will spare you the ordeal of hearing my entire statement, which I would like to submit for the record.

This statement goes into the background and historical role of the Internal Revenue Service, some of the philosophical questions involved and a rather detailed description of the bill.

Mr. GIBBONS. Without objection, we will make it a part of the record.

[The prepared statement follows:]

STATEMENT OF HON. SAM NUNN, A U.S. SENATOR FROM THE STATE OF GEORGIA

Mr. Chairman, thank you for scheduling these hearings on the issues raised by the bills which you and I have introduced to amend the disclosure, summons, criminal sanction and civil penalty provisions of the Tax Reform Act of 1976.

The legislative package I introduced in the Senate is the result of extensive hearings held by the Permanent Subcommittee on Investigations last December on illegal narcotics profits and the impediments faced by law enforcement authorities in eliminating those profits.

We heard testimony from 35 witnesses and received 34 exhibits. Our printed hearings record, which I will supply for your information, totaled 507 pages.

A report on our investigation, will be filed in the Senate next Monday.

THE DECLINE OF IRS

Mr. Chairman, it has long been recognized that financial investigations, relying on financial and tax records, are one of the most effective tools in piercing the veil of secrecy that protect those at the top of any organized crime ring—be it a drug smuggling operation or a traditional organized crime family.

Today, when organized crime and narcotics trafficking are becoming bigger and more sophisticated than ever before, the one law enforcement agency that the kingpin criminals fear most—the Internal Revenue Service—has withdrawn from the battle.

The FBI testified at our December hearings that its cooperative efforts with IRS are down over 95 percent since 1976.

IRS-initiated cases against organized criminals are down more than 50 per cent during that same period.

During all of 1979, the IRS made just 10 or 12 cases against high-level narcotics traffickers.

In 1974, IRS had 927 employees working on narcotics cases. In 1979 that number had dropped to 163.

The untaxed profits from narcotics and organized crime run into the billions of dollars every year and are growing all the time, yet since 1976 the IRS has made only a minimum effort to tax these profits or help convict those who make them.

These untaxed dollars often leave our country, are laundered through overseas banks or businesses, and come back to America in the form of hidden investments which are having a tremendous inflationary impact. Consequently, honest businessmen and women have great difficulty competing against the criminal tax evader in the market place.

Since 1976, IRS has concentrated its efforts on the ordinary taxpayer while the criminal has gotten a relatively free ride. This has encouraged average citizens to get into the "underground" economy in which they pay little or no taxes.

Mr. Chairman, these are some of the findings which are contained in our Subcommittee's draft report. I point them out today to illustrate that the IRS has withdrawn as an effective weapon against organized crime and narcotics dealers.

I also point them out in order to emphasize that the beginning of this decline coincided with enactment of the disclosure provisions of the Tax Reform Act of 1976.

THE TAX REFORM ACT OF 1976

These disclosure provisions, which are found in 26 U.S.C. 6103, were passed in the wake of certain abuses that came to light during the various Watergate and intelligence gathering investigations.

For the most part, these abuses involved the loose dissemination outside IRS of individual tax returns for various purposes, such as coercing campaign contributions or checking on groups which some agencies considered to be subversive.

To cure these abuses, Congress enacted section 6103, which makes tax returns confidential and subject to disclosure by IRS only in accordance with very strict procedures.

But the section goes much further and covers more than just tax returns. Also included in its proscription is most other information that IRS gathers in connection with tax investigations.

Under section 6103, IRS agents are forbidden to disclose, on their own initiative, not only tax returns but "tax return information"—which is any information they gather in connection with a tax return—or "taxpayer return information"—which is any information they obtain from a taxpayer or his representative, such as his attorney or accountant.

In other words, the prohibition now applies to information gathered from such items as books and records, bank accounts, taxpayer interviews, and so forth. The other law enforcement agencies once relied on IRS to disclose to them evidence gained from these sources, but this is no longer true.

As a result, there is very little criminal information exchanged today between IRS and the other federal law enforcement agencies. IRS has turned over an average of just 32 pieces of criminal evidence per year over the past 3 years. DEA officials testified at our hearings that they received no non-tax criminal evidence over the same period.

What happens to the non-tax criminal evidence that IRS agents come across during the course of their tax investigations? Apparently, it is buried somewhere in the IRS files.

For example, IRS agents told our Subcommittee that they found evidence of massive embezzlements when they audited a labor union's records, but they could not report this information to the Justice Department. Thus, Justice had no information upon which to begin a non-tax prosecution.

In another example, IRS agents found evidence in a taxpayer's business records that he had bribed a policeman. That evidence was never disclosed, and the policeman is still on the job.

These examples pale in comparison to an incident known as the "Case of the Trash Can" in which DEA was investigating a chemist suspected of concocting illegal drugs. DEA learned that an IRS agent had searched the chemist's trash can and had discovered evidence that the chemist indeed was making illegal drugs. However, IRS would not volunteer this evidence.

The prosecutor subpoenaed the IRS agent and the trash can documents, but IRS cited the Tax Reform Act and refused to let the agent answer the subpoena. IRS said the trash was gathered in connection with the chemist's tax return; therefore, the prosecutor needed a court order under section 6103 to see the documents.

In my mind, by keeping secret this evidence of criminal activity found in a taxpayer's books and records, bank account statements and check stubs, we have legislated an exemption for criminals.

Our investigation has convinced me that the disclosure provisions of section 6103, coupled with the way they have been interpreted and enforced by IRS, have had a highly detrimental effect on our federal law enforcement system.

That system is complex and sophisticated. We do not have a federal police state. Instead, we have a series of agencies broken down by criminal jurisdiction that must operate with a high degree of coordination and cooperation. It is not unusual, in fact it is quite common, to combine the skills and information of many agencies to achieve any measure of success in criminal enforcement.

IRS has a fine tradition and history of being one of the most effective law enforcement agencies, especially in cases involving high echelon criminals. Obviously, since the purpose of criminal ventures is to make money, very few substantive crimes can be committed without some tax consequences. Therefore, IRS always has been—and continues to be—a key agency both in terms of financial expertise and in terms of financial information.

The language and interpretation of the Tax Reform Act, however, have caused a severe breakdown in our delicate and complex federal law enforcement system. It has taken up to 13 months simply to receive the assistance of IRS agents in joint investigations because the Tax Reform Act and its interpretation by IRS has caused a bureaucratic nightmare in cases where federal agencies should willingly assist each other. Moreover, the Tax Reform Act and its interpretations by IRS have made, in effect, common criminals out of IRS agents who must ignore the dictates of justice for every other American, and refuse to turn over evidence of serious crimes to the appropriate authorities.

THE "CATCH 22"

It is possible, of course, for other agencies to obtain tax returns and other IRS-gathered information under section 6103. However, they must apply for a court order in order to get tax returns, and they must make written requests to obtain other IRS information about non-tax crimes such as forgery, bribery, or narcotics violations that comes from sources other than tax returns.

In either situation, the requesting agency must describe the information it seeks to obtain.

The court order and written request requirements have created a "Catch 22" situation. Since IRS agents are forbidden to tell the other agencies of the criminal evidence they gather, it is virtually impossible for these other agencies even to know that such information exists, much less to describe that information with such particularity that they can satisfy the requirement for a court order or written request.

In other words, section 6103 requires federal investigative agencies to go through elaborate request procedures to obtain information that they may not even know that IRS has.

This "Catch 22" situation has made it all but impossible for the FBI, DEA, and other agencies to receive the necessary information and cooperation from the IRS.

IRS ATTITUDE

Section 6103 is only a part of the problem. The bulk of the problem lies with the attitude of the top officials of the IRS and the policies and procedures they have adopted in interpreting and applying section 6103.

For the past 6 years, a series of IRS commissioners and their top aides have taken the view that IRS should stick to "tax administration"—by which they mean tax collection and only tax collection—and out of the general law enforcement arena.

They say that paying attention to ordinary taxpayers is a better way of keeping the voluntary tax collection system working than is cracking down on organized criminals who pay no taxes on their tremendous ill-gotten gains.

I beg to differ with that view of tax administration.

Obviously, IRS must be aggressive in collecting the Nation's taxes, but I can understand the skepticism of a small town waitress who is caught for under-reporting her tips when organized crime millionaires escape without reporting a cent of their illegal income.

I believe that if the average taxpayer knows that IRS can successfully collect taxes from the mob, he is a lot more likely to ante up his fair share—if for no reason than the fear of being caught.

When he sees a drug pusher prosecuted for tax evasion, he is likely to have confidence in our voluntary tax collection system and feel that his taxes are being well spent, especially on law enforcement. On the other hand, if he sees criminals getting away with tax evasion on top of murder and extortion, his natural skepticism toward our tax policy will increase.

IRS' recent emphasis on ordinary taxpayers has not increased voluntary compliance with the tax laws. In fact, statistics compiled by both the IRS and the General Accounting Office indicate that voluntary compliance with the tax laws actually has decreased since passage of the Tax Reform Act of 1976 and the subsequent withdrawal of IRS from cooperative law enforcement efforts aimed at big-time criminals.

Other statistics indicate the extent of IRS' withdrawal: Between 1974 and the first 9 months of 1978, the number of organized crime cases which originated from IRS developed tax information dropped from 620 to just 221.

I do not mean to imply that IRS is totally unaware of the effect of the Tax Reform Act. Just last December, for example, the Deputy Commissioner of IRS appointed a special study group to assess the impact of the disclosure provisions. That group made a number of recommendations for administrative action. A copy of the group's report has been provided to our Subcommittee, and I submit that for your consideration.

Despite some changes that have been made by IRS, legislative action is still necessary.

DISCLOSURE AMENDMENTS

My colleagues and I do not advocate scrapping the privacy safeguards which were written into the Tax Reform Act. However, 3 years' experience under the act have convinced us that a balance needs to be struck between the privacy of tax returns and the legitimate needs of law enforcement agencies.

We think that our amendments to the disclosure provisions strike that balance.

Under S. 2402, ordinary taxpayers may rest assured that a Federal judge will have to approve any disclosure of their tax returns and all other information they are required by law to provide the IRS.

In order for a law enforcement agency to see this information, it still will have to get an ex parte order from a U.S. district court. It will have to convince the court that there is reasonable cause to believe that the information in the return is material and relevant to a lawful criminal investigation or proceeding.

On the other hand, drug traffickers and organized criminals may rest assured that nonreturn records which show unusual cash desposits and transfers into and out of their bank accounts will be called to the attention of the appropriate law enforcement agency.

Under our proposal, the DEA could get this type of nonreturn information from IRS by making a written request rather than being required to obtain a court order.

Under this proposal we would separate IRS information into two simple and distinct categories. The first category of "Returns" would cover tax returns and all other information a taxpayer is required to give IRS. This category of privileged information would require a court order. The second category, called "Non-return" information, would cover all other information IRS obtains in the normal course of its business. This category would require a specific written request procedure which would be monitored by the Justice Department and IRS.

I realize that there are differing views with regard to how much information should be afforded the protection of a court order prior to disclosure. For example, I have read the GAO's critique of our bills on this issue, and I think GAO will make some very good points before you today.

Let me emphasize that our bills were drafted to provide concrete pieces of legislation which we can use to formulate solutions to the problems brought on by the Tax Reform Act. Mr. Chairman, I stand ready to assist your committee in refining these bills.

To eliminate the "Catch 22" snag, S. 2402 puts an affirmative burden on IRS to notify the Justice Department whenever it uncovers evidence, other than from a tax return, or crimes such as narcotics trafficking, bribery and extortion. IRS will be required to reveal enough about that evidence so that the prosecutor can make a written request to IRS for it.

Admittedly, it will be easier for prosecutors to get information that IRS obtains from sources other than tax returns—sources such as banks and business records, accountants and other taxpayer representatives.

But it will not be easy for prosecutors to see a person's tax returns.

Nor would any agency other than the Justice Department be able to request access to tax returns. Every such request will have to be made by a Justice Department lawyer, who would exercise his own legal judgment that the return is material and relevant to a lawful investigation or proceeding.

And a U.S. district court will be the final arbiter of whether a tax return and its supporting information—such as a list of contributions to Good Will—will be disclosed outside the IRS.

Even when tax returns and other information are disclosed, they can be used only in connection with lawful criminal proceedings and investigations, certain types of civil litigation involving Federal Claims, and situations involving certified State felony violations.

The proposal also contains a provision that allows IRS to immediately release information in emergencies such as threats to life, property, and national security. This change would cure the situation that now exists which requires IRS to pursue elaborate and time-consuming disclosure procedures even in such emergencies as assassination attempts.

In summary, as it amends the disclosure provisions of the Tax Reform Act, our proposal would—

First, require IRS to notify the appropriate law enforcement agency whenever it uncovers evidence, other than from a tax return, of a non-tax crime.

Second, once certain requirements are met and a written request made, IRS can release nonreturn criminal information directly to the Justice Department.

And third, Government attorneys can obtain tax returns and supporting documentation only by showing a Federal district judge that there is reasonable cause to believe that the returns are material and relevant to a lawful criminal investigation.

SUMMONS PROVISIONS

While the disclosure provisions of the Tax Reform Act have caused problems, the IRS admits that the administrative summons section of that act is an impediment to effective law enforcement.

Under that section, 26 U.S.C. 7609, IRS is required to notify a taxpayer whenever it issues a summons to a third party—such as a bank—to get access to the taxpayer's records. The taxpayer then has a right to automatically stay the performance of that summons until IRS can take the issue to court. To obtain this stay, the taxpayer does not have to establish any legal reason why IRS should not see his records. It is all automatic.

Let us say a person reports a modest income on his tax return for 1979, but it comes to the attention of IRS that he lives a very extravagant life style. Maybe

he has reported an income of \$23,000—but during the year he bought a house costing \$230,000 and two cars costing \$19,000 apiece.

Suspecting that he is not reporting all of his income, IRS issues a summons to his bank to have a look at his account records, which may very well show that he has made a number of large cash deposits—a telltale sign of drug pushing.

Under the existing summons provision, the suspected narcotics dealer can automatically stay the enforcement of that summons, and the IRS is stymied until it can go to court and establish why it needs to see those records. In the meantime, the pusher keeps on dealing drugs.

This automatic stay provision has resulted in delays of more than a year. One automatic stay lasted 33 months. The average length of such stays has been 9 months.

In addition, there is no limit to the number of automatic stays a tax evader can initiate. All investigators know that one set of records often creates the need for a second set. Consequently, after a year's delay, IRS may find from the originally-summoned records that additional documents must be obtained. IRS then issues another summons, the tax evader invokes another automatic stay, and another year goes by.

In the meantime, witnesses may die, evidence becomes stale, and the Government's case is weakened.

An IRS study of this problem revealed that in more than 2000 automatic stays, over 80 percent of the time the protesting taxpayers failed to show up in court. It is fair to conclude from this statistic that delay—and not a legal issue—was the purpose of most automatic stays.

In another survey, the General Accounting Office found that over 75 percent of all persons who took advantage of the automatic stay were known organized crime members, narcotics dealers, or persons who habitually protest paying their taxes.

We propose to change the automatic stay provision to make the summons procedure similar to the one Congress applied to every Federal investigative agency except the IRS through the Right to Financial Privacy Act of 1978.

Under our proposal, a taxpayer still will be given notice whenever his records have been summoned by the IRS, and he will be able to contest the summons in court before IRS can see his bank or other records held by a third party.

In keeping with the policy of the Right to Financial Privacy Act, however, the taxpayer will have to assert a legal argument and convince the court that IRS has no right to see his records. It will not be an automatic stay.

Ordinary taxpayers with good legal arguments will have no fear of indiscriminate access to their records by the IRS. But criminals and tax evaders will find it much more difficult to delay, interrupt and impede a serious investigation for years on end.

In addition, under our proposal, the Government can present to the court, for in camera inspection, evidence indicating that a notice to the taxpayer could result in the destruction of records, obstruction of justice, threats to witnesses, or other similar acts. If the court agrees, an order can be issued postponing the advance notice requirement.

We believe that by enacting our proposal and applying the same summons procedure to the IRS that is applied to all other Federal agencies, Congress will be improving law enforcement while continuing to provide adequate privacy safeguards for everyone's records.

CIVIL DAMAGE PROVISIONS

As I pointed out earlier, the Tax Reform Act of 1976 contains severe criminal and civil penalties for persons who disclose tax returns or related information in violation of the act.

The civil damage provision, 26 U.S.C. 7217, makes any person who willfully or negligently discloses a tax return or tax return information in violation of the act personally liable for civil damages in a suit brought against him by the taxpayer.

There is no liability for disclosures which result from good faith, but wrong, interpretations of the act.

Our proposed amendment to section 7217 provides that the Government will be liable for damages awarded against a Federal official or employee so long as the disclosure occurred within the scope of his employment and was not done corruptly,

maliciously, in return for anything of value, or willfully in violation of the disclosure provisions of the act.

We do not believe that IRS agents should be personally liable for damages arising out of disclosures which are not done with wrongful intent, and S. 2405 spells this out.

CRIMINAL PENALTIES

The criminal penalties of the Tax Reform Act, 26 U.S.C. 7213, makes it a felony to willfully disclose tax returns or tax return information in violation of the act. Persons found guilty can be fined up to \$5,000 or sentenced to jail for up to 5 years, or both, and assessed the costs of prosecution.

Under existing law, there is no defense available for good faith but wrong interpretations of the disclosure provisions. As a result, IRS agents testified before our subcommittee, they will always stay on the safe side of the law and not disclose any IRS information to other agencies except in the most serious situations. The disclosure provisions are not always easy to interpret in every situation when an IRS agent comes across evidence of a nontax crime. In fact, even though IRS has issued a number of "clarifying" interpretations and instructions, its agents testified that they never could be sure if they were violating the act when they disclosed information. In fact, IRS' own legal counsel had difficulty interpreting the provisions when asked questions at our hearings.

In order to ease the minds of IRS agents and to encourage them to report nonreturn information to possible crimes, we propose in S. 2404 that an affirmative defense provision be added to the criminal penalty section to relieve them of criminal liability when they can establish that they made the disclosure based on a good faith, though erroneous, interpretation of the disclosure provisions.

CONCLUSION

Mr. Chairman, for generations the Internal Revenue Service led the way in this Nation's battle against organized crime and narcotics trafficking, but since 1977 it has hidden behind the disclosure provisions of the Tax Reform Act to stay out of the fray.

As Fred Bonadonna, whose father was an identified member of the Kansas City mob, testified at our recent hearings, organized criminals—who once feared the IRS—now arrogantly display the wealth created by their criminal ventures, knowing full well that the IRS will do nothing about their ill-gotten gains.

Only part of the SIR withdrawal can be blamed on the existing law. In passing the disclosure provisions, Congress intended to provide greater protection for the privacy of each citizen's tax returns, but we did not intend for IRS to withdraw from this important fight.

It is now time for us to make a policy decision for the top-level administrators of the IRS, rather than having them make it for us. That decision is that the IRS should become once again the effective force for justice that it was in the days of bootleggers and rumrunners.

My colleagues and I believe that our proposals will send IRS a clear and unmistakable signal that it should do just that.

We have spent many long hours in drafting what we feel is very well-reasoned legislation. We will retain very important privacy safeguards that will prevent any repetition of Watergate-type abuses. At the same time, we put a duty on IRS to cooperate once again with the fight against the ever increasing organized crime and narcotics problems facing the Nation.

Three years of inactivity by this once effective law enforcement agency is enough. It is time to act.

Thank you very much.

Senator NUNN. I also have a comprehensive comparison of S. 2402 and the existing law, which might be helpful.

Mr. GIBBONS. I have seen that and I think we should make it a part of the record also.

[The information follows:]

Comparison of 26 USC 6103 to Nunn Proposal

§6103 Existing Law	§6103 Nunn Proposal	Comments
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(a) General Rule--"Returns" and "return information" shall be confidential, and no person who has had access to returns or return information shall disclose the returns or information, except as authorized in §6103.

(a) General Rule--"Returns and "non-return information" shall be confidential, and disclosure shall be prohibited, except as authorized in §6103.

No substantial change; change reflects our change in terminology by reflecting on 2 categories of IRS info: return information and non-return information.

(b) Definitions
 (1) Return--Tax or information return, declaration of estimated tax or claim for refund, or amendment or supplement thereto, including supporting schedules, attachments, or lists which are supplemental to, or part of, the filed return.

(b) Definitions
 (1) Return--Any document the taxpayer is required by law to file, including same items mentioned in existing §6103.

We have divided IRS material into only 2 categories.
 (1) Return information: all information the taxpayer is required by law to give IRS;
 and (2) non-return information: all other information IRS discovers.

(2) Return information--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; whether the taxpayer's return was, is being, or will be examined or subject to investigation or processing; any other data received, recorded, prepared, or collected by, or furnished to, IRS with respect to a return or to a determination of tax liability; any written determination, or any background file document relating to such determination, which is not open for public inspection.

(2) Non-return information--Any information, other than a return, which IRS collects, receives, or obtains with respect to a taxpayer or return, or with respect to a determination of the existence of tax liability, etc.; any written determination, or any background file document relating to such determination, which is not open to public inspection.

This avoids the interpretations under the present act where corporate records, bank records, agent interviews, FBI information, etc. were considered by IRS to fall in the vague category of "Return Information." This also enables us to separate those items which deserve a higher degree of privacy and hence a court order for disclosure from those items that IRS, like any other investigative agency, uncovers in a typical investigation.

§6103 Existing Law	§6103 Numm Proposal	Comments
(3) Taxpayer return information--Return information (as in (2)) which is filed with, or furnished to, IRS by or on behalf of the taxpayer or to whom such information relates.		
(6) Taxpayer identity--Name of a person with respect to whom a return is filed, his mailing address, his taxpayer identifying number, or a combination thereof.	(6) Taxpayer identification information--Any information in possession of IRS which identifies the name, address, or social security number of any taxpayer or which reveals whether the taxpayer filed a tax return for any given year.	Substantially similar; adds the fact of whether or not a taxpayer has filed to the definition of taxpayer identity.
No (10)	(10) Attorney for the Government--Attorney General, Deputy AG, Assistant AG, Deputy Assistant, AG, U.S. Attorney, Attorney in Charge of a Strike Force, any head of a local or regional office of the Justice Department, or anyone else designated by the AG.	Designates who may request and receive IRS material. The designations are worded in such a way that heads of field offices may request and disclose information upon filing the appropriate court and/or IRS requests. This eliminates the untenable bureaucratic time delays encountered under the present act in having the head of the agency approve everything.
No (11)	(11) Secretary or his designee--Secretary of the Treasury or his designee.	
No (12)	(12) District Court--A U.S. district court judge or a U.S. magistrate designated by the judge to carry out his duties under §6103.	Allows a U.S. District Court Judge or U.S. magistrate to rule on disclosure requests.
No (13)	(13) Federal investigative agency--Any federal department or agency which has responsibility or duty to investigate the violation of any federal criminal statute.	Defines federal investigative agency.

(i) Disclosure for administration of Federal Laws not relating to tax administration.

(i) Disclosure for administration of Federal Laws not relating to tax administration.

Our revision has two safeguards: (1) Every request must be made by a Justice Department attorney thereby providing a legal check on the appropriateness of the request before it is made. Moreover, all disclosure is made through a Justice Department attorney thereby eliminating indiscriminate disclosure to each agency who could request information from IRS; (2) Our revision also requires an application to a federal court and a court order to release any information a taxpayer is required by law to provide IRS such as his tax return.

(1) Non-tax criminal investigation--

(1) Disclosure of tax returns for non-tax purposes shall be permitted only as follows:

(A) Information from taxpayer--Upon grant of an ex parte order by a Federal district court judge, a return or taxpayer return information shall be open, but only to the extent necessary as provided in the order, to officers or employees of a Federal agency who are personally and directly engaged in--and solely for their use in--preparation of any administrative or judicial proceeding (or investigation which may result in such a proceeding) pertaining to the enforcement of a specifically designated Federal criminal statute.

(A) Ex parte order--Upon application by an attorney for the Government, a district judge may, by ex parte order, direct that a tax return be disclosed to the attorney for use during or in preparation for any administrative, or judicial, or grand jury proceeding, or in a criminal investigation which may result in such a proceeding.

(B) Application for order--The head of any Federal agency described in (A) or, if the Justice Department, the AG, Deputy AG, or Assistant AG, may authorize an application for an ex parte order.

The present statute had a provision which included return information which had been loosely interpreted to cover taxpayer books and records, accountants' books and records, corporate records, third-party interviews, tips from other agencies and other material a taxpayer is not required by law to provide IRS. Thus, the present act had the unfortunate result of putting IRS in the position of discovering bribery, embezzlement, union payoffs, etc. in financial records of organizations but not being able to turn it over or tell the Justice Department about it.

The judge may grant the order if he determines on the basis of facts submitted by the applicant that--

Such ex parte order shall be issued only upon a determination that--

- (i) there is reasonable cause to believe, based on information believed to be reliable, that a specific criminal act has been committed;
 - (ii) there is reason to believe that such return or return information is probative evidence of a matter in issue related to the commission of such criminal act; and
 - (iii) the information sought to be disclosed cannot reasonably be obtained from any other source, unless the information constitutes the most probative evidence of a matter in issue relating to the commission of such criminal act.
- However, IRS shall not disclose any return or return information if it determines and certifies to the court that such disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation.

(i) the application is made in connection with a lawful administrative, judicial, or grand jury proceeding, or an investigation which may result in such a proceeding, pertaining to the enforcement of a specifically designated Federal criminal statute.

(ii) there is reasonable cause to believe that the information contained in the return is material and relevant to such a proceeding or investigation.

(See paragraph (i) (6) below.)

(B) Application for order--Application shall set forth (1) name of taxpayer, (2) time period to which request relates, (3) statutory authority for criminal investigation, (4) nature and purpose of the proceeding or investigation, (5) reasons why, in opinion of attorney for the Government, the disclosure of the information on the return is or may be material to the proceeding or investigation.

Our revision requires the Government to provide information to the court which shows that a legitimate federal criminal investigation is being pursued and that there is reason to believe that the information contained in the tax return is material and relevant to the investigation or proceeding.

Our standard is more reasonable with the added safeguard of prosecutorial intervention. The main criticism of the present standard was it was impossible to meet. Therefore, no one used it. Also we've eliminated the third requirement that the Government prove the financial information cannot be obtained from any other source. The fact is that the financial information is "available" elsewhere but that the Government would have to completely reconstruct a taxpayer's bank records to duplicate the information on the return. This unreasonable result should be laid to rest.

This third requirement of the present act also required the Government to prove that the tax return was the most probative evidence of the crime to be proven. Since this section deals only with non-tax crimes, the tax return itself would never be the most probative evidence of the crime. Only the actual financial records would qualify. Thus an impossible standard has been deleted.

§6103 Existing Law

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No (C)

(C) Procedures--Judge shall set upon the application within 5 days.
In the event he denies application--

- (i) motion to reconsider shall be acted on within 5 days, and
- (ii) appeal shall be disposed of as soon as practicable but not later than 30 days.

No (D)

(D) Duty of Secretary--Upon issuance of order, IRS shall disclose returns pursuant thereto within 10 days.

No (E)

(E) Further disclosure--Attorney for Government may further disclose return to such other Government personnel as he deems necessary to assist him in preparation for any administrative, judicial, or grand jury proceeding, or in a criminal investigation which may result in such a proceeding.

(2) Return information other than taxpayer return information--Upon written request by agency heads authorized to apply for ex parte order (para. (1)(A)), information supplied by third parties (i.e., return information not supplied by or on behalf of a taxpayer) shall be disclosed to officers and employees of such agency personally and directly engaged in, and solely for their use in, preparation for any administrative or judicial proceeding (or investigation which may result in such a proceeding).

(2) Disclosure of non-return information--Information in the possession of IRS, other than tax returns, shall be disclosed as follows:

- (A) Within 10 days of receipt of a written request by an attorney for the Government, IRS shall disclose any non-return information in its possession.

We have placed time limits on the courts action and IRS's response to eliminate the dreadful delays testified to in our hearings.

We have also provided a mechanism so that the Government attorney can disclose tax information to those agents and agencies assisting him in the investigation. This has the added safeguard of prosecutorial supervision and yet provides an avenue for other agencies to receive criminal information that didn't exist under the old act.

With respect to any information IRS discovers that the taxpayer is not required by law to give the IRS, an attorney for the government can request that information by written request to IRS. Again this clears up the grey area of what is protected by court order and what isn't. It also requires IRS to disclose such information within a specific time period to avoid the delays inherent in the old act and IRS procedures.

Such written request shall set forth--

- (A) the name and address of the taxpayer;
- (B) taxable period(s) to which the return information relates;
- (C) the statutory authority under which the proceeding or investigation is being conducted; and

(D) the specific reason(s) why such disclosure is or may be material to the proceeding or investigation.

However, IRS shall not disclose any return or return information if it determines that such disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation. The name and address of a taxpayer may be disclosed under this paragraph.

No (B)

Such written request shall set forth--

- the name and address of the taxpayer;
- the taxable period(s) to which the information relates;
- that the request is being made in connection with an administrative, judicial, or grand jury proceeding, or an investigation which may lead to such a proceeding, pertaining to the enforcement of a specifically designated Federal criminal statute which the agency is authorized to pursue; and
- the reason(s) why, in the opinion of the attorney, the disclosure is or may be material to such proceeding or investigation.

(See paragraph (i) (6) below.)

Our written request requirements are substantially similar to the present act but more specific in terms of what information must be supplied to IRS.

The procedure to be used, however, does not require the approval of the head of the agency. Under our procedure the head of any Justice Department office can make the request so long as he complies with the law and the head of any local IRS office can comply by disclosing the information. This obviates the need for the frustrating and time-consuming review of heads of agencies.

(B) The attorney for the Government may further disclose non-return information to such Government personnel as he deems necessary to assist him during or in preparation for any administrative, judicial, or grand jury proceeding, or in a criminal investigation which may result in such a proceeding.

This allows the attorney for the Government to disclose the information given to him to the agents or agencies assisting him in the criminal investigation. This provision is almost identical to the Grand Jury secrecy rules.

§6103 Existing Law

Under paragraph (1)(1), taxpayer identity information is considered to be taxpayer return information and subject to disclosure only by grant of an ex parte order. However, under paragraph (1)(2), taxpayer identity information may be disclosed in connection with the disclosure, pursuant to written request, of return information other than that provided by or on behalf of a taxpayer (i.e., third-party information).

(3) Disclosure of return information concerning possible criminal activities--IRS may disclose in writing return information (other than that provided by or on behalf of a taxpayer) which may constitute evidence of a violation of Federal criminal laws to the extent necessary to apprise the head of the appropriate Federal agency charged with enforcing such laws. The name and address of a taxpayer may be disclosed, even though supplied by the taxpayer, if there is third-party return information that may constitute evidence of a Federal crime.

No (B)

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(3) Taxpayer identification information
--IRS shall disclose taxpayer identification information to the attorney for the Government upon written request.

(4) Secretary's duty to disclose non-tax criminal information.

(A) The Secretary (IRS) shall disclose, as soon as practicable, to an attorney for the Government any information, except returns, which may constitute evidence of a federal crime or which may be pertinent to a federal criminal investigation, to the degree necessary to permit the attorney to request non-return information as provided in paragraph (1)(2)(A) above.

(B) Exigent circumstances--Under exigent circumstances, including a possible threat to persons, property or national security, IRS shall disclose such information (including returns) to the extent necessary to apprise the appropriate federal agency with responsibility to enforce the law. As soon as practicable

Comments

Our section makes it clear that taxpayer identification information is available upon written request of the attorney for the government. This avoids problems such as those faced by law enforcement officers when trying to return stolen property according to social security nos. and IRS won't provide the information under the present act.

Our section requires the IRS to disclose criminal information it uncovers except anything listed on the tax return itself. Under the present act IRS was not required to disclose the information [+ the evidence at the hearing disclosed that they didn't]. We are still making the tax return inviolate except via court order.

This section eliminates the Catch-22 situation of requiring an agency to request information without ever knowing what information exists. This section would require IRS to alert the Justice Department to criminal information.

We have included a section for emergencies which will allow IRS to disclose any information to the appropriate agency in circumstances where a threat exists to person, property or national security. This obviates problems that exist under the present law where even threats of assassination couldn't be disclosed without elaborate and time-consuming procedures.

thereafter, IRS shall notify the attorney for the Government of its actions, and the attorney shall notify an appropriate district court of the disclosure.

This section requires that after the emergency disclosure, the Government notify the court of said disclosure.

No similar provision

- (5) Assistance of IRS in joint tax and non-tax investigations--No portion of §6103 shall be interpreted to preclude or prevent IRS from assisting any other federal investigative agency in investigations of criminal matters which may lead to income tax violations, or from investigating or gathering relevant information concerning persons involved in such criminal activities.

This section makes it clear on the face of the statute that IRS is free to work jointly with other government agencies in combating crime. This is to obviate the need to process a Title 26 Grand Jury request simply to obtain the assistance of IRS. Hearing testimony revealed that the Grand Jury request process took upwards of one year just to obtain the services of IRS in a criminal case.

Under paragraphs (1)(1) and (1)(2), IRS shall not disclose any return or return information if it determines that such disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation. The determination is not subject to challenge.

This section is similar to the present act. It allows IRS not to disclose information that would identify an informant or endanger a tax case. This section, however, requires IRS to apply to the court in those cases where it would refuse disclosure to support their decision. It also gives the Justice Department a mechanism to contest IRS's decision not to disclose criminal evidence.

(6) Reasons for non-disclosure by IRS--

- (A) IRS may apply to a district court to prevent disclosure of information if it determines that the information would identify a confidential informant or seriously impair a civil or criminal tax investigation.

- (B) Attorney for the Government shall have 5 days to reply to the application for non-disclosure, stating his reasons why disclosure would not identify a confidential informant or seriously impair a tax investigation, including sufficient information to assure the court that disclosure is of such substantial importance to a criminal investigation as to take precedence over a tax investigation.

No similar provision.

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No similar provisions.

- (C) The district court shall rule on the application not less than 5 nor more than 15 days from receipt.

No similar provisions.

- (D) Motion for reconsideration of denial shall be acted upon within 5 days.

No similar provisions.

- (E) Appeals shall be disposed of as soon as practicable but not later than 30 days after filing.

No similar provision.

- (7) Disclosure to State authority upon certification of evidence of a State felony violation.

- (A) Attorney for the Government to whom disclosure has been made may apply to a district court for an ex parte order to further disclose to a State law enforcement official possessing information that is evidence of or material to a violation of a State felony statute.
- (B) The application shall set forth the name of the taxpayer, the relevant taxable period(s), the State felony violation and statute, a certification that disclosure is necessary to enable the State authorities to investigate or prosecute the violation, and the name and position of the State official.

This section gives the government a mechanism to provide evidence of state crimes to the appropriate authorities. The present act contained no such provision. This section provides for a court-authorized procedure to give evidence of state crimes to state authorities. Under the present act, for instance, evidence of bribing a policeman in the hands of IRS could not be given to the appropriate state authorities. Our revision provides a mechanism to accomplish this.

No similar provision.

(c) The district court shall, within 10 days, issue an ex parte order upon a finding that (1) the application is made in connection with an investigation or proceeding concerning the enforcement of a specifically designated State felony statute; (2) that disclosure is necessary to enable the State authorities to investigate or prosecute a State felony violation; and (3) that the State official named in the application is an appropriate State official to whom disclosure may be made.

No similar provision.

(D) Supplemental applications or appeals are to be made subject to the procedures set out in paragraph (3)(1).

No similar provision.

(8) Disclosure concerning federal civil litigation.

(A) The attorney for the Government may apply to a district court for an ex parte order to further disclose information which is evidence of or material to any federal civil litigation.

No similar provision.

(B) The application shall set forth (1) the name and address of the taxpayer; (2) the exact information sought to be disclosed; (3) the federal law under which the civil action is authorized; (4) a certification that disclosure is necessary to enable federal authorities to initiate, investigate, or litigate any federal civil claim; (5) and the name and position of the official charged with initiating, investigating and litigating the claim, and to whom disclosure will be made.

This section provides a mechanism to transfer information concerning Federal Civil Litigation to the appropriate Federal authority. Under the present act, no such provision existed. GAO found, for instance, that the Government under the old act lost federal civil cases of substantial size because it could not obtain information from IRS. This section would provide a mechanism to transfer information in serious civil cases such as civil rights, anti-trust and fraud cases.

\$6103 Existing Law \$6103 Numm Proposal Comments

No similar provision.

(C) The district court shall, within 10 days, issue the order upon a finding that (1) the application is made in connection with an investigation or proceeding concerning the litigation or potential litigation of a specifically designated Federal statute; (2) that disclosure is necessary to enable Federal authorities to initiate, investigate, or litigate any Federal civil claim; and (3) that the official named in the application is the appropriate official to whom disclosure may be made.

No similar provision.

(D) Any supplemental application or appeal shall be made pursuant to the procedures set out in paragraph (i) (1).

No Similar Provision

(10) Disclosure for use in mutual assistance treaties requires the Secretary to disclose tax returns and non-return information consistent with the procedures in the act to the attorney for the Government for use with respect to mutual assistance treaties with foreign countries which provide for an exchange of criminal evidence or information.

This section creates a mechanism to allow the Government to perform according to mutual assistance treaties it has entered into with foreign countries to exchange criminal evidence. Under the present act IRS refused to give criminal evidence to the Justice Department so that it could comply with this country's mutual assistance treaties.

Senator NUNN. I appreciate the opportunity to testify before this subcommittee. I want to thank you personally for taking the lead on the House side in bringing this matter to the attention of the House. I have done likewise on the Senate side with the help of Senator Percy, Senator Chiles, and a good many other Senators on a bipartisan basis, including Senators Long and Ribicoff who occupy positions on the Senate Finance Committee.

I consider this to be the most important law enforcement issue that we will face in this Congress.

In summary, the key parts of our proposal would amend the disclosure provisions of the Tax Reform Act, 26 United States Code 6103. When you try to summarize what this rather complicated measure does, it is always with some degree of jeopardy, but I will try to summarize very briefly.

First, the proposal would require the Internal Revenue Service to notify the appropriate law enforcement agency whenever it uncovers evidence other than from a tax return of a nontax crime.

Second, once certain requirements are met and a written request made, IRS can release nonreturn criminal information directly to the Justice Department, and we specifically define what "nonreturn information" is.

And, third, Government attorneys can obtain tax returns and supporting documentation only by showing a Federal district judge that there is reasonable cause to believe that the returns are material and relevant to a lawful criminal investigation.

Mr. Chairman, in the interest of the subcommittee's time, I will just turn now to the questions that you have asked the witnesses to address today, because I believe that would be the most meaningful form of testimony I could give.

As to question No. 1 regarding changes in the standard for an ex parte order, there are serious problems with the second and third standards in the existing law.

These standards require, No. 1—and this is the existing law—that there be reason to believe that such return or return information is probative evidence of a matter in issue and, two, that the information sought cannot reasonably be obtained from any other source unless it constitutes the most prohibitive evidence of the matter in issue.

Mr. GIBBONS. If you want to make that vote and come back, we can take some of these other witnesses.

Senator NUNN. If that will be more convenient to you.

Mr. GIBBONS. Whatever you want to do.

Senator NUNN. Let me go through this particular question and then I think that would be a good place to break.

Mr. GIBBONS. All right. You may proceed.

Senator NUNN. The second provision, which I just read, under the present law is that the information sought cannot be reasonably obtained from any other source unless it constitutes the most probative evidence of the matter in issue.

Frankly, this provision is worded such that it is hard to even tell what it means because the "unless" should really not be there. I think what was intended was "or" but nevertheless that is the provision that the IRS is trying to live under now.

We are not talking about tax crimes here, in which the return or return information certainly would be probative evidence. We are talking about nontax crimes such as embezzlement, bribery, or narcotics trafficking. In these cases the actual tax return would never be the most probative evidence and they may not even be probative. Very seldom would they be the most probative, but they would be and have been over the years useful to law enforcement authorities in solving nontax crimes because they are relevant and material.

Accordingly, in S. 2402 and H.R. 6826 we have provided standards which require that the application for a court order be made in conjunction with a lawful proceeding pertaining to the enforcement of a specific Federal criminal statute, and that there be reasonable cause to believe that the information contained in the tax return is material and relevant to the proceeding.

I believe that the reasonable cause and material and relevant standards provide adequate safeguards against unwarranted disclosure.

What we have, to make a long story short, is a Catch-22 situation. There is no way that anyone who has never seen a tax return would be able to show to a court's satisfaction that it is the most probative evidence, and even if they could, it is very seldom that it would be.

So we just believe as a minimum, very minimum, this part of the present law must be changed.

Mr. Chairman, I have a little more time, but I imagine the page was going to notify me when I have 3 or 4 minutes left, but if you would like to break here, I can come back in probably 10 minutes.

Mr. GIBBONS. We can start with the panel that consists of Commissioner Kurtz and Mr. Nathan and Mr. Csontos, both of the Justice Department, and then when you come back we can interrupt them and let you finish. Then we will work back and forth, but we might as well get Mr. Kurtz and company started here.

If you see Senator Weicker, tell him we can work him in, too. Senator NUNN. I will do that.

Mr. GIBBONS. Commissioner Kurtz, Mr. Nathan from the Criminal Division, and Mr. Csontos from the Tax Division of the Department of Justice—we regret that there may be some informality about the way this proceeds today, gentlemen.

Mr. MOORE. We have the Department of Justice and we are not talking about Billygate, are we?

Mr. GIBBONS. There is no tax relevance to that.

Mr. MOORE. Have the taxes been paid on that?

Mr. GIBBONS. I think the taxes are not due yet.

Mr. Kurtz, you are first on the list.

Commissioner KURTZ. I think Mr. Nathan is going to start.

STATEMENT OF IRVIN B. NATHAN, DEPUTY ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION, DEPARTMENT OF JUSTICE

Mr. NATHAN. If I may, I will submit my prepared statement and now I will address some of the variations between the administration's proposal and the chairman's bills.

[The prepared statement follows:]

STATEMENT OF IRVIN B. NATHAN, DEPUTY ASSISTANT ATTORNEY GENERAL,
CRIMINAL DIVISION, DEPARTMENT OF JUSTICE

Mr. Chairman and members of the subcommittee, I appreciate this opportunity to testify regarding proposed amendments to the tax disclosure provisions of the Internal Revenue Code. As you know, the Administration—through the efforts of the White House, the Internal Revenue Service and the Department of Justice—has developed a series of proposed amendments to the tax disclosure restrictions that were enacted in 1976. Although in the nature of technical and perfecting amendments, we believe our proposals are critically important to remove serious impediments to effective law enforcement, particularly in such priority areas as the prosecution of narcotics trafficking, organized crime and white-collar offenses. Moreover, it is our belief that these carefully developed amendments will achieve their purpose without compromising taxpayer privacy or the administration of our self-assessment income tax system.

In summary, we believe that the tax disclosure restrictions adopted in 1976 require fine tuning to correct several provisions, some of which are unnecessarily severe, some ambiguous, and some needlessly cumbersome. The consequences of these defects include excessive delay, reduced coordination and cooperation between the Department of Justice and the Internal Revenue Service, and too often the inability of federal law enforcement agencies to obtain crucial data in the hands of another federal agency. Based on their experiences under the 1976 law, many federal prosecutors believe that enactment of tax disclosure amendments would be the greatest single contribution that could be made to improved enforcement of federal criminal laws.

The Administration proposals are similar in most respects to the bills introduced by Chairman Gibbons. I will address some of the variations between the Administration proposal and the Chairman's bills today; others are noted in prior testimony.

Because previous Congressional hearings have dealt at length with the need for and anticipated effects of these amendments, I am submitting with my statement, for inclusion in the record, the testimony of the Department of Justice before the Permanent Subcommittee on Investigations of the Senate Governmental Affairs Committee and the Subcommittee on Internal Revenue Service Oversight of the Senate Finance Committee. Taken together, these statements set forth the position of the Department in some detail. Having provided you with this background material, I will proceed to respond to the specific questions raised by the Chairman regarding tax disclosure amendments. The Legislative Counsel of the Tax Division will then address summons provisions of the Internal Revenue Code.

First, the Administration favors amendment of the present standards for court-ordered disclosure under § 6103(i) (1). The existing court order requirements, if strictly construed, create a Catch-22 situation; a prosecutor seeking access to tax information cannot realistically make the showing required to obtain disclosure without having access to the tax information he is seeking. Virtually all the courts which have considered applications for (i) (1) orders have interpreted the law in a commonsense fashion, but the current language of the statute creates the risk of inconsistent judicial determinations. Furthermore, the language of § 6103(i) has a severe chilling effect on investigators and prosecutors.

Our amendment would replace the standards of (i) (1) with the standards actually required by most courts, those which common sense indicates an applicant can reasonably be expected to meet: that a specific criminal act has been committed or is being committed; that the information is sought exclusively for use in a federal criminal investigation or proceeding concerning such act; and that there is reasonable cause to believe that the information may be relevant to a matter relating to the commission of such criminal act. This change will assist law enforcement authorities with no practical adverse effect on taxpayer privacy or tax administration.

Second, the Administration proposes that § 6103(i) (2) be modified to authorize the attorney General to designate responsible officials, including Assistant United States Attorneys and supervisory agents, to request third-party tax information. This will permit prosecutors and regional investigative offices in the field to obtain such information directly from regional IRS officials. Under existing law, all such requests must be routed through Washington with attendant delay and paperwork.

Third, the Administration proposes creation of an affirmative duty to report federal crimes reflected by information other than returns or taxpayer return information. We believe the Administration proposal sets out a workable formula for such disclosures. With respect to the proposal that IRS be authorized to seek (i)(1) disclosure orders, we oppose this concept due to the disincentive it would pose to honest and complete reporting of income; moreover, such a procedure would raise fairness questions by forcing a taxpayer to choose between reporting his income fully thereby risking criminal prosecution on the one hand or concealing income thereby risking criminal tax prosecution on the other.

Fourth, the Administration proposal would treat financial books and records and other information submitted by or on behalf of corporate taxpayers—excluding actual returns—as return information available pursuant to § 6103(i)(2). We believe this approach is proper for four reasons. First, corporations are chartered by government and owe their very existence to the state. As such, they do not have the same privacy interests as individual citizens. Second, organizational books and records are already subject to intensive government inspection under other laws. Third, corporations and other legal entities do not have a Fifth Amendment privilege against self-incrimination. And fourth, organizational books and records are normally maintained for purposes other than tax administration while the reverse is often true of books and records maintained by individuals.

We would treat single-shareholder corporations as individuals for purposes of this provision. The Administration distinguishes between single-shareholder corporations and other organizations because such one-person corporations are normally simply the mechanism by which an individual transacts business.

Fifth, with respect to redisclosure of tax information, the Administration proposal contains no specific redisclosure provisions. Rather, our proposal is to modify § 6103(i)(4) governing admission of tax information at trial. We believe admission should be governed by the Federal Rules of Evidence and that tax information should be admissible in civil forfeiture proceedings.

Finally, the Administration proposes some minor amendments to the civil penalty provisions of the Internal Revenue Code. We propose that the civil penalty be amended to conform with the Administration's proposed amendments to the Federal Tort Claims Act and with the Right to Financial Privacy Act, both of which would restrict civil damage actions to those against federal agencies rather than individual employees.

Mr. Chairman, in summation, financial information is often important in connection with investigation and prosecution of crimes involving large sums of money such as narcotics trafficking, organized crime and white-collar offenses. In many cases, tax information represents the best—and sometimes the only—evidence of crucial financial transactions. And it is widely recognized that the highly trained investigators of the Internal Revenue Service are the best in the Federal Government at piecing together complex financial puzzles. Going well beyond the intent of the sponsors of the Tax Reform Act, § 6103 has had a significant adverse effect on coordination and cooperation between the Service and the Department.

Despite the substantial administrative steps which have been taken in an effort to mitigate the problems created by the 1976 law, the Administration is persuaded that legislation is needed to achieve a proper balance between the individual privacy interests of taxpayers and the public interest in the administration of justice. We believe the amendments we propose would achieve that balance and are deeply grateful to you for turning from your many other pressing duties to conduct these hearings. We stand ready to provide you and your staff with any information and assistance you may need in connection with your deliberations.

Thank you.

Mr. NATHAN. Before proceeding with the testimony, what I would like to do, with the permission of the chairman, is to have included in the record testimony that the Department of Justice has given in two prior Senate hearings on this question, which contain a great deal of the background information and our positions.

Mr. GIBBONS. Without objection, that will be made a part of the record.

[The information follows.]

STATEMENT OF IRVIN B. NATHAN, DEPUTY ASSISTANT ATTORNEY GENERAL,
CRIMINAL DIVISION, DEPARTMENT OF JUSTICE

(Before the Senate Governmental Affairs Committee, December 7, 1979)

Mr. Chairman and distinguished members of this Committee:

I am pleased to have the opportunity today to discuss with you the efforts of the Federal Government to address the financial aspects of the illicit drug trade in this country and some of the means by which we could improve our ability to take the profits and incentives out of this extremely lucrative criminal industry.

It will come as no news to this Committee that illegal drug trafficking is big business, and that the flow of money in this subterranean economy is torrential. Last year alone, the Federal Government seized heroin, cocaine and marijuana which would have retailed on the streets of our country at approximately \$3.2 billion. This, of course, represents only a small fraction of the undetected cash flow. The Internal Revenue Service conservatively estimates that the untaxed profits from illegal drug trafficking approaches \$25 billion each year. The National Narcotics Intelligence Consumers' Committee estimates that in 1978 retail sales of illegal drugs were about \$58 billion, and are rising annually. While we in the Department of Justice have no independent basis for making overall estimates of the dollars involved in the industry, we have and are presently prosecuting large trafficking organizations which we can prove have grossed hundreds of millions of dollars over relatively short periods.

One of the hardest hit areas of drug trafficking is south Florida, which is the principal entry point in this country for cocaine and marijuana shipped from Latin America. The financial figures from Florida banks speak for themselves. Earlier this year the Federal Reserve banks in Florida reported a currency surplus of over \$3.2 billion. This represented approximately 77% of the entire Federal Reserve currency surplus at that time. In most other regions, more cash flows out of Federal Reserve banks than into them. Clearly, the major factor for the Florida surplus is the deposit of "narco dollars" -- cash derived from drug sales -- in the banks of south Florida. Also illustrative of the financial picture is the fact that the foreign exchange account of Colombia -- the major transshipment center for cocaine and marijuana destined for this country -- had as of last month a favorable balance of \$3.5 billion, up from \$405 million in 1975. At least part of this must be a reflection of the amount of American dollars recently received for drugs exported from the country. Indeed, I was recently informed by a Colombian official that marijuana may now have exceeded coffee as that nation's largest export.

Apart from the health risks which this influx of drugs presents to our nation (which I leave to others to assess and describe), the enormous sums of money generated by the sales of these drugs pose grave dangers for our economy in general and for the criminal justice system in

particular. First, of course, the money is almost entirely unreported and untaxed, creating a loss of federal tax revenues estimated by the IRS at between four and six billion dollars each year. Second, the drug trade has an adverse impact on our foreign balance of payments. Third, the normal economy of an area is disrupted when there are such large financial resources in the illegal sector. Drug trafficking is now estimated by some to be south Florida's single largest industry. The work ethic of those citizens who are struggling to make an honest living can only be undermined by the general awareness and ostentatious display of ill-gotten gains. Sound economic planning and development are impossible under such obviously unstable conditions. As recent financial reports from Florida attest, the ready cash available to drug dealers has a direct inflationary impact on the local economy. Moreover, drug dealers, in search of ways to launder their funds, may choose to invest in legitimate businesses, with potentially adverse impact on either those businesses or their competitors. Even worse, money not invested in legitimate businesses is available to finance other, and potentially more dangerous, criminal activities.

The devastating impact on the criminal justice system from this excess cash hoard is direct and immediate. The

large accumulation of money in criminal hands is a readily tapped source to corrupt government authority in order to perpetuate and further the smuggling enterprises. Even if they are identified, captured and charged, drug dealers too often possess the resources to make even the highest bail and flee. They may simply write off the cost of bond as a necessary business expense. Finally, those who are brought to trial -- at tremendous expense to the Government -- may use their vast resources to offer bribes to juries or otherwise finance efforts to impede the proper functioning of the judicial system.

Because of our concern about these disruptive consequences and because we simply must take the financial incentives out of this industry to deter potential entrants, federal narcotics law enforcement is placing increasing emphasis upon cash flow investigations and the forfeiture of illegal profits and the fruits of those profits. Those persons in the highest echelons of the distribution networks who are in a position to accumulate and control millions of dollars may never have actual, direct contact with the drugs themselves. Consequently, the usual tools of interdiction and "buy-bust" investigation are often ineffective against them. We have to be able to trace the flow of money, prosecute and convict the leaders and financiers and obtain forfeiture of their fortunes.

Fortunately, within the last decade Congress has provided some effective legal tools to attack the financial assets of sophisticated drug trafficking organizations, and we are beginning to develop expertise to use them successfully. The Continuing Criminal Enterprise statute (21 U.S.C. §848) is proving one of our most useful weapons, permitting the imposition of a life sentence on a person convicted of being the manager or organizer of a large drug organization and permitting the forfeiture of drug profits. At least 35 such indictments were authorized by the Narcotic and Dangerous Drug Section in the last year. The Racketeer Influenced and Corrupt Organization statute (18 U.S.C. §§1961-64), which has not yet been employed to maximum advantage in the drug area, also represents a potent tool for prosecuting narcotics conspirators and depriving them of their illicit income and assets. In addition to the criminal forfeiture provisions of the Continuing Criminal Enterprise and RICO statutes, the Controlled Substance laws permit the civil seizure and forfeiture of drug-related money and property. Since an amendment last November, the Federal Government is now authorized to seize and forfeit to the general treasury the proceeds of drug dealing as well as the vehicles and other property used in trafficking.

The provisions of the Bank Secrecy Act (12 U.S.C. §1829, 1951 et seq. and 31 U.S.C. §1051 et seq.) could also prove increasingly important in assisting financial investigations and prosecutions, assuming that there is cooperation and compliance from banks and individuals and that there is effective and prompt coordination among federal agencies. These statutes and implementing regulations require banks to maintain written records and file reports of major cash transactions and require individuals to file reports of international currency transportation and details of their foreign bank accounts. These required filings are essential for narcotics investigators to follow a paper trail to the upper levels of trafficking networks. Especially significant is the fact that a violation of the Bank Secrecy Act combined with a narcotics violation subjects the violator to lengthy imprisonment and extremely heavy fines. This was the result in a recent case in Minneapolis, where an Indian hashish smuggling ring was fined over \$1.5 million dollars and \$750,000 worth of assets were seized. Frankly, the law enforcement potential of the Bank Secrecy Act has not yet been realized, primarily because of compliance delays and lack of an adequate data base. However, we believe the situation is improving. The use of the recently implemented Treasury Enforcement

Communication System (TECS) computer and permanent liaison between the Treasury and other agencies needing the information are important developments.

We are striving to educate prosecutors and investigators concerning the techniques and potential advantages of these tools. Large narcotics trafficking organizations are sophisticated, the nature of financial investigations and prosecutions is technical, and the statutes I have discussed are relatively new and complex. This demands continual educational efforts to upgrade the training of all federal prosecutors and investigators in the drug field. We are carrying on this effort vigorously. Next week in Los Angeles, for example, we will conduct the 11th Major Drug Trafficker Prosecution Conference. Sponsored by the Narcotic and Dangerous Drug Section, the Executive Office for United States Attorneys and DEA, the conference presents lectures and workshops based on actual cases to instruct agents and Assistant United States Attorneys in the use of financial investigation techniques, the Continuing Criminal Enterprise and RICO statutes, lawful electronic surveillance and other technical subjects. Recently, DEA held its Third Financial Investigation Seminar. These seminars are for senior agents who spend a week learning from members of the Department of Justice, the Internal Revenue Service, the

Customs Service, Securities and Exchange Commission and others knowledgeable in the field of financial investigations. The Narcotic and Dangerous Drug Section is now publishing a monthly newsletter as a means of educating all drug prosecutors and other enforcement officials of legal developments and strategies which may improve their performance.

A key to the successful implementation of these statutes is the close coordination of the information, expertise and efforts among a number of federal agencies. In those cases where we have attained success, such coordination has been critical. For example, the recent Minnesota case, which was premised on a combination of Bank Secrecy Act and narcotics violations, resulted from close cooperation between DEA and Customs. In the recently concluded Araujo case -- involving a heroin and cocaine smuggling ring which had funnelled more than \$33 million dollars to Mexico -- the investigation coordinated the information and activities of DEA, Customs and the Internal Revenue Service, working closely with an Assistant United States Attorney. The main defendant in that case was convicted of a Continuing Criminal Enterprise violation, sentenced to 35 years' imprisonment and fined more than a million dollars. In another major case recently concluded in Los Angeles, an individual was convicted of a RICO violation and the investments from his drug sales approximating \$800,000 have been seized and are awaiting forfeiture.

It is ironic that while Congress has given us the tools to attack the financial dangers posed by drug trafficking, a confidentiality provision in the Tax Reform Act of 1976 has impeded our success in this area somewhat. The Act was enacted in response to concern about access to tax return information. When the Act was passed in 1976, it is noteworthy that there were few, if any, complaints about abuses by prosecutors of tax information which they obtained and used in developing criminal cases. The statute, as enacted and interpreted by the Service, given the penalties to which IRS personnel are subjected for improper disclosure, has made it extremely difficult for law enforcement officials working in such high financial crime areas as narcotics, organized crime, white collar crime and public corruption.

The Administration has recognized the need to achieve greater coordination between law enforcement agencies and the IRS, and has initiated under the auspices of the White House Domestic Policy Staff a process of meetings and communications between the Criminal Division, DEA, Treasury, and IRS to identify specific impediments to cooperation and agree upon necessary legislative and administrative improvements. This process has been facilitated by the March report of the General Accounting Office on the Tax Reform Act and by the interest of this

Committee. As a result of these meetings, the Administration hopes to develop a policy position within six to eight weeks. In the meantime, I can set forth for the Committee the Department of Justice's perspective of the situation.

Under the Tax Reform Act of 1976, the Federal Government's ability to identify and prosecute narcotics financiers and to trace and seek forfeiture of their assets has been severely restricted. Federal prosecutors and investigators from other agencies have been deprived of the opportunity to work closely with the Service and readily to obtain critically important information which it has in its files. This is extremely unfortunate because the Service agents are by training, experience and temperament among the best qualified of any in the Federal Government to assist in conducting financial investigations, and the information available to the Service is among the most important to assist in developing financial cases.

The Tax Reform Act and its implementation by the Service have essentially had four major negative effects on our enforcement efforts in the narcotics area as well as in other large-scale financial crimes:

1. The Service is usually unable to advise us adequately of the cases on which it is working, which precludes us from close coordination with it and leads in some instances to needless duplication of effort.

2. It is unduly difficult for prosecutors and investigators from other agencies to obtain financial information in the hands of the Service which would materially assist in developing prosecutions against major criminals.

3. It is extremely difficult for the Service to provide to prosecutors or other federal investigative agencies evidence concerning non-tax criminal violations which the Service obtains in the normal course of its investigations.

4. In those limited circumstances where prosecutors and other investigative agencies can work with the Service, the time delays involved tend to thwart the benefits that might otherwise be obtained.

The March GAO report, while claiming that the adverse effects had not been fully documented, found that IRS coordination with the Department of Justice and in particular with the Drug Enforcement Administration had been adversely affected and that the IRS was precluded from disclosing, or even alerting agencies to seek, relevant criminal information. The report concluded that "these types of coordination...point up the need for Congress to consider whether the adverse impact on federal law enforcement activities warrants revision of the legislation and whether any revision can be made

without disrupting the balance between criminal law enforcement and individuals' rights." We believe that some documentation is now available and we are conducting a survey to compile additional information.

I will explore below in some detail the precise impediments created by the Tax Reform Act and cite specific examples of the enforcement difficulties these provisions have caused. However, I believe that the major problem with the statute is the signal it has sent to the Service. This message appears to be that the Service is to minimize its role in non-tax law enforcement and devote itself to enhancing the voluntary tax-collection system. From our perspective, we believe this is a critical loss to the Federal Government's law enforcement capacity. The statute unfortunately has also sent a signal to prosecutors. Rather than complying with the elaborate procedures set forth in the statute, prosecutors have frequently gone without obtaining needed financial information already in possession of the IRS. The decline in the number of requests for tax information by Department prosecutors has been precipitous since passage of the Act. In 1975, there were 1,816 such requests; for a six-month period in fiscal 1979, there were only 124.

It is, of course, difficult to quantify a negative -- i.e., the number of cases which would have been made or improved or the amount of fines or forfeitures which we would have obtained if we had the full benefit of the Service, its expertise and information. However, two figures do dramatize the point. First, according to an IRS report, DEA provided IRS with the identity of the 868 alleged Class I (major narcotics) violators to be evaluated for criminal tax potential under a special IRS project. Of this 868, as of a few months ago, 128 investigations had been initiated, 125 investigations completed, 31 prosecutions recommended, nine indictments obtained and only six, or less than 1% of the Class I violators had been convicted of a tax offense. Further graphic evidence of the impact of the statute is provided by the fact that since its effective date in 1977, the Organized Crime Strike Force inventory of joint IRS cases has been cut in half, from well over 600 investigations to slightly more than 300. As we calculate information provided by the Service to a House Committee earlier this year, IRS now devotes less than 5% of its criminal investigative resources to narcotics matters and only 25% of its criminal resources to pursuing illicitly derived unreported income as opposed to unreported income from lawful activities.

I will now turn to the specific problems under the statute. As you know, under Section 6103(i) the only way in which federal law enforcement officials can obtain tax returns or "taxpayer return information" for non-tax cases, such as narcotics violations, is by obtaining a court order. The application for an order must show (1) reasonable cause to believe that a specific crime has been committed; (2) reasonable cause to believe that the information sought constitutes probative evidence of the crime; and (3) the information sought cannot be obtained from any other source or at least that it is the most probative evidence available. The statute defines "taxpayer return information" as that "filed with or furnished to the Secretary by or on behalf of the taxpayer."

Let me give you a few particularly dramatic examples of what has occurred under this provision. Recently, in Philadelphia, DEA and IRS were conducting independent, parallel investigations on a suspected illegal drug chemist. Under the statute IRS could not (and did not) disclose that it was investigating this individual, and hence there could be no coordination with DEA's efforts.

However, DEA became aware that during the course of its investigation, the IRS had obtained information from the chemist's trash can -- including drug precursor formulae, hotel bills and other evidence corroborative of drug dealing. The prosecutor in the drug trial subpoenaed the IRS agent, but the IRS took the position that the agent could not testify about why he was going through the defendant's trash unless the prosecutor obtained a court order, which could not be done prior to conclusion of the trial. The prosecutors' inability to present testimony regarding what was found in the defendant's trash by someone unwilling to explain why he was searching the trash made it impossible to use the evidence. Fortunately, the prosecutors managed to secure a conviction without IRS assistance, but were left with serious doubts about the Tax Reform Act.

Another example cited by GAO occurred when IRS' analysis of records submitted by a taxpayer during a criminal tax investigation showed that a union official had accepted gratuities from company officials. IRS could not disclose this apparent violation of the Taft-Hartley Act.

These and other similar stories illustrate the three major problems which prosecutors have had with the court order requirement. First, because IRS cannot provide advance notice that it has useful information, another agency has no reason to request disclosure of taxpayer

information on a particular individual that might be useful to it. Second, even if the agency suspected IRS possessed useful information, the other agency may be in the Catch-22 position of being unable to justify its need for the information -- as required by the disclosure provisions -- before it has the information. Unless the requesting agency has actually seen the material, it is often difficult to certify that it is probative of a material fact or that it is the best possible source of that evidence. In some ways this is a more difficult standard than we impose upon seeking a search warrant to enter the private premises of a suspect to seize personal property. Finally, the requirement of going to court for the interdepartmental transfer of information in the possession of the Government seems unnecessary and inappropriate. The preparation and processing of these court papers not only consume judicial and prosecutorial resources but also often produce delays which can in certain kinds of investigation prove fatal.

A case illustrating the importance of tax information and the danger posed by delays in its disclosure to prosecutors involved the prosecution two years ago of the Nicky Barnes organization in New York City, believed at that time to be one of the largest heroin trafficking networks in the United States. Barnes was charged with a violation of the Continuing Criminal Enterprise statute

which requires proof of substantial amounts of income from narcotics. Six months before trial the prosecutors sought disclosure under 26 U.S.C. §6103(i)(1) of the tax returns of the main defendants. The trial began in October, 1977, without the tax returns. For a number of reasons, most of the returns were not received until midway through the two-month trial; some of the returns were never produced at all. Despite the late date of receipt, the returns we were able to obtain proved extremely valuable to the Government in proving that Barnes and his associates had no legitimate sources for the excessive income they reported (Barnes reported over \$250,000 in miscellaneous income in one year alone) and helped prove the substantial income requirement of the Continuing Criminal Enterprise statute. Barnes was convicted and is now serving a life sentence. If the tax returns had been delayed any longer, we might not have been able to secure this conviction.

Under Section 6103(i)(2), a federal agency can obtain information in the possession of the Service other than "taxpayer return information" if the head of the agency certifies that the information sought is material to and will be used solely in connection with an investigation or proceeding. This is in essence information supplied to IRS by a person other than a taxpayer.

Because of the sanctions imposed by the Act, the Service is extraordinarily cautious about making improper disclosures under Section 6103(i)(2). I am advised that on one occasion a DEA agent provided an IRS agent with a list of individuals in whom he thought IRS might be interested. Several days later the DEA agent misplaced the list and called the IRS agent to obtain the names. Because of the Tax Reform Act, the IRS agent refused to disclose the names. Apparently, since the information was provided by a third party, the IRS agent believed that a written request from the Assistant Attorney General was required.

I am also informed of an investigation in Cleveland in which the FBI asked IRS to examine film of documents it had photographed to assist in identifying the material and to join them in the investigation. Upon receipt of the film, IRS advised that because it had become a tax-related matter, IRS could not discuss the case or even return the film.

In an effort to move beyond anecdotal evidence, the Department has recently distributed a questionnaire concerning the impact of the Tax Reform Act to all United States Attorneys' and Strike Force offices throughout the country. After we have obtained and processed the answers to these questionnaires, we will be pleased to supply the

results to this or any other appropriate Congressional committee.

The extreme examples which I have cited today do point up the difficulties which the statute creates for the coordination of IRS with other agencies. It is a fact of life that agencies will not work harmoniously when the information flow is a one-way street. The problem is not confined to narcotics investigations or even to the Organized Crime Strike Forces which are predicated in part on the synergism of several agencies sharing information and working cooperatively. As an example, the United States Attorney in Arizona has recently formed a special investigative task force to focus on white collar fraud. Ideally, such a task force should include IRS participation. However, because of difficulties it has encountered in providing tax information to other participating agencies, the IRS has not even been included in the multi-agency task force.

The statute and IRS procedures have also had an adverse impact on grand jury investigations in which we have attempted to combine both tax and non-tax violations. The principal problem here is delay. In order to obtain approval for a joint grand jury investigation (which would include charges of tax violations as well as other criminal allegations), the Department of Justice must provide justification and seek IRS approval for each specific taxpayer to be investigated by the grand jury. As I understand the procedure, the Department of Justice request must first

be approved by an IRS Special Agent, who passes it on to his manager, who sends it to the Chief of the Criminal Investigation Division, who transmits it to the Chief Counsel of IRS for decision on whether to refer the matter to the Tax Division of the Department of Justice, where the final decision is to be made. As you can imagine, the delays under this kind of multi-layered procedures can be staggering. I am aware of one case in Buffalo, in which approval was obtained 13 months after it was first sought. In the Araujo case, which I mentioned earlier as an example of a successful joint IRS-DEA case, it took 8 months for the Department of Justice to obtain IRS concurrence to conduct the joint investigation. I am aware of another case in which the request was submitted last March and as of this date, it has not yet gotten past the first level of review.

As I noted, even when approval is obtained, it is limited to the individuals then identified as tax violators. As others are identified during the course of the joint investigation, the same involved procedure must be negotiated to secure approval to investigate them. In a fast-breaking investigation, it can be extremely harmful to have to go back to square one of the procedures. As you may imagine, prosecutors often conclude that the attempt to secure approval for joint investigations is

simply not worth the effort.

We recognize that legitimate privacy interests of taxpayers are furthered by the Tax Reform Act. At the same time we question how American society as a whole is benefitted by significantly reducing the ability of the IRS to lend its financial expertise and store of information to the investigation and prosecution of persons engaged in multi-billion dollar criminal conduct. The forthcoming Administration study which I mentioned earlier will address these problems and suggest what legislative changes, if any, should be made to correct the problems which I have identified without unduly disrupting the delicate balance contained in the statute between preserving the legitimate privacy interests of law-abiding taxpayers and permitting the Government to enforce the criminal laws against major offenders.

I should also like to touch briefly on a number of other issues affecting our ability to deal with the financial aspects of large-scale drug trafficking. Foremost among these is the difficulty in tracing funds generated by drug

trafficking after they have left the United States. Money has been traced from drug dealers into and out of U.S. bank accounts, but the trail often disappears when the money is transferred into banks in foreign countries with strict bank secrecy laws. We are trying to address this problem through negotiations with the countries involved, but the prospects are not promising at this time. We believe it essential to have a mutual assistance treaty with each affected country by which we will be able to obtain financial information from that country concerning persons

treaty with Switzerland; and a similar treaty with Turkey has just been ratified by the Senate and awaits implementation. We are also hopeful that we will be able to consummate, and send to the Senate for ratification, a similar treaty with Colombia.

I should note that under the Tax Reform Act the IRS will not provide to any foreign country any information except for tax prosecutions. As a consequence, certain countries, such as the Netherlands, which would otherwise provide us financial information for any prosecutorial use are insisting that as a matter of reciprocity they will not produce the financial infor-

mation to us except for tax prosecutions here. However, the real stumbling block in this area is that those jurisdictions which serve as bank havens -- such as the Bahamas and the Grand Cayman Islands -- have shown no disposition to provide the needed information. We hope to resume discussions with these governments and to demonstrate to them, as we demonstrated to the Swiss Government, that the legitimate economies of all nations are adversely affected by large-scale illegal drug trafficking and that the international community has a responsibility to avoid shielding these bandits. We believe that it can be demonstrated that it is not in the long term interest of any nation to establish havens, financial or otherwise, for these criminals.

At the same time, we should take a closer look at our own banking laws and the compliance with them by our banks. At present, the Bank Secrecy Act requires banks to report cash transactions of \$10,000 or more. While there have been a few prosecutions for non-compliance, the Department of Justice cannot solve the problems acting alone. We need more vigorous compliance by the banks and closer supervision by the bank regulatory agencies. Further, it may be that there should be reporting requirements with respect to certain types of wire transfers, which we suspect the narcotics financiers are using.

Congress should also give consideration to proposed amendments to the Currency and Foreign Transaction Reporting Act (31 U.S.C. §1051) which are designed to strengthen the Government's ability to monitor and interdict the movement of illicitly obtained money into and out of the country. For example, H.R. 4071 would provide a reward for information leading to seizures of currency. H.R. 4072 would make it a crime to attempt to violate the requirement to report the movement of currency of \$5,000 into or out of the United States. At present while it is a crime to take \$5,000 out of the country without reporting it, at least one court has held that under the statute there can be no arrest or prosecution until after the person has left the country without reporting. We believe that once a person is on board an aircraft with more than \$5,000 in his possession and has not filed the appropriate report despite notice of the requirement to do so, he should at that point be subject to arrest and prosecution.

Finally, I should note that the Biaggi Bill, or the High Seas Bill, has been passed by the House and is awaiting action by the Senate. The bill would make it a crime for any American or person on an American ship or ship subject to United States jurisdiction to commit on the high seas any

violation of the Controlled Substance Act. At present, it is difficult to prove that a boatload of drugs on the high seas is destined for the United States and hence that its occupants have the intent to distribute those drugs here. This bill would obviate the problem by making it an offense for the covered person to be in possession of the controlled substances on the high seas. We urge enactment of this bill.

These legislative provisions should enhance the tools we presently have to investigate and prosecute major drug trafficking networks. They should improve our ability to ferret out and convict the major offenders and to deprive them of their illicit gains. However, in our view, law enforcement techniques and resources alone will not halt illicit drug traffic and its attendant high profits. As long as there remains a strong demand and a ready market for illicit drugs, there will be individuals willing to run the risks to supply them. To deal rationally with this increasingly serious problem, we must also focus attention on the nature of the demand for these substances and sensible approaches to respond to, and hopefully, minimize the demand. This would require a commitment by all affected segments of society, not just law enforcement officials. We believe that this Committee is an appropriate vehicle for focusing attention on all facets of the problem and suggesting ways in which we can deal

comprehensively with them. We look forward to working with this Committee as it pursues these issues, and we welcome any assistance you can provide us as we strive to stem the flow of illicit drugs and the enormous profits which criminals are reaping from this traffic.

Thank you. I will be happy to respond to any questions you may have.

STATEMENT OF IRVIN B. NATHAN, DEPUTY ASSISTANT ATTORNEY GENERAL,
CRIMINAL DIVISION, DEPARTMENT OF JUSTICE

(Before the Senate Finance Committee, June 20, 1980)

Mr. Chairman and Members of the Subcommittee:

I appreciate this opportunity to provide you with the views of the Department of Justice regarding proposed modifications in the nondisclosure provisions of the Internal Revenue Code. These proposals, although in the nature of technical and perfecting amendments, are critically important to remove serious impediments to effective federal law enforcement, particularly in such priority areas as the prosecution of narcotics trafficking, organized crime and white-collar offenses.

At the outset, I emphasize that we share the commitment of this Committee and the Congress to proper safeguards for the privacy interests of taxpayers. I am pleased to report that the disclosure amendments supported by this Administration have been developed after close consultation between the Internal Revenue Service and the Department of Justice and are endorsed by both of those agencies. We are confident that the proposals will enhance our law enforcement capacity without adversely affecting privacy interests or the administration of our voluntary federal income tax system.

THE PROBLEM

Prior to 1976, the Internal Revenue Service was an integral part of federal law enforcement, coordinating its efforts with other agencies, such as the Federal Bureau of Investigation, the Drug Enforcement Administration and the Organized Crime Strike Forces. Trained criminal investigators from the Service provided

leads and assistance to investigators from other agencies who were not as well trained in sophisticated accounting matters. When information developed during the course of IRS investigations showed serious violations of non-tax federal criminal statutes, the IRS agents routinely provided this information to the appropriate law enforcement agency. Such information often formed the cornerstone of successful prosecutions of serious white-collar or other sophisticated crimes.

This coordination and assistance were badly disrupted when Congress enacted the non-disclosure provisions of the Tax Reform Act of 1976. A thorough review of the legislative history of those provisions reveals that they were passed to prevent the kind of political misuse of tax returns that had been perpetrated by White House aides working for President Nixon. You will recall that it was widely reported in the press that in the early 1970's some White House aides had obtained the tax returns of political enemies of the Nixon Administration whom they desired to embarrass. There is no question that such abuses were improper and this Administration shares the sentiment of the Congress that legislation should prohibit access to tax returns for political purposes.

Unfortunately, the statute passed went far beyond that salutary purpose. The Act's complex web of substantive and procedural restrictions on the disclosure of any information in the possession of the Internal Revenue Service has severely limited access to essential information for perfectly legitimate law enforcement purposes. At a time when our society uniformly seeks to combat and bring to justice high-rolling narcotics traffickers, entrenched organized crime kingpins and sophisticated corporate swindlers, the front line federal agencies must fight without the benefit of crucial data in the hands of another federal agency. It must be emphasized that nowhere in the legislative history of the 1976 statute were there any reported instances of abuse by federal prosecutors of information theretofore provided by the Service. The information provided to federal prosecutors prior to 1976 was used exclusively in a lawful manner to investigate and prosecute serious federal crimes.

However, as enacted in 1976, subsection 6103(i) of the Internal Revenue Code established needlessly severe, ambiguous, and cumbersome restrictions upon law enforcement access to tax information necessary in non-tax criminal investigations. Generally, the statute provides that all tax information is confidential and cannot be disclosed to law enforcement agencies

unless one of the express -- and highly complicated -- exceptions applies, and then only pursuant to complex procedures. Moreover, the 1976 law establishes civil and criminal sanctions for violations of its provisions. An IRS employee who in discloses information to the Department of Justice in violation of the statute risks up to five years in prison, a criminal fine of up to \$5,000, and civil damages by the aggrieved taxpayer of at least \$1,000, or more if any actual damages can be established. Of course, these sanctions are all in addition to any administrative sanctions, including dismissal, which may be imposed by IRS.

The effect of these new provisions was immediate and dramatic. Recognizing the consequences of mistaken disclosure of information, IRS took prompt steps to implement the statute and adopted internal procedures, definitions and regulations to protect taxpayers and IRS employees. A 1979 General Accounting Office Report concluded that as a result of the 1976 law, "coordination between IRS and the Department of Justice has suffered."

We have now had the experience of three and a half years of operating under the non-disclosure provisions, and I can state unequivocally that federal prosecutors and criminal investigators are convinced that no legislation is a greater handicap on our ability to contain serious financial crimes than the non-disclosure provisions of the Tax Reform Act.

MANIFESTATIONS OF THE PROBLEM

With sharply limited access to tax information and the expertise of highly trained IRS personnel upon whom we had long relied for assistance in unraveling complex financial transactions, we have found it extremely difficult to investigate and prosecute complex financial crimes. This loss has been felt in many areas of criminal law enforcement, but is particularly severe in the investigation of narcotics trafficking, organized crime syndicates, fraud against the government, foreign corrupt payments, corporate bribery, illegal currency transactions, and public corruption. In many of these cases, our investigations require us to follow a complex and purposely circuitous paper trail of financial transactions. Tracking down all of the key transactions to establish a complete picture of what occurred is like piecing together a puzzle. Not only are IRS personnel among the world's best at assembling such puzzles, IRS often has the missing pieces among its records.

Generally, the 1976 law creates four major problems: (1) IRS is unable to advise us of the cases on which it is working with the result that there is sometimes duplication of effort; (2) it is unduly difficult to obtain IRS information which would materially assist in development of important criminal cases; (3) the statute makes it difficult for IRS to provide other law enforcement agencies even with evidence developed based on sources independent of tax returns; and (4) in those few circumstances where prosecutors are permitted to work with the Service, the delays caused by the intricate and cumbersome mechanisms of the Act often stall investigations interminably.

The statute has caused a number of concrete problems which are frustrating to prosecutors and criminal investigators. In its 1979 Report, the GAO found that the IRS Disclosure Office literally has a file drawer full of evidence of serious federal non-tax crimes which the Service has uncovered in the last three years but which the statute prevents from being

transmitted across the street to the Department of Justice for investigation and prosecution. Included in this material revealed by the GAO Report were evidence that a corporation had paid bribes to a federal official; evidence that an individual had defrauded the Customs Service of hundreds of thousands of dollars; and evidence that corporations had made substantial payments to union officials and politicians which violated the Taft-Hartley and Corrupt Practices Acts. In the last two months alone, we have been informed that such serious non-tax crimes as wire and mail fraud, perjury, embezzlement, concealment of a large government overpayment and illegal political contributions, as well as the location of a homicide suspect, have been reported by IRS agents to headquarters, which has been barred by the Tax Reform Act from doing anything but adding them to these file drawers.

In my testimony before the Senate Permanent Investigation Subcommittee last December, I described several specific cases in which prosecutors had been denied access, as a result of the statute, to important incriminating information in the possession of the Service. I will not rehearse those examples here.

Those examples were anecdotal in nature and were offered merely to serve as illustrations of the problems caused by the Act. In an effort to provide the Congress with comprehensive documentation of the impact of the Act on law enforcement, we developed and distributed a detailed questionnaire to all federal prosecutors late last year seeking to assess their experience under the Tax Reform Act. The questionnaire consisted of 60 specific questions and sought information on virtually every case in which Department attorneys have attempted to obtain information or assistance from the IRS in connection with non-tax cases and joint tax/non-tax grand jury investigations, as well as on the use of tax information in criminal tax cases.

A total of 355 responses to the survey were received, representing the experience of 105 different offices. These responses were carefully reviewed and analyzed, and the results compiled into a report of over 50 pages. For your ready reference, the summary section of the report is appended to my statement. We will, of course, provide the entire report to the Subcommittee upon request and can arrange for your staff's review of the individual responses to the questionnaire if you desire. Additional examples of the unfortunate consequences of the statute were contained in the report.

This report represents the first comprehensive effort to document the problems arising from the Tax Reform Act. Its 50 pages are filled with examples of serious difficulties with obtaining access to information, confusion over complex and ambiguous statutory standards, and -- the factor most readily quantified -- the enormous delays in obtaining either tax information, technical assistance, or the participation of the Service in joint tax/non-tax grand jury investigations.

Perhaps the most revealing finding is that more than 50% of those surveyed sought information from the Service on only one of two occasions in the last three and a half years because they claimed their experiences and those of other prosecutors indicated that the statutory procedures were too cumbersome, too time-consuming and too restrictive. Even those offices which have continued to struggle with the disclosure procedures have sought tax records relatively infrequently. Total requests for tax information by federal prosecutors have plummeted from 1,816 in the year before the Act took effect to 255 in the most recent 12-month period for which statistics are available. It is, of course, impossible to quantify precisely the effects of this reduced access to tax information, but we believe that many investigations and prosecutions of complex financial criminal cases have been jeopardized or frustrated for want of information known only to IRS.

The report's statistics on delay point up why so many prosecutors have given up on seeking to obtain information from the Service under the Tax Reform Act. In one case it took over two years to obtain a defendant's tax returns. In 1979-80 an average of 65.8 days elapsed before tax information sought pursuant to court order -- and which we were entitled to obtain under the statute -- was received by prosecutors. A significant part of this delay resulted from the requirement that the prosecutors in the field seek permission from the Assistant Attorney General in Washington before they can even file their papers with the court. Unlike delays within the Service, which have recently been addressed by administrative charges, this aspect of the delay must be corrected by legislation. The cumulative effect of these delays in major investigations can be disastrous. Faced with Speedy Trial Act deadlines, statutes of limitations, and the demands of fast-moving investigations, delays produced by the 1976 law often foreclose the opportunity to obtain needed information under the disclosure provisions of the Internal Revenue Code.

Internally, the Administration has addressed these problems and the serious effect of these difficulties on federal law enforcement activities. For the past six months, IRS has worked closely with the Department in an effort to narrow the gap between us created by the statute. After a series of high

level meetings, we have created a permanent IRS-DOJ Coordinating Committee which convenes every other week. These meetings have been productive and have resulted in administrative measures which should lessen some of the problems caused by the Act. These administrative changes are detailed in Commissioner Kurtz's testimony.

In addition to these administrative changes, the Administration is convinced that there must be legislative amendments in order to achieve an acceptable level of coordination and effectiveness on the part of federal law enforcement.

THE EMERGING CONSENSUS FOR REFORMS

With the documentation of Tax Reform Act problems developed by the Department of Justice, and through hearings by Senator Nunn's Permanent Investigation Subcommittee, Senator DeConcini's Subcommittee on Judicial Machinery, and Senator Chiles' Appropriations Subcommittee, support for corrective legislation has emerged. Chairman Long has joined Senator Nunn and six other Senators in co-sponsoring proposed amendments, which are now before this Subcommittee. Similar legislation has been introduced in the House of Representatives.

The General Accounting Office, which in 1979 concluded that adverse effects of the Act on law enforcement had not been sufficiently documented, now endorses corrective legislation. The Administration supports amendments to the Tax Reform Act developed by the Department of Justice, the IRS and the Domestic Policy Staff of the White House. Major national and local news organizations have reported on the problems created by the Act and advocated fine-tuning of the 1976 law. In short, support has developed in the Congress, the Administration and among the public generally for legislation to establish a proper balance between taxpayer privacy interests and the need for the proper administration of justice.

THE REMEDY TO THE PROBLEM: SUMMARY AND ANALYSIS

Our proposed revisions of the disclosure provisions would (1) redefine with precision those materials in the hands of the Service which are to be accorded confidential protection; (2) simplify and expedite the processes for obtaining the available information; (3) mandate the disclosure of evidence of serious non-tax crimes coming to the Service from non-protected sources; and (4) facilitate closer cooperation between the Service and other agencies for legitimate law enforcement purposes. As I have noted and will explain further as we proceed, we believe that all of these revisions can be accomplished without invading the legitimate privacy interests of taxpayers or impairing our voluntary tax collection system.

We believe that the information which should be protected are the tax returns themselves and the financial books and records which an individual keeps and submits to the Service to support the accuracy of his or her return. We do not believe that the Service should be required by law to withhold from any appropriate federal law enforcement agency (1) incriminating information provided about the taxpayer by third parties; or (2) evidence obtained by the Service from corporate records which are maintained for non-tax purposes.

Tax returns which are required by law to be prepared and filed should clearly be given confidential protection. The Administration believes taxpayers will report their income more fully and honestly if they are confident that the information they report will not be used to incriminate them. Further, the Administration believes that in order to encourage an individual to maintain and retain accurate underlying financial records, these too should be accorded confidential treatment when they come into the possession of the Service. Accordingly, under the revisions we propose, no tax return and no individual's financial books and records in IRS possession could be disclosed to a federal law enforcement agency except upon a properly obtained court order.

Consistent with this policy, our proposed revisions provide that if a taxpayer engages in fraud upon the Service by wilfully filing false returns, then the confidential protection for his return and underlying books and records is lost. Thus, we propose that once it becomes clear that a taxpayer has engaged in tax evasion, all of the information developed by the Service in that case involving non-tax offenses committed by that individual would be turned over at the same time to the appropriate federal law enforcement agency. We believe it makes no sense to continue to provide to a tax evader the benefits of a policy of confidentiality which was designed to encourage honest compliance in the first place. We would also provide that information in the possession of the Service, regardless of its derivation, which reveals the imminent commission of a crime involving bodily harm, could be disclosed. We believe that society's interest in preventing the harm is greater than any theoretical damage to the voluntary tax assessment system which could result from such a narrow exception.

Under present law, the Service may provide to appropriate law enforcement agencies evidence about non-tax crimes which comes to the Service's attention from third parties. Thus, if an informant tells an IRS agent that a taxpayer is engaging in tax fraud by deducting bribes paid to a federal official, the Service may inform the Department of Justice about the allegation of bribery.

There are other kinds of information about individuals which do not derive from third parties but which we believe should also be turned over by the IRS to criminal investigators. This would include, for example, contraband obtained in a lawful manner by the Service. We are confident that the present statute does not mean to give protection to this category of information but some doubts appear to have arisen because of field-level interpretations of the statute. We believe that either in the revised definitional section of the statute or by administrative regulations, we should make clear that materials, such as contraband, are not protected by the disclosure provisions of the statute.

In a similar vein, we believe that evidence of non-tax crimes in the possession of the Service which comes from the books and records of corporations should be reported to the appropriate federal authorities. To reach this conclusion, we start from the premise that evidence of crime in the possession of a federal agency should be made available to the agency responsible for investigating and prosecuting that offense, unless there is a clear overriding policy reason for maintaining the confidentiality of that material. As we have seen, there is such an overriding policy reason for tax returns and for protection of an individual's underlying financial records.

However, the reasons which support providing confidentiality to tax returns and individuals' financial records do not obtain with respect to a corporation's books and records. In the first place, corporations and other commercial entities are required by many non-tax federal and local laws to maintain accurate books and records. Second, these records are available for production and inspection by federal and local agencies other than tax authorities. Third, corporations and commercial entities, unlike individuals, have no Fifth Amendment privilege against self-incrimination. Thus, there is no overriding reason which justifies giving confidential protection to evidence of non-tax crimes which the Service finds in the books and records of corporations. Under our proposed revision of the disclosure provisions, if the Service finds evidence of non-tax federal crimes in the books and records of a corporation, it will be required to report such information to the appropriate law enforcement agency, much as we would expect any citizen to report evidence of crime coming to his or her attention.

By requiring the Service to turn over incriminating information from all sources -- other than tax returns and an individual's underlying financial records -- we will eliminate an important source of problems under existing law. Presently,

if third-party information alone does not constitute evidence of a crime, but must be added to corporate financial data in the hands of the Service to make out the offense, the Service cannot turn over any information, including the "tip" of the third party. Under our proposed revision, experienced Service personnel can combine the third-party information and the corporate financial data, and if they add up to a non-tax offense, the Service will be free to transmit it to the proper authorities.

Having now explained our views concerning which categories of information should be protected and which should not, I would like to proceed sequentially through the statute and explain the nature of each of our proposed revisions and the reasons for them.

SPECIFIC AMENDMENTS NEEDED

Section 6103(i)(1) establishes the mechanism and standards by which we can seek a court order to obtain from the Service tax returns and other protected information which may be necessary in a criminal investigation. We support the principle that an ex parte court order should be necessary for seeking access to this type of protected information, but believe that the standards and procedures can be substantially refined.

Under the present statute, the application for such an order must show (1) reasonable cause to believe that a specific crime has been committed; (2) reason to believe the information sought -- which the applicant hasn't yet seen -- constitutes probative evidence of a matter in issue related to the commission of the crime, and (3) reason to believe the information sought cannot be obtained from any other source or that it is the most probative evidence available. This standard is a Catch-22 test; normally an applicant cannot attest that the tax information is the most probative evidence of a matter in issue without access to the information itself. Yet he cannot see the information until he obtains the order. Further, it is often difficult to predict at the early stages of an investigation what matters will be "in issue" by the time of trial. Such a standard does not protect privacy. It merely confuses applicants and courts, creates grave uncertainty over permissible disclosures, and in the end deters most prosecutors from seeking tax information.

Because federal judges are familiar with the realities of criminal investigation and prosecution, most federal courts interpret the statutory standard of §6103(i)(1) in the light of reason and experience and accept a factual showing limited to the information that common sense

indicates a prosecutor can reasonably be expected to develop through investigation: that a specific crime has been committed and that independent reasons exist to support a belief that the tax returns or financial data sought are relevant to the criminal investigation or prosecution. We believe this logical standard should be codified to eliminate the confusion and deterrent effect of the current statute and to insure uniform determination of disclosure applications by the courts. As this standard is in fact the one now followed by most courts, we believe codification would have no practical adverse effect on taxpayer privacy interests or tax administration.

A second problem with §6103(i)(1) is that federal prosecutors cannot now file applications for disclosure orders without approval from Washington. The statute requires all applications for (i)(1) orders to be signed by an Assistant Attorney General. Thus, federal prosecutors must mark time while their applications are sent to Washington for the required signature and then returned for filing with the court. This is a time-consuming and pro forma process; rarely, if ever, does an Assistant Attorney General refuse to permit an application for return information to be filed with the courts. The requirement of approval in Washington significantly delays the process and makes the procedure more cumbersome for federal prosecutors. Its contribu-

tion to privacy or tax policy is unclear because a neutral and detached magistrate must review the application. We believe §6103(i)(1) should be modified to authorize United States Attorneys, who are appointed by the President with the advice and consent of the Senate, to approve applications in the field.

We also believe that the order should be obtainable from United States Magistrates as well as district court judges. Magistrates are authorized to enter analogous orders, such as search and arrest warrants, and it would expedite the process if the application could be filed with and ruled on by them as well as by busy district court judges.

Section 6103(i)(2) applies to information relating to a taxpayer obtained by IRS from third parties rather than from the taxpayer or tax returns. The law permits this information to be disclosed pursuant to a formal written request to IRS specifying identifying information and "the specific reason or reasons why such disclosure is or may be material to the proceeding or investigation". As with (i)(1), we believe it is unreasonable to require a showing of materiality when the applicant has not yet seen the information which IRS has in its possession. Moreover, any expectation of privacy in such information gleaned from third parties is far less than exists as to information which the taxpayer himself has furnished to IRS. We believe, therefore, that (i)(2) should be revised to permit disclosure of such third-party information upon

a certification that the material is sought exclusively for use in the investigation of a specified crime. This procedure effectively protects against abuse by creating a paper trail in connection with such disclosures; all (i)(2) disclosures would be documented and individual accountability established. As with (i)(1) applications for court orders, the (i)(2) request letters must now be signed by an Assistant Attorney General necessitating that every disclosure be routed through Washington. We recommend, therefore, that (i)(2) requests be permitted by field prosecutors and investigators designated by the Attorney General. Finally, (i)(2) should authorize disclosure of whether a tax payer filed a return for a particular year and whether there is or has been a criminal investigation of a taxpayer.

Section 6103(i)(3) governs situations in which IRS agents come across evidence of non-tax crimes in the course of their tax investigations. We are often unaware of the existence of this information and have no reason to request it under (i)(1) or (i)(2). The Service cannot pursue the matter itself because its investigative jurisdiction is limited to tax offenses. Section 6103(i)(3) permits, but does not require, the Service to disclose the information to us if it was obtained from third parties. The limited disclosure mechanism established by (i)(3) has not worked well. The flow of (i)(3) information has been a mere trickle -- about two referrals per month.

We believe that there should be two fundamental changes made to 6103(i)(3). First, the Service should be required to transmit to appropriate federal law enforcement agencies the unprotected information which reveals evidence of serious non-tax crimes. Second, as I have explained earlier, the unprotected information should include all information in the possession of the Service, except tax returns themselves and an individual's financial records which were retained and submitted to the Service to support the return. These changes are necessary to eliminate the anomalous and unhealthy present situation in which one federal agency is prohibited from initiating disclosure of evidence of serious crimes to other agencies responsible for investigating and prosecuting those offenses. Finally, in addition to making (i)(3) disclosures mandatory and establishing a broader category of information which may be disclosed, we believe the law should be amended to require (i)(3) disclosures to be made to the appropriate official in the district involved rather than to the agency head in Washington as is now the case.

Along with the changes to (i)(1), (2), and (3) I have suggested, the other major revision to the statute should be the modification of the penalty provisions. The sanctions of present law chill disclosures under the statute. The minor revisions to the penalty provisions made in November of 1978 have proven inadequate to reverse the prevailing attitude, and extreme caution persists.

We recommend that where a disclosure is made inappropriately by an IRS employee, any civil action for damages must be brought against the Service rather than the individual employee. This approach is consistent with the Right to Financial Privacy Act of 1978, 12 U.S.C. 3417, and the Administration's proposed amendments to the Federal Tort Claims Act. If the court hearing the civil damage action finds that the violation was wilful, the Office of Personnel Management would be required to initiate administrative disciplinary proceedings against the responsible employee.

With respect to criminal sanctions, the Nunn bill would establish, as an affirmative defense to criminal prosecution, that the unauthorized disclosure resulted from a good faith, but erroneous, interpretation of the law. We are not certain that this would make any significant change in existing law as interpreted by the courts. We would note that §1525 of S. 1722, the proposed Federal Criminal Code Revision, makes it an affirmative defense to criminal prosecution for disclosure of private information submitted for a governmental purpose that the disclosure was made to report a potential violation of law and was made to a law enforcement officer charged with investigating or prosecuting such a violation. The Administration supports that provision of the proposed Criminal Code bill. Of course, we are prepared to discuss with the Committee or other interested parties whether there are reasons why this proposed general principle is not appropriate in the area of tax disclosure.

The Administration also proposes minor amendments to §6103(i)(4) governing admissibility of tax information into evidence in trials. We propose that admissibility of tax information be governed expressly by the Federal Rules of Evidence and that admission should be authorized in connection with civil forfeiture and other proceedings related to criminal cases. Furthermore, (i)(4) should make clear that tax information used in criminal cases is available to defendants under the Jencks Act and discovery provisions of the Federal Rules of Criminal Procedure. This is necessary to protect the due process rights of criminal defendants.

Finally, we favor an amendment to §6103(k)(4) to clarify that federal tax information can be obtained for use by law enforcement authorities of foreign governments who provide United States authorities with similar information pursuant to mutual assistance treaties. Such international exchanges are presently authorized in connection with tax investigations and proceedings and should, we believe, be authorized pursuant to court order in connection with non-tax criminal matters as well. Of course, reciprocity is essential in dealing with foreign governments and any inability to furnish tax information to foreign governments in connection with their legitimate non-tax investigations will make it impossible for us to obtain foreign tax information in connection with our investigations. Because many complex criminal cases do require access to foreign tax information, this issue should be addressed in any disclosure amendments.

We believe the revisions I have outlined to §6103(i), §6103(k) and the penalty provisions will not undermine taxpayer privacy or our tax system and, they would substantially reduce the impediments to effective law enforcement created by the 1976 law.

COMPARISON OF ADMINISTRATION AND SENATE PROPOSALS

The proposals we endorse, after months of careful analysis and consultation between IRS and Justice, are remarkably similar to the proposals co-sponsored by Senators Nunn, Long and six others. Their proposals, based on the extensive hearings held in the last six months by Senators Nunn and Chiles and others, help resolve the major problems we have experienced with current law. The major differences between our proposals and those of the Senate bills relate to the protection of an individual's financial records which underlie the tax return. The Nunn bill would permit access to this information without a court order and would require the Service to report evidence of non-tax crimes revealed in those records. We recognize that the Nunn proposal would greatly assist law enforcement, but we believe that this involves an area where the taxpayer has a legitimate expectation of privacy and could adversely impact on the tax collection system. Accordingly, we do not endorse that aspect of the Nunn bill.

I should also add that the Senate proposals for reforming the penalty provisions are somewhat at odds with my suggestions. We believe our proposals more effectively address the problem. Finally, the Senate bills do not contain provisions with respect to admissibility of tax information or mutual assistance treaties. The Senate bills do, however, provide for limited access to federal tax information by State law enforcement authorities. It is our view that the Senate proposal for State access should be deleted as one which unjustifiably compromises taxpayer privacy interests.

CONCLUSION

In conclusion, let me emphasize that legislation to amend the Tax Reform Act will have an impact much more important than mere resolution of the specific disclosure problems I have discussed. We believe that such legislation will enable the Internal Revenue Service, the Department of Justice and other federal law enforcement agencies to work more closely as cooperating partners in the enforcement of federal law. After three and one-half years of experience, we believe that our fully documented legislative proposals will significantly reduce the impediments to such cooperation without jeopardizing privacy protection or our self-assessment tax system. On behalf of federal prosecutors, I deeply appreciate your prompt consideration of these proposals and assure you that they are imperative to effective federal law enforcement efforts.

Thank You.

VII. SUMMARY OF RESPONSES TO
PART V OF THE
QUESTIONNAIRE

This section summarizes the responses of the replying offices to the open-ended request in Part V of the questionnaire for comments and additional information regarding the impact of Section 6103 on the Department's law enforcement activities. Fifty-six of the 105 responding offices provided additional information or general comments in response to Part V of the survey.

A. Tax Cases - Section 6103(h)

The following additional information was provided by the responding offices regarding the impact of Section 6103(h) on tax cases. This information was furnished in the form of specific examples of problems encountered in the utilization of Section 6103. The following summaries are based solely upon the information provided by the responding offices, and should be considered together with the data set forth in Section III of this report. Nine offices provided additional information in Part V of the survey regarding the impact of Section 6103 on tax cases.

- Two offices noted that IRS's fear of violating Section 6103 frequently causes that agency to fail to provide to the Government attorney all the tax information needed to prepare adequately for the trial of a civil tax case.
- One office noted that in 26 U.S.C. 6672 cases, where all the parties are not before the court (the ordinary situation in the Court of Claims), a problem exists in learning what, if anything, has been collected by IRS from the other assessed persons. Although payments by these other persons have no effect on the liabilities of the parties in the suit, the Government's policy is to collect 100% only once in such cases. Thus tax information regarding collection activity with respect to assessed nonparties is very useful to the Government attorney, but difficult to obtain under Section 6103.
- One office raised the question of whether Section 6103 permits the disclosure of tax information to outside experts specially hired by the Government in civil tax litigation to handle special issues such as valuation.

- One office pointed out that, after the passage of the 1976 amendments to Section 6103, tax protesters have attempted to "trap" Government attorneys into making allegedly unlawful disclosures of tax information relating to them by submitting fictitious powers of attorney or revoking existing powers of attorney, and then challenging the attorney's disclosure to the lawyers that the attorney believed were actually representing the protesters.
- One office noted that in summons enforcement cases, IRS agents, fearful of violating Section 6103, have neglected to tell the Government attorney handling the proceeding that Section 6103(i)(1) orders had been obtained by offices seeking tax information regarding the taxpayer for nontax purposes. In other cases agents have neglected to report that, by the time of trial, they had already recommended to their superiors at IRS that a grand jury investigation of the taxpayer be conducted. In some cases the Government attorney has learned this information from opposing counsel. Information regarding both is extremely important on the issue of improper criminal purpose (see United States v. LaSalle National Bank, 437 U.S. 298 (1978)).
- One office noted the need for better coordination with FOIA units within the Department, which make determinations whether requested information may be disclosed consistent with the restrictions of Section 6103. This office reported that, in a civil tax case, the Government attorney disclosed information which she believed was disclosable under Section 6103(h)(4). However, the attorney subsequently learned that plaintiff's counsel had made an FOIA request before instituting the tax suit, and that some of the information which the plaintiff was requesting--information which the Government attorney disclosed under §6103(h)(4)-- had not been disclosed by the individual handling the FOIA request, on the ground that disclosure would violate Section 6103.
- Two offices stated that Chief Counsel of IRS directs disclosure of wagering tax information to the Department of Justice under 26 U.S.C. 4424(b), but is very reluctant to disclose information under Section 6103(h)(2), although the language of the two statutory provisions is essentially the same.

B. Nontax Cases - Section 6103(i)

Twenty-five offices provided additional information in Part V of the survey regarding the impact of Section 6103 on nontax cases. The following summaries are based solely upon the information provided by the responding offices, and should be considered together with the data set forth in Section IV of this report.

Thirteen offices commented that the procedures for obtaining tax information under Section 6103(i) for nontax criminal purposes are simply too cumbersome and too time-consuming, especially, as some offices noted, in view of the requirements of the Speedy Trial Act. These offices offered the following proposals for improving the procedures for obtaining disclosure:

- "Return information" should be redefined so as to include only the information which is contained on a tax return, and should not be interpreted to encompass information obtained through an investigation. (One office)
- The distinction between "return information" and "taxpayer return information" should be abolished. (One office)
- Authorization to seek disclosure from IRS under §6103(i)(1) and §6103(i)(2) should lie with the United States Attorney. (One office)
- Department procedures should be amended so as to eliminate the need for the second "request letter" to IRS which accompanies the signed ex parte order obtained pursuant to §6103(i)(1). This office noted that there is no need to again set forth "probable cause" for obtaining the information, when the grounds justifying disclosure are already set forth in the application and the court order. (One office)
- Procedures under §6103(i)(1) should be amended so that returns, taxpayer return information, and return information can all be obtained using the ex parte order procedure--then IRS would not be required to separate out return information when responding to a disclosure request under Section 6103(i)(1). (One office)

--The Government attorney should not be required to utilize §6103(i)(1) simply to learn that the taxpayer in question has not filed tax returns. (Two offices)

One of these offices also noted that, in nontax cases, the restrictions of Section 6103 conflict with the requirements of the Jencks Act, where the Government attorney is aware that IRS has interviewed an individual who is a Government witness in a nontax case.

Two offices reported having disagreements with IRS over which documents or information is covered by an order under §6103(i)(1), or a request under §6103(i)(2). In one case an additional order had to be obtained in order to get the remainder of the needed information from IRS. One office reported that IRS frequently requires separate orders when information is sought regarding more than one taxpayer. Another office stated that if a typing error or misspelling of a name appears in either the court order or the authorization letter from the Assistant Attorney General, Criminal Division, IRS refuses to produce the returns, even though the addresses, social security numbers, and other identifying information on the documents clearly indicate that the error is clerical and not substantive. One office reported that after the court had issued a §6103(i)(1) order, IRS stated that it did not believe that the order was adequately supported by the reasonable cause showing required in §6103(i)(1)(B), "and even went so far as to 'request' that additional 'probable cause' be added to the order and the application." One other office also had problems when it learned that IRS was not satisfied with the language of the order issued by the court.

Two offices complained of internal delays at IRS in the processing of court orders authorizing disclosure; one of these offices cited IRS's requirement that the orders be sent to its National Office in Washington, D.C. before being served on the appropriate Service Center as one cause for the delays.

One office reported that it was required to get a §6103(i)(1) order before IRS would permit an agent to testify in a civil habeas corpus proceeding (28 U.S.C. 2255), where the agent had investigated the defendant for potential criminal tax violations, and was asked to testify as to defendant-petitioner's use of pseudonyms in conducting his real estate transactions. Delays encountered in obtaining the order in turn delayed the habeas corpus proceeding.

One office reported that, after a court requested an in camera inspection of a return that was the subject of an application for a §6103(i)(1) order, the IRS disclosure officer refused to let the tax returns out of her presence when being reviewed by the judge, and forbid any discussion of the returns with the judge's law clerk--a procedure which disturbed the court.

Finally, three offices reported that they have not encountered any difficulties thus far in the utilization of Section 6103(i), and another office stated that while the procedures under §6103(i) are time-consuming, "[m]ost Assistants probably exaggerate the difficulty and amount of work that is required to secure disclosure."

C. General Comments
Regarding Section 6103

Twenty-two offices provided additional information in Part V of the survey regarding the impact of Section 6103 generally on their law enforcement activities. The following summaries are based solely upon the information provided by the responding offices.

Fourteen offices expressed the view that Section 6103 has had a "chilling effect" on law enforcement, in that it makes IRS investigating agents apprehensive of making disclosures, and restricts information sharing between federal investigatory agencies. Four offices noted that the procedures under Section 6103 for obtaining needed tax information are so complex and/or time-consuming that frequently Government attorneys do not view the information as worth the effort of attempting to obtain it.

One office reported that it has had no difficulty utilizing Section 6103, and has found both IRS and the Department of Justice quite cooperative in processing its requests for tax information.

One office suggested that uniform instructions should be given to IRS agents, and made available to courts and Government attorneys, regarding the scope of permissible disclosures under Section 6103, so as to minimize possible contempt problems that might arise if a court, in either a federal or state case, should insist on the agent appearing and testifying regarding certain tax information. In this regard, this office noted that in 1979, a subpoena duces tecum was served on an IRS special agent to appear in state chancery court and bring the joint tax return of a husband and wife for use in a divorce proceeding. After much debate between IRS Regional Counsel and the attorney representing the wife involved in the divorce proceeding, the attorney was persuaded to withdraw or cancel his subpoena.

— Another office complained that IRS does not take uniform positions regarding disclosure requests: in one case, this office sought tax information regarding 3 defendants from IRS, the requests being submitted at various times. One request was granted, but an identical form request as to another defendant was rejected.

One office has noted what appears to be a problem regarding

what types of information come within the scope of Section 6103. Specifically, this office reported that during the course of executing search warrants for evidence of wagering tax violations, IRS agents discovered certain weapons in the possession of a convicted felon then on probation. An attempt was made to revoke the felon's probation, but an attorney in the office of IRS Regional Counsel prohibited the agents from discussing the discovery of the weapons with the United States Attorney's office on the ground that this would violate Section 6103. This attorney was also reluctant to permit the agents to discuss anything that was included in the affidavit for the search warrant. The probationer eventually pled guilty to the probation violation charge.

One office reported that IRS takes an unduly restrictive view of the information that it may disclose to the Department of Justice under Section 6103(i)(3).

One office reported the following situation: In a prosecution of X for bribery of an FBI employee, the employee testified for the Government that X had asked if she could obtain information relating to the criminal tax investigation that was being conducted regarding X by the Criminal Investigation Division of IRS. (It was generally known that IRS had issued a large number of summonses throughout the city seeking evidence of X's tax liability.) To corroborate the testimony of the employee, the prosecuting Government attorney wanted an IRS special agent to testify that X had been the subject of a criminal tax investigation during the period in question. IRS prohibited the agent from testifying on the ground that this would violate Section 6103, even though the IRS agents, when conducting witness interviews, had already disclosed to third parties that X was under investigation.

Finally, one office stated that most Assistant United States Attorneys are unfamiliar with Section 6103 and its procedures, and therefore usually do not make use of the statute to obtain tax information. This office stated that the Department of Justice can and should take steps to educate Government attorneys regarding Section 6103, either through the Attorney General's Advocacy Institute or through a separate seminar.

Mr. NATHAN. I would essentially address the questions which the staff has sent to us in terms of what the position of the administration is with respect to certain key issues in this area.

First, with respect to the amendment of the present standard, for court ordered disclosure under 6103(i)(1), Senator Nunn has accurately described the problems that prosecutors and the courts have with (i)(1), and that is, that the second and third prongs of the present test are virtually impossible tests to meet, particularly when the prosecutors have not, in advance of their application to the court, seen the material that they have to make representations about.

I should make it very clear that with respect to tax returns from all sources and with respect to the underlying financial records of the individual, the administration believes that we should continue to have the court proceeding, that is, the intervention of a neutral court to determine whether or not we are entitled to access to the tax returns. But we would make some adjustments in that procedure; the adjustments relate both to the standards to be applied, who is entitled to make the application, and what procedures have to be followed internally to do that.

With respect to the standards, what we suggest is that, first, there be a representation to the court that there is a legitimate investigation of a specific criminal offense, describing what that offense is; and, second, that the information would be used only for that legitimate law enforcement purpose; and, third, a representation with some documentation that there is reasonable cause to believe that the information may be relevant to a matter relating to the commission of that criminal act.

We think that those relatively modest changes will not have any adverse effect on taxpayer privacy or tax administration but will significantly improve our ability when we go to court to obtain the tax returns and will also encourage prosecutors—when it is appropriate—to make their applications.

Now, another problem we have with the present statute is that it requires authorization from the Assistant Attorney General in Washington even to make the application to the court.

This is a needlessly protracted procedure which means that any U.S. attorney out in the 94 districts, when he has a criminal case which, of course, we in Washington are not fully aware of, and wants to make an application to his district court—to the judge in that district—he can't even make the application without filing papers in Washington, having it all come to one Assistant Attorney General, and having him approve the application.

This has needlessly bogged us down and we propose—the administration proposes—that the application can be made upon the representation of the U.S. attorney, who, as you know, is appointed by the President and confirmed by the Senate, and that he could then make that application to a judge or magistrate in his district.

I think this would speed up the process considerably.

As an example, we have conducted a detailed study of the situation and find that over the past year, for example, the delay between seeking court-ordered disclosure of tax returns and finally obtaining it is well over 2 months. These are matters, of course, where the court has decided we were entitled to it, but all of the delay in coming to

Washington, and delays in the IRS as well, combined, have provided a delay of over 2 months.

Second, with respect to the (i)(2) area—this is the area where the information comes from third parties; it does not come from the taxpayer, it doesn't come from the tax return and it is not furnished by the taxpayer—presently we need the same kind of procedure, that is, that any U.S. attorney out in his district who wants to get this kind of information, in which clearly there is very little privacy interest—

Mr. GIBBONS. Let me invite those who are standing, if you like, to come up here and have a seat. We don't want anyone to be uncomfortable.

Mr. NATHAN [continuing]. In this kind of information. Of course, the taxpayer has very little expectation of privacy because he has not furnished it to the tax service; it has been furnished by third parties and informants and other entities.

Presently, that, too, requires a letter from an assistant attorney general to the Commissioner of Internal Revenue here in Washington, and then has to go through various levels in the IRS and within the Department of Justice.

We think it would be a lot simpler and would not adversely affect privacy interests if the assistant U.S. attorney and supervisory agents were entitled to make this request at their regional district level to the IRS. It would eliminate a great deal of delay and paperwork and give us much prompter access to this information.

Third, the administration proposes creation of an affirmative obligation by the Internal Revenue Service to report Federal crimes reflected in the third-party information. Again, this is not information that comes from any tax returns and it is not information that comes from individual taxpayer's return information. The administration suggests that when the IRS receives from third parties information that there has been a nontax crime committed that the IRS submit that evidence or that information to the appropriate law enforcement agency.

When the GAO did a study of this area, it found that as a result of the 1976 statute, the Internal Revenue Service has received in its Washington office a file cabinet full of information about serious criminal offenses, nontax offenses, which because of the statute they were not permitted to send to the Department of Justice. This information came from books and records and third-party information—I am not talking about information from the tax return—and we have been unable to obtain that information.

We think this does not make good sense and there should be an obligation to turn over that kind of information.

Next, the administration would treat financial books and records and other information submitted by or on behalf of corporate taxpayers in a different manner from an individual's underlying books and records.

Again, we make clear that with respect to tax returns submitted by corporations, we think it is entitled to the same protections. We need a court order to get the tax returns of corporations. Also, we need a court order to get the tax returns of individuals or the underlying books and records; but the books and records of a corporation are different from the books and records of the individual which are often maintained primarily for tax returns.

The tax service requires individuals to keep books and records and it seems unfair to use them against individuals, but in the case of corporations, they are chartered by the States and they owe their existence to the State. They don't have the same degree of privacy interests as individuals.

Second, organizational books and records are already subject to intensive Government inspection under other laws. That is to say that the State which charters them is entitled to see the books and records, the shareholders are entitled to see the books and records, the SEC is entitled to look at the books and records, and the Environmental Protection Agency and a number of agencies are entitled to look at these books and records.

Therefore, it is different, we think, from an individual's papers.

Third, corporations and other legal entities do not have a fifth amendment privilege against self-incrimination as individuals do. We think that one of the reasons we have the provisions of the Tax Disclosure Act is to balance the fifth amendment privilege an individual has of not incriminating himself and his obligation to pay taxes.

So, what we have said in that case is that if you make full and fair disclosure to the Internal Revenue Service, then the information you have provided will not be turned over by the Internal Revenue Service to the nontax authorities to prosecute you. That is fair as far as individuals are concerned, but where a corporation doesn't have such a privilege it seems that a distinction would be appropriate.

Mr. GIBBONS. Let me interrupt here.

We have Senator Nunn back and he may have to leave again, so why don't you sit here and let him come up and work off the end of the table over there, and let him present the rest of his testimony.

We are privileged to have him here and we know how valuable his time is. He may be running his legs off here.

STATEMENT OF HON. SAM NUNN, A U.S. SENATOR FROM THE STATE OF GEORGIA (RESUMED)

Senator NUNN. I think I left off on question No. 2, regarding the level of officials who should be allowed to request disclosure under existing law.

Under existing law the head of any Federal agency may make application for an ex parte court order so long as the tax information will be used in the preparation of any administrative or judicial proceeding or investigation pertaining to the enforcement of any Federal criminal statute.

In the case of the Justice Department, the Attorney General or Deputy Attorney General may make the application. This requirement that all applications be made at the Washington headquarters level has caused lengthy delays in obtaining disclosure.

For the most part, the U.S. attorney or strike force chief in the field is the one who needs the information, but by the time they have obtained the necessary action on the part of Washington, the timeliness of the information may well have vanished.

Accordingly, in our proposal we would allow only Justice Department attorneys to make the application. This includes the Attorney

General, division heads, U.S. attorneys, attorneys in charge of the strike forces, the heads of local or regional offices of the Justice Department or supervisory attorneys designated by the Attorney General.

All requests would have to be made by Justice Department attorneys who would exercise their own independent legal judgment as to the materiality and relevance of the information sought.

I would urge strongly that the committee leave the provision as we have drafted it, but in any event that U.S. attorneys and strike force chiefs who are the attorneys most familiar with the case, be allowed to make application for a court order. We think that is very important.

Question No. 3 pertains to an affirmative duty on the Internal Revenue Service to disclose certain types of return information to law enforcement agencies.

In S. 2402 and H.R. 2628 we have provided an affirmative burden, on IRS to notify the Justice Department whenever it uncovers criminal evidence from sources other than tax returns and other information the taxpayers are required by law to provide to IRS.

Under present law it is permissive for IRS to disclose this third-party information, but the record of such disclosure is so minimal that I believe the agency should be affirmatively required to disclose this type of information.

The General Accounting Office has a report they have issued on this overall bill, and I know you have that.

One of the things they suggested was that there be an affirmative duty placed on IRS to seek a court order to disclose information of criminal activity even when the information comes from a tax return. That goes beyond what we have recommended. Such a provision would certainly strengthen the IRS' role in law enforcement and I have no objection to that provided that the Federal judicial officials still stand between the Federal IRS and other agencies.

I think that is the key to it.

Question No. 4 deals with the distinction between individual and corporate return information.

In S. 2402 and H.R. 6826 we define two types of information. The returns are the actual tax returns and all other items the taxpayer is required by law to give to the Government, and nonreturn information is any other type of information. We make no distinction between individual and corporate returns, for two reasons:

First, an individual has an absolute fifth amendment right not to disclose to IRS information which may tend to incriminate him; but as the Supreme Court held in *U.S. v. Sullivan*, once the taxpayer has filed that incriminating information, his privilege is waived. That means the tax return of whatever he is filing.

Second, there is no fifth amendment privilege for corporate or any other entity's business records. Therefore, I see little reason to give statutory protection to this type of record. I would not object to records provided by an individual or individually owned businesses such as sole proprietorships being included within the return definition of S. 2402 requiring a court order.

I believe that that is one of the things that the administration has proposed. I would not object to that, and I see some rationale for that; but I do not believe that nonreturn information contained in corporate or multiowner businesses should receive a statutory privilege that does not otherwise exist in law.

There is just not the same privacy expectation in these types of business records. There is not that kind of expectation.

Question No. 5 asks about redisclosure of tax information to such authorities as State law enforcement agencies and foreign governments.

The existing section 6103 permits disclosure of tax information to such officers or employees of a Federal agency who are personally and directly engaged in and solely for their use in Federal criminal proceedings. Our proposals would allow the attorney for the Government to further disclose information to such government personnel as he deems necessary to assist him in or during the preparation for such proceedings.

I don't believe that our proposal would change the actual practice under existing law and its provisions or are analagous to the applicable sections of rule 6 of Federal Rules of Criminal Procedure which cover among other things further disclosure of grand jury material.

Our proposals also permit the attorney for the Government to go back to court to seek further disclosure to State officials for use in State felony prosecutions.

I believe, again, as I understand it, there have been some objections by the administration to the Federal civil litigation, and I think the suggestion has been made that only that Federal civil litigation which flows directly out of the criminal proceeding be covered. I see some logic to that restriction.

Question No. 6 deals with criminal and civil penalties for unauthorized disclosure.

We propose in our bills that the criminal and civil penalty provisions of the Tax Reform Act be changed to protect Federal employees from liability for innocent disclosures. In the criminal area, we would provide an affirmative good faith defense. In the civil penalty area, we believe that the Government should be liable for damages stemming from innocent disclosures by Federal employees who are acting within the scope of their employment.

Several IRS officials told our subcommittee that the severe criminal penalties in existing law—which contain no good faith defense—make the agents reluctant even to disclose a plot to assassinate the President because they would be in jeopardy of violating the existing criminal and civil sanctions if they did so.

As to civil penalties, I believe we should tread very carefully in this and all other areas before saddling Federal employees with personal liability for their on-the-job activities. A frivolous lawsuit can be devastating to a Federal employee just in terms of attorneys fees alone.

Our proposal would remove the chilling effect on IRS disclosures while at the same time maintaining strong civil and criminal penalties for intentional, corrupt or malicious disclosures.

Question No. 7 addresses the administrative summons provisions. S. 2403 would change the IRS summons provisions to make them analogous to those that apply to all other Federal agencies through the Right to Financial Privacy Act. The automatic stays of the IRS summons process have resulted in delays averaging 9 months—and some have lasted up to 3 years. The stay is obtained by the taxpayer without his having to advance any legal or factual basis for the delay. Obviously, such a technique is disruptive of any investigation and is extremely costly to the Government.

Under our bill a taxpayer would be notified when his financial records are summoned, but he would have to go to court and present a legal or factual reason why the summons should be stayed; thus the taxpayer still will have a right and opportunity to challenge the summons, but would not be entitled to an automatic stay.

With respect to the appeal provisions suggested by the administration, I think these are suggestions that warrant the careful attention of the committees on both sides.

Mr. Chairman, this responds to the questions. As I said, I have a statement that goes into a great deal of detail, and I hope the members of the staff will have reason to study that; but I don't believe the committee should be burdened with that lengthy discussion now.

Mr. GIBBONS. Your statement will be in the record.

Let me commend you for the skill and interest you have in this area. It is a very touchy area and your leadership is welcome.

Does the gentleman from Georgia wish to interrogate the Senator from Georgia?

Mr. JENKINS. I want to commend my colleague from Georgia for all of his work in this area. As a cosponsor of your bill over here in the House, I am aware of the problems that you are attempting to address, and I think you do a good job in addressing those problem areas.

As a former prosecuting attorney with the Justice Department and as a defense attorney after that, I see both sides of the issue. I know you have attempted in this legislation to protect the right of privacy that all of us want.

At the same time, you are opening the possibility for our law enforcement agencies to properly use every legitimate avenue in reaching decisions and prosecutions on many cases.

I commend you for it. I can think back on information that I received as a prosecuting attorney before the 1976 act, of course, which came from IRS. Many times that was extremely valuable and stopped fraud and bankruptcy fraud and a host of other criminal activities.

So, I commend you for your interest in this field.

I have no questions. I am very familiar with your proposal and I thank you for your testimony.

Senator NUNN. I appreciate very much your kind words and also your cosponsorship and your leadership in this area.

I think the area that is most in need of IRS expertise and assistance is in the narcotics/cash flow area. That is an area that I happen to think is important. I know the chairman is from Florida and you have tremendous problems there, but I believe that we could make the most significant improvement in narcotics enforcement by passing this legislation or something similar to it, particularly in the cash flow area, because the kingpins of narcotics normally don't touch the drugs and very seldom are caught with them, but they always touch the money.

The IRS has the most expertise and experience in the money area of any Federal agency. So I do hope we have struck a balance here. I am very respectful of those who are worrying about the privacy aspect, and I am not locked in concrete on those provisions.

I think the General Accounting Office report has made some constructive suggestions. I think the administration has made some

constructive suggestions, and we hope we can come out in this Congress with a bill that does strike that appropriate balance.

Mr. JENKINS. Thank you, Mr. Chairman.

Mr. MOORE. I certainly appreciate your coming and testifying and you have delved into something that is quite technical and quite difficult.

There is something you said in your testimony and what Mr. Nathan said, at which point he stopped, both of which concern me and the concern is basically a lack of knowledge of this area and I am trying to spend some time educating myself on it.

But I am concerned about the treatment of the corporate records as being something you don't have to worry about.

I have read both statements closely and you are telling me the law is already that way with the exception of the statute which needs to be amended, but I know, Mr. Nathan, this is not a point to question you on, but the Senator came to the same conclusion. You make a point that organization books and records are normally maintained for purposes other than tax administration. I am not certain that that is a true statement. Very often, there is not much difference between a sole proprietorship and a sole proprietorship who incorporates for the purpose of escaping liability. You are still talking about a small, one-man proposition and you are talking about the possibility of him incriminating himself or the possibility of him divulging information for which he will be liable for a criminal fine or penalty, and prosecuting people for white-collar crimes and whatever.

I am not defending them. I am a little concerned that we don't seem to be concerned about those records. We are talking about a corporation where the Justice Department has been reaching officials within those corporations to penalize them for whatever the action of the corporation may have been that is wrong, and that is probably right to do that.

Mr. NATHAN. With the Senator's permission, I would like to respond briefly to your observations.

In the first place, the administration would make an exception for a single shareholder corporation, which I think you are quite right is like a sole proprietorship, except the person has incorporated to limit his liability or for whatever reason.

Further, we are not suggesting that the corporate books and records which are provided to the Internal Revenue Service to support its tax returns be made available willy-nilly to the Department of Justice or any other entity beyond the Internal Revenue Service.

All we are suggesting is that when the corporate books and records contain within them evidence of nontax crimes on their face—for example as the GAO report shows, corporate books and records which have shown payments, illegal payments, going to labor leaders, going to political figures and others, they would be violations of Federal law and not the tax law, but the criminal code—in those limited circumstances the Internal Revenue Service would turn that information over to the Department of Justice or an appropriate enforcement agency without a court order and without having the Department of Justice request disclosure. Of course, the Department doesn't know what is in those returns or what is in those books and records.

So, what we are saying is that where the individual books and records show that that individual has been involved in nontax crime, that would remain involate in the hands of the Service and they would have no obligation and would not turn that over to law enforcement officials because the individual has complied with his tax obligations and been forthcoming with the Service. But where a corporation has in its books and records evidence of a nontax crime, then in that case the Service will turn over that information.

We think that makes a great deal of sense for the reasons I have suggested, and the distinction must be made between an individual and a corporation.

Mr. MOORE. In the case of a small family-owned corporation you are willing to make an exception to that?

Mr. NATHAN. A single shareholder corporation.

Mr. MOORE. There are not many of those. In my State you have to have three shareholders, which is usually the husband and wife and the oldest child.

Mr. NATHAN. This is the point that Senator Nunn made.

Senator NUNN. We require three incorporators but you don't have have to have three shareholders.

Mr. NATHAN. I don't think any of these things are cast in concrete if there is some amendment that is satisfactory. When it is an alter ego of an individual or a small group, we would afford the same protection, but we are talking about large corporations, major commercial entities.

Mr. MOORE. I was never a prosecutor. I did defense work and I am not a prosecutor and maybe that is the wrong side to be talking about today; but the thing that concerns me about this is if you are willing to concede that maybe there is something here where we should take care of a single shareholder proposition, then where do you begin to draw the line between a family corporation that has two brothers and two shareholders? Am I not right that when you formally find evidence of what you just elicited, which is a crime, it is usually an individual you prosecute and the corporation may want to pay a fine.

Don't you also go after the corporation official who authorized that?

Mr. NATHAN. We often go after the corporation and the individuals involved in the corporation, but I don't think that should make any difference.

Mr. MOORE. It is just your dealing with people?

Mr. NATHAN. You are dealing with people, of course, who are acting for the corporation.

Mr. MOORE. We exempt the sole proprietor but we are probably going to wind up getting the president of a two-man corporation, and I don't see much distinction there, except the corporate structure.

The thing I am concerned about is where do we begin to draw the line? One shareholder is OK and sole proprietorship is OK, but what about a two-person corporation, and what about Exxon?

Senator NUNN. You make a good point of where you draw the line, and I don't think there is any real answer to that. I think the committee's decision will be just as good as any judgment I might

offer here. It seems to me the reason for the distinction is based on the fifth amendment distinction. The fifth amendment on self-incrimination does not apply to corporations and the legislation is trying to follow that example.

Of course, you could make the same argument that you are presenting here on the fifth amendment decision by the court, that why does it not apply to a corporation when they do turn over records and there are individuals who may be prosecuted.

If that decision is valid, then this distinction is valid. But that is the legal end of it. It is a question of legislative judgment here.

It seems to me the most important thing here is not so much where you draw the line, or whether you even have a line. It might be that you don't want a line between business records and entity records, but you put an affirmative burden on IRS when they do find evidence of a crime to make that information available either through the court or through the written request procedure. So we will still have a procedure they have to go by.

The question here would be whether you treat a corporation the same as you would treat an individual. That is to say whether they would have the protection of a court between IRS and the Justice Department, and I do not consider that to be the crucial part of this legislation, if the committee decides it does not want a distinction.

Mr. MOORE. Up to this point everything sounds reasonable, and I appreciate your answers, and I will do some more study on it.

Mr. Chairman, I thank you.

Mr. HEFTEL. I think both sides of the aisle are concerned over the distinction. I am thinking of the corporation that isn't the single individual and yet it is what you are talking about. It is 3 or 10 individuals, and I don't think that it has to be prolonged, but I still wonder whether that distinction should be there if it is real. It is something that should be pursued in the legislative history of this proposal.

Senator NUNN. There is not a lot of difference between an individual proprietorship and an individual.

Mr. HEFTEL. Someone should demonstrate along the line why it should be there. The real issue is the issue that has been raised in cases of both cash flow and drug trafficking. There is the fact that we don't seem to recognize, and I think the Senator is properly trying to address it, that the people we are dealing with are so far removed from conventional activity that they are almost unreachable. There is a question in Florida about whether or not some of the banks and other financial institutions are instrumentalities of drug traffickers. If we don't do something to protect ourselves, then I think a lot of people will be hurt in the name of what seems to be the understandable concern for the civil rights of perhaps a few.

I think you should be commended for what has transpired and the IRS should be commended. I think the 1976 act just simply has to be changed, because of the changing conditions we now recognize about what is occurring in the legal/financial circles as it relates to drug trafficking.

I again commend the chairman and yourself and my colleague for the initiative that has been taken.

Senator NUNN. Thank you very much.

I just want to leave one point with you.

If we adopted everything in here without any changes, we would still have far more protection for the taxpayer than we did prior to 1976.

Mr. GIBBONS. Thank you. We will not hold you any further.

I see Senator Weicker has come in.

Would you come up Senator and you can testify from up here. We have all of this panel of experts sitting up here by you. They started their testimony when the bells rang for your vote in the Senate.

**STATEMENT OF HON. LOWELL P. WEICKER, JR., A U.S. SENATOR
FROM THE STATE OF CONNECTICUT**

Senator WEICKER. Mr. Chairman, I want to thank you for the opportunity to appear before the subcommittee to discuss the tax privacy rights of individuals. In the interest of time I am going to highlight my prepared statement, which I will submit for inclusion in the record.

Mr. GIBBONS. Without objection, we will put the entire statement in the record.

[The prepared statement follows:]

**STATEMENT OF HON. LOWELL P. WEICKER, A U.S. SENATOR FROM THE STATE
OF CONNECTICUT**

Mr. Chairman, thank you for the opportunity to appear before this Subcommittee today to discuss the tax privacy rights of Americans.

In 1976, Congress reviewed the statutory rules governing the disclosure of tax information for the first time in 40 years. Prior to then, income tax returns and information were deemed to be "public records". Federal law enforcement officials were able to obtain tax information simply by stating that, in their discretion, it was "necessary in the performance of . . . official duties". The Internal Revenue Service, for all intents and purposes, operated a lending library.

Congress enacted tax privacy safeguards in the Tax Reform Act of 1976 as a result of:

1. Abuses uncovered during the Watergate investigations which documented use of the IRS as an intelligence body to derive information harmful to enemies of the Nixon Administration and helpful to its friends. These abuses were summarized by the House Judiciary Committee in Article II, subparagraph 2 of the Articles of Impeachment of President Nixon: "He has, acting personally and through his subordinates and agents, 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, and to cause, in violation of the constitutional rights of citizens, income tax audits or other income tax investigations to be initiated or conducted in a discriminatory manner."

2. Violations of Americans' Constitutional rights discovered by the Church Committee. In its 1976 Report, the Committee concluded that: ". . . The FBI used as a weapon against the taxpayer the very information the taxpayer provided pursuant to his legal obligation to assist in tax cases and, in many cases, on the assumption that access to the information would be restricted to those concerned with revenue collection and used only for tax purposes."

3. Disclosures that special powers of the IRS were being misused to collect information for purposes well beyond tax administration but related to other law enforcement activities which led to a series of Congressional hearings on the propriety of various uses of tax information. In the 93rd Congress the Senate Judiciary Committee held hearings and numerous hearings were conducted by the Senate Finance Committee and House Ways and Means Committee in the 94th Congress. Law enforcement officials testified at length concerning the need for efficient enforcement procedures, raising a spectre similar to that being raised today.

4. Recommendations made by the Privacy Protection Study Commission for more stringent safeguards with respect to disclosures of records made by the IRS. The Commission stated that the taxpayer's disclosures to the IRS ". . . can

not be considered voluntary because the threat of criminal penalties for failure to disclose always exists. The fact that tax collection is essential to government justifies an extraordinary intrusion of personal privacy by the IRS, but it is also the reason why extraordinary precautions must be taken against misuse of the information the Service collects from and about taxpayers."

Mr. Chairman, I have taken the time to review this history because it is important to remember the events surrounding, and consideration given, the formulation of the existing standards governing disclosure of tax information. Based upon this substantial record, Congress carefully drafted legislation which balanced the rights of Americans to certain privacy standards with the needs of government in enforcing the law.

Now, less than four years after the striking of this balance, legislation is introduced which tips the scales in favor of law enforcement, at the expense of the taxpayer's privacy rights.

What is the rationale for this new encroachment upon the rights of Americans? It is done under the banner—which all good citizens willingly carry—of the fight against organized crime, mobsters and narcotics traffickers. Why? Because one is best able to obfuscate the true issues by arguing in an inflammatory way that a change in the law is the only solution to these evils.

One must look behind the rhetoric to ascertain the reason for this legislation. The reason is expediency. It is not that the Justice Department does not have the means of obtaining evidence other than from tax return information in its fight against crime. The Justice Department, as evidenced by the great number of its successful prosecutions, does. But it is far quicker—and more expedient—to go directly to the tax return and related information than to the other sources.

Jerry Litton, the late Congressman from Missouri who coauthored the disclosure protections in 26 U.S.C. § 6103, succinctly rebutted the expediency rationale. In testimony before the House Ways and Means Committee in January of 1976 he said that "if we are only looking for expediency, let's wiretap every one thousand homes, open the mail of every one thousand citizens, if we are only looking for expediency." But this country does not look just for expediency when dealing with the rights of citizens. Our heritage is otherwise.

Two hundred years ago our founding fathers authored a Constitution premised on the principle that individuals—as human beings—are more important than the conveniences of society. A greater importance was placed on individual liberties than on governmental efficiency. That was the philosophy underlying the Bill of Rights.

The existing tax information disclosure provisions reflect the fact that Americans are compelled to surrender the Constitutional rights guaranteed by the Fourth and Fifth Amendments—the right to "be secure in their . . . papers, and effects, against unreasonable searches and seizures" and the right against self-incrimination. In order to facilitate the effective administration of our tax laws, each American voluntarily surrenders certain rights and assumes the duty of self-investigation, fact-finding and reporting. This baring of private papers and matters is an accommodation by citizens for their government for tax purposes—not for non-tax law enforcement purposes, not for scientific purposes, not for sociological purposes, not for political purposes, not for statistical purposes.

The method in which taxpayers voluntarily comply with our tax laws and, in most cases, fully report their earnings is the envy of most other nations where dishonesty is often the rule rather than the exception. If taxpayers become convinced that confidential data they submit each year is being used for other than tax purposes, how long will it be before cheating is commonplace? Widespread cheating would be beyond the capacity of the IRS to control and our entire system of voluntary self-assessment would collapse.

The few years that have transpired since enactment of the Tax Reform Act have not shown that Congress erred in enacting needed tax reform legislation or that provisions of the law have unfairly or unduly burdened law enforcement efforts.

What time and experience have shown is not that the law is burdensome, or wrong, or unfairly restrictive, but that those who have interpreted the law have done so incorrectly. For example, in testimony in December before the Senate Permanent Subcommittee on Investigations, Peter B. Bensinger, the Administrator of the Drug Enforcement Administration, commented with respect to the authority given IRS under 26 U.S.C. § 6103(i)(3) to disclose to other law enforcement agencies information it has regarding violations of criminal law. Astonishingly, his testimony revealed that DEA records do not show ever having received

such disclosures from IRS. This indicates not a problem with the law, but a problem with the agency empowered to act pursuant to the law. How can one profess that the provisions of the Tax Reform Act prohibit effective law enforcement when a provision of the Act designed to assist law enforcement is not properly utilized?

What the record justifies is a fine tuning of the provisions of the Act, to ensure that law enforcement officials properly utilize the tools that are already available. Thus, the provisions in the proposed legislation which place time limits on court action and the IRS's response, that allow magistrates to act upon *ex parte* applications, which limit those empowered to make applications, and that send a signal to the IRS, are justified.

However, those provisions which would expand the material available to the Justice Department without affording Americans the protection of a court order are simply not justified—nor tolerable. And, cutting through the rhetoric, that is the thrust of the proposal.

Section 6103 of Title 26 of the United States Code presently requires that a court order be obtained by law enforcement officials before the IRS can turn over a taxpayer's return or any information supplied in support of the return. H.R. 6826 would grant court protection only to the tax return and information filed with it—nothing else. Therefore, any information produced to substantiate the return—such as correspondence, sources of income, investments, any check ever written by the taxpayer, any bill ever paid, and the reasons for doing so—would be routinely available to the Justice Department, who in turn could turn the information over to anyone they want. This proposal constitutes an unwarranted invasion of the taxpayer's privacy rights, and is unacceptable.

The taxpayer's privacy rights would be further eroded by relaxing the standards necessary for the Justice Department to prove in order to obtain an *ex parte* order. Under the proposal, a tax return could be obtained by a court order provided that application for the order is made in connection with a "proceeding" that pertains to the "enforcement" of a Federal criminal statute, or for an investigation which "may result in such a proceeding". This substantially cuts back on the present standard which requires that there must be "reasonable cause to believe . . . that a specific criminal act has been committed". I might add that the law as it now stands does not afford the taxpayer his Fourth Amendment rights, which require proof of "probably cause".

In addition, H.R. 6826 eliminates the requirement that the Justice Department must exhaust all other sources before it can turn to the IRS to obtain information. This provision, which was suggested by then IRS Commissioner Donald Alexander, is similar to the requirement deemed necessary by Congress in 18 U.S.C. § 2518(1)(C) that investigative procedures be attempted before a court may order a wire tap or other form of electronic surveillance.

I might also add that the provision in H.R. 6826 which would require the IRS to disclose to "the appropriate" agency any information under "exigent circumstances", including "a possible threat . . . to national security", contains insufficient safeguards to ensure that the taxpayer is not stripped of his privacy rights in the name of "national security". The vague standards of this provision could give the IRS the unbridled discretion to turn over any information in their files to anyone in the government, and, if improperly used, would mark the return of the days of the "lending library" which IRS formerly operated. This proposal does not even afford the taxpayer the protections contained in 18 U.S.C. § 2518(7), which require notification to and approval of a court within 48 hours after a wire or oral communication has been intercepted in an "emergency situation".

The loosely drafted provision in H.R. 6826 which would permit disclosure to state law enforcement officials concerns me. The abuses which I enumerated earlier in my testimony were not confined to high level Federal employees. There is ample documentation that State and local officials were responsible for equally appalling abuse.

Finally, I am worried about the provision which would authorize disclosure of information on American citizens to foreign countries. The thought that personal information on Americans can be disclosed to other countries which do not have the guarantees of individual rights which are contained in our Constitution is simply repugnant to the principles upon which our nation was founded.

Mr. Chairman, I am in complete agreement with those who desire to vigorously enforce our laws. The purpose in offering this legislation is unquestionably beneficial. However, too many Constitutional safeguards are sacrificed here. I am

reminded of the observation of Justice Brandeis that: ". . . experience should teach us to be most on our guard to protect liberty when the Government's purposes are beneficent. . . . The greatest dangers to liberty lurk in the insidious encroachment by men of zeal, well meaning, but without understanding."

Senator WEICKER. In 1976, Congress reviewed the statutory rules governing the disclosure of tax information for the first time in 40 years. Prior to then the Internal Revenue Service, for all intents and purposes, had operated a lending library.

Congress enacted tax privacy safeguards in the Tax Reform Act of 1976 as a result of:

One, abuses uncovered during the Watergate investigations which documented the use of the IRS as an intelligence body to derive information harmful to enemies of the Nixon administration and helpful to its friends.

Two, violations of Americans' constitutional rights discovered by the Church committee.

Three, disclosures that special powers of the IRS were being misused to collect information for purposes well beyond the tax administration but related to other law enforcement activities which led to a series of congressional hearings on the propriety of various uses of tax information, including numerous hearings which were conducted by the House Ways and Means Committee.

And, four, recommendations made by the Privacy Protection Commission for more stringent safeguards with respect to disclosures of records made by the IRS.

Based upon the substantial record before it, Congress carefully drafted legislation which balanced the rights of Americans to certain privacy standards with the needs of Government in enforcing the law.

I want to make it clear that one of your colleagues, whom you knew, waged this fight with me and it was a long one. I am talking about Jerry Litton.

Mr. GIBBONS. I remember Jerry.

Senator WEICKER. And I might add, Jerry got the Republican nomination for the U.S. Senate and was killed in a plane crash. The privacy protection provisions in the Tax Reform Act of 1976 are as much his work as anyone else.

Now, less than 4 years after the striking of this balance, legislation is introduced which tips the scales in favor of law enforcement at the expense of the taxpayer's privacy right.

What is the rationale for this new encroachment upon the rights of Americans? It is done under the banner of the fight against organized crime, mobsters, and narcotics traffickers. Why? Because one is best able to obfuscate the true issues by arguing in an inflammatory way that a change in the law is the only solution to these evils.

I know on the floor of the Senate I keep on hearing from my good friend, Senator Nunn, and others that Al Capone would be laughing in his grave if he saw the Tax Reform Act of 1976. I would like to point out to you and every member of this subcommittee that Al Capone was sent up the river on tax evasion charges and nothing else: tax evasion charges. And, the disclosure provisions added in the Tax Reform Act of 1976, do not in any way affect the powers of the IRS and the Justice Department to investigate and enforce tax-related offenses.

One must look behind the rhetoric to ascertain the reason for this legislation. The reason is expediency. The Justice Department, as evidenced by the great number of its successful prosecutions, has other means of obtaining evidence in its fight against crime. But it is far quicker and more expedient to go directly to the tax return and related information than to the other sources.

Jerry Litton, the late Congressman from Missouri who coauthored the disclosure protections, succinctly rebutted the expediency rationale. In testimony before the Ways and Means Committee in 1976 he said that "if we are only looking for expediency, let's wiretap every 1,000 homes, open the mail of every 1,000 citizens, if we are only looking for expediency." But this country does not look just for expediency when dealing with the rights of citizens. Our heritage is otherwise.

I might add that Litton's interest in the legislation was not inspired by any particular Watergate measures but the fact that the Internal Revenue Service was turning over to the Department of Agriculture the returns of farmers in his district. That is how Litton got interested in this.

Two hundred years ago our Founding Fathers authored a Constitution premised on the principle that individuals as human beings are more important than the conveniences of society. A greater importance was placed on individual liberties than on governmental efficiency. That was the philosophy underlying the bill of rights.

The existing tax information disclosure provisions reflect the fact that Americans are compelled to surrender the constitutional rights guaranteed by the fourth and fifth amendments. In order to facilitate the effective administration of our tax laws each American voluntarily surrenders certain rights and assumes the duty of self-investigation, factfinding and reporting.

This barring of private papers and matters is an accommodation by citizens for their government for tax purposes, not for nontax law enforcement purposes or any other purposes.

The level of compliance with our tax laws makes the United States the wonder and the envy of other nations. If taxpayers conclude that their compliance is being used to violate their rights, how long will it be before cheating is commonplace?

As numerous former IRS commissioners have testified, the IRS well realizes that if American taxpayers cheated on a scale anywhere approaching what is commonplace in most other nations, our entire revenue collecting system would collapse.

Indeed in testimony before the Senate Finance Committee back in April 1975, every single commissioner of Internal Revenue testified that the degree of compliance is directly related to the degree of confidentiality. That was their testimony.

I think first of all we should lay the basis for the program of the IRS because there is a tendency to look upon it as a law enforcement agency. It is not. It is a revenue collecting agency and that alone is their job. The testimony of every commissioner testified that the degree of compliance is directly related to the degree of confidentiality.

There is one other remark I would like to make in passing, because I remember getting into this with my old law professor from the University of Virginia, Mortimer Caplin. He indicated to me that foreign

country after foreign country come over here thinking that the degree of success that we enjoy in tax collection is due to some management system or some particular type of computer system.

They are all amazed to leave here finding out that the reason for its success is the willingness of every American citizen to take a duty on his or her own shoulders to voluntarily comply. It is as simple as that. That implies that there has to be credibility in the system. What the system promises the system must deliver.

Indeed all of the fallout of Watergate, what was one of the worst? It was when the chief law enforcement officer of the Nation fraudulently filled out his tax returns. Then the dam breaks at that point. Indeed it will break even further if when persons fill out their returns they find out that indeed this is being used not to collect taxes but for a multitude of reasons.

Mr. Chairman, the few years that have transpired since enactment of the Tax Reform Act have not shown that Congress erred in enacting needed tax reform legislation or that provisions of the law have unfairly or unduly burdened law enforcement efforts.

What time and experience have shown is not that the law is burdensome or wrong or unfairly restrictive but that those who have interpreted the law have done so correctly.

Congressional hearings have revealed that even those provisions of the act which permit the IRS to assist enforcement agencies are not being effectively utilized. If the agencies do not use the authority at their disposal to proper effect, why should that authority be further expanded at the further expense of constitutional rights?

What the record does justify is a fine tuning of the provisions of the act, to insure that law enforcement officials properly utilize the tools that are already available. Thus, the provisions in the proposed legislation which place time limits on court action and the IRS's response, that allow magistrates to act upon ex parte applications, which limit those empowered to request disclosure from the IRS to high-level Justice Department officials, and that requires the IRS to disclose information of nontax violations obtained from third parties, are justified.

However, those provisions which would expand the material available to the Justice Department without affording Americans the protection of a court order are simply not justified nor tolerable. And cutting through the rhetoric that is the thrust of the proposal.

The law presently requires that a court order be obtained by law enforcement officials before the IRS can turn over a taxpayer's return or any information supplied in support of the return. H.R. 6826 would grant court protection only to the tax return and information filed with it, nothing else.

Therefore, any information produced to substantiate the return, such as correspondence, sources of income, investments, any check ever written by the taxpayer, any bill ever paid, and the reasons for doing so, would be routinely available to the Justice Department who in turn could turn the information over to anyone they want.

This proposal constitutes an unwarranted invasion of the taxpayer's privacy rights and is unacceptable.

The taxpayer's privacy rights would be further eroded by relaxing the standards necessary for the Justice Department to prove in order to obtain an ex parte order. Under the proposal a tax return could be obtained by a court order provided that application for the order is made in connection with a "proceeding" that pertains to the "enforcement" of a Federal criminal statute or for an investigation which "may result in such a proceeding."

This substantially cuts back on the present standard which requires that there must be "reasonable cause to believe * * * that a specific criminal act has been committed."

In addition, H.R. 6826 eliminates the requirement that the Justice Department must exhaust all other sources before it can turn to the IRS to obtain information. This provision is similar to the requirement deemed necessary by Congress in 18 U.S.C. section 2518(1)(C) that investigative procedures be attempted before a court may order a wire tap or other forms of electronic surveillance.

Furthermore, the provision in H.R. 6826 which would require the IRS to disclose to the appropriate agency any information under "exigent circumstances," including "a possible threat * * * to national security," contains insufficient safeguards to ensure that the taxpayer is not stripped of his privacy rights in the name of "national security."

The vague standards of this provision could give the IRS the unbridled discretion to turn over any information in their files to anyone in the Government and threatens to mark the return of the days of the IRS "lending library."

This proposal does not even afford the taxpayer the protections contained in 18 U.S.C. section 2518(7), which require notification to and approval of a court within 48 hours after a wire or oral communication has been intercepted in an "emergency situation."

The loosely drafted provisions in H.R. 6826 which would permit disclosure to State law enforcement officials concerns me. The abuses which I enumerated earlier in my testimony were not confined to high-level Federal employees. There is ample documentation that State and local officials were responsible for equally appalling abuses.

Finally, I am worried about the provision which would authorize disclosure of information on American citizens for foreign countries. The thought that personal information on Americans can be disclosed to other countries which do not have the guarantees of individual rights which are contained in our Constitution is simply repugnant to the principles upon which our Nation was founded.

I will repeat, in closing, that it took us 40 years before the first change in the law governing disclosure of tax information took place. It was 40 years for the first change, yet when certain people were inconvenienced, they pushed to get back to the old standard. I can quote Justice Brandeis, who I always find to be good for supporting many of the things in which I believe, " * * * experience should teach us to be most on our guard to protect liberty when the Government's purposes are beneficent * * * The greatest dangers to liberty lurk in the insidious encroachment by men of zeal, well meaning, but without understanding."

You talk about organized crime all you want but there is no differentiation in the coverage of the law. The same law is going to apply

to Congressmen and Senators and artists and bankers and businessmen and labor leaders, as well as to criminals. There is no differentiation.

So let us understand that whatever it is your subcommittee does or is done on the floor of the House or of the Senate is going to apply to all Americans. I think we learned our lesson well in 1976. It was 3 years before we got the necessary change passed by both Houses, so it wasn't done as a matter of the particular aberrations of the Nixon administration.

The changes were enacted after a long careful look, and I would hope that we would give the system a chance to work, which does not mean to say there cannot be certain administrative improvements or improvements in the administration of the laws.

Mr. GIBBONS. We have a vote on now and this would be a good time for us to take a recess.

Senator WEICKER. I have to get away shortly.

Mr. GIBBONS. Are there any parts of the Nunn proposal that you support?

Senator WEICKER. I have detailed those in my testimony and prepared responses, but they do not include the areas involving constitutional rights. They are the administrative area.

Mr. JENKINS. Do you think the main problem is with the administration of the existing law?

Senator WEICKER. I do.

Mr. JENKINS. And the fault lies either with the other Federal agencies or IRS in the construction of it?

Senator WEICKER. IRS to the extent I think they have been a little super-cautious in their interpretation of the law as it was written in handing over nontax crime information received from third parties to the other agencies. Maybe that is not bad at the outset, if you will, considering what the situation was prior to that time.

Mr. JENKINS. You have read or heard Senator Nunn on his Catch 22 situation, with the ex parte order now. Do you have any comment on that?

Senator WEICKER. I will say this to you, Congressman: About 8 months ago there was an amendment to the windfall profits tax bill, and I had to go out on the floor of the U.S. Senate and beat down an effort to revive the disclosure provisions under a time limitation. You are used to that and we are not over there.

That was to eliminate the ex parte order requirement entirely, to eliminate the judicial system entirely in this process. It was an amendment offered by Senator DeConcini and supported by Senator Nunn. I understand where he is trying to go with this legislation and it is to do away with the nuisances, if you will, that protect your rights and mine and the man on the street.

So I am saying that I cite this because I think I understand exactly where this legislation is coming from. The DeConcini approach has been modified in what Senator Nunn has offered, but I understand that given their druthers, Senator Nunn and the Justice Department would like to do away entirely with that filter which is so important to all of us, which is the judicial system.

Mr. JENKINS. Thank you.

Senator WEICKER. If there are any further questions I would be glad to respond to them.

Mr. GIBBONS. I think because of the time pressure we had better release you now, Senator, and thank you for coming. Your testimony is interesting and informative.

Senator WEICKER. Mr. Chairman, I have prepared responses to the seven questions which you submitted to me, and I would like to submit them for inclusion in the record.

Mr. GIBBONS. Without objection, the responses will be included in the record.

Senator WEICKER. It is good to be back and I am sorry that all of you saw fit to demote me to the U.S. Senate. I had a better time here.

Mr. GIBBONS. It is interesting to me that your locker and my locker are next to each other in the gym. However, I don't get a chance to see you.

Senator WEICKER. It is nice to see you, Mr. Chairman.

Mr. GIBBONS. We will take a short recess.

[The responses of Senator Weicker follow.]

PREPARED RESPONSES OF SENATOR LOWELL WEICKER, JR., TO QUESTIONS
SUBMITTED BY THE SUBCOMMITTEE ON OVERSIGHT

1. How should the standards for an ex parte order be changed?

As indicated in the testimony, the thrust of the proposed change is to expand the material available to the Justice Department without the protection of a court order. Under present law, a court order must be obtained before IRS can turn over a taxpayer's return or any information supplied in support of the return. The proposed change would grant court protection only to the tax return—nothing else. This is unacceptable.

However, assuming that court protection were to extend to "return" and "taxpayer return information", as defined under present law, some modification of the existing standards for an ex parte order would be appropriate.

Issuance of an ex parte order should be predicated upon a showing of each of the following:

(i) There is reasonable cause to believe, based on information believed to be reliable, that a specific criminal act has been committed *or is being committed* (from present law, with addition of italic phrase).

(ii) There is reasonable cause to believe that the information sought to be disclosed is material and relevant to the commission of such criminal act (based on language in the Nunn bill).

(iii) There is a full and complete statement as to whether or not other investigative procedures have been tried and failed or why they reasonably appear to be unlikely to succeed if tried or to be too dangerous (this is similar to a provision in present law which requires exhaustion of all other sources before disclosure. The language cited tracks that contained in the electronic surveillance law, 18 U.S.C. 2518(1)(C)).

These are minimum standards. It should be noted that these standards, like existing law, do not afford the taxpayer his Fourth Amendment rights, which require proof of "probable cause". Accommodations of privacy rights have already been made in existing law, and no further ones beyond the above should be made.

2. What level of Administration official should be allowed to request disclosure from the IRS under Section 6103(i)(2) of the Internal Revenue Code?

The thrust of the proposal in the Nunn bill to restrict authority to seek access to tax information to Justice Department attorneys is commendable. This would substantially decrease the number of persons who, under present law, may request and receive IRS material. No longer would heads of other agencies be able to make such applications.

However, as suggested by GAO in testimony before the Senate Finance Committee, the authority to request tax information should be limited to fewer Justice attorneys than in the Nunn bill. These would be the Attorney General, the Deputy Attorney General, the Assistant Attorneys General, and, when designated on an individual basis by the Attorney General, U.S. attorneys and

attorneys in charge of Organized Crime Strike Forces. This would eliminate heads of regional offices or supervisory attorneys designated by the Attorney General, who would be allowed to request disclosure under the Nunn bill.

3. Should there be an affirmative duty on the IRS to disclose certain types of return information to law enforcement agencies? If so, how should this duty be defined and under what conditions should it apply? Should the IRS be authorized to seek an ex parte order to disclose tax returns and, if so, when and under what conditions?

As indicated in the testimony, the record discloses not that the Tax Reform Act is burdensome, or wrong, or unfairly restrictive, but that the IRS has incorrectly interpreted the law. The provision contained in the Nunn bill obligating the IRS to disclose information obtained from third parties (but not from taxpayers) which may constitute evidence of a Federal crime will help eliminate this problem. However, the scope of the IRS's responsibilities must be clarified to ensure that the IRS is not required to regularly search its files for evidence of crimes. Only evidence uncovered during the normal course of IRS' business and activities should be subjected to this provision. Absent this clarification, the IRS could become too deeply involved in crime fighting—at the expense of its basic duty to collect revenues.

The IRS, however, should not be allowed to unilaterally disclose information of any sort obtained from a taxpayer. Before any such information may be disclosed, the IRS should be required to obtain an ex parte court order, under the same standards which are applicable to requests made by Justice. IRS could seek such an order when, in the normal course of business, it discovers evidence that a specific criminal act has been committed or is being committed. The court order standard should not be relaxed under any circumstances.

4. Should corporate taxpayer return information and corporate return information be treated differently from individual taxpayer return information and individual return information insofar as disclosure restrictions are concerned? Among corporations, should different standards apply as between corporations required to register with the Securities and Exchange Commission and those which are not—that is, as between publicly held (large) corporations and others?

Privacy hearings held by the Senate Small Business Committee in November, 1979, show that businesses are quite concerned about their privacy rights. Tax return information on small businesses invariably contain personal information concerning the principals of the firm. This information shouldn't be treated differently than information obtained from the individuals involved in the business.

There is no reason to relax the burden on the government when it comes to access to records of larger corporations. For example, there is no lesser standard for search warrant orders for corporate records than for individuals records. The standard is the same because of the interest of the public as a whole to protect privacy rights by preventing "unreasonable searches and seizures" under the Fourth Amendment. Similarly, the Supreme Court has established that speech does not lose its protection under the First Amendment because it has a corporate rather than an individual origin.

5. Is there a need to change present law to allow the recipient to whom tax information has been disclosed—by court order, by written request or by IRS initiative—to redisclose to others and, if so, when and under what conditions?

No. Redisclosure increases the chances that the taxpayer's privacy rights will be violated. A taxpayer discloses information to the IRS for tax purposes—not for the use of state law enforcement agencies or foreign countries.

The potential for abuse by these subsequent recipients is great. For example, the Watergate investigations documented scores of abuses by state officials. As Jerry Litton noted in April 1975 testimony before the Senate Finance Committee: "However, I think it should not be concluded from the Watergate-related abuses that recent misuse of tax information was confined to the Nixon administration. State and local officials . . . have been responsible for equally appalling abuses—utilizing tax returns as weapons in State political campaigns and aiding in the theft of such information for use by private detectives, insurance companies, and credit firms in order to gain information on citizens which, in many cases, was used to an individual's detriment."

6. What changes, if any, should be made to present law concerning civil and criminal penalties for unlawful disclosure?

There does not appear to be any compelling reason requiring a change in these provisions. These penalties serve as an important deterrent to willful violations of taxpayer's privacy rights by government employees.

However, the proposal which would make it clear that criminal sanctions for unauthorized disclosure of tax information are to be applied only when there is an intentional violation of the disclosure provisions is acceptable. Likewise, there would not seem to be any great objection to the proposal which would hold the United States—and not the Federal official—civilly liable for negligent violations of the act. The official would still be personally liable for willful violation of disclosure provisions.

7. Are there any objections to the proposals in pending legislation and by the Administration for amending the administrative summons provisions in present law? If so, please explain.

The proposal to shift the burden from the government to the taxpayer to show why there should not be compliance with the summons conforms to the procedure in the Right to Financial Privacy Act, and is not objectionable.

However, under the proposal, only individuals and partnerships of not more than five persons would be entitled to notice of a third party summons. Corporations—no matter how small—would not be entitled to notice. This would not be acceptable. Small corporations are generally nothing more than legal shells for individuals, whose rights would be infringed upon by this proposal. Notice of a third party summons to the party whose documents are being examined—no matter how large or small—comports with the American notions of fair play and due process.

Mr. GIBSON. Gentlemen, I want to thank you for allowing us to be so informal and to go back and forth among the witnesses.

Mr. NATHAN. If I could continue, if I could make one observation following Senator Weicker, notwithstanding the vigor and eloquence of his presentation, I find it hard to discern exactly where he differs from the bill that has been put forth by the chairman in the House and by Senator Nunn and certainly from the administration proposal.

As I understand it he is in favor of some fine tuning of the legislation and in essence that is all we are seeking. We are not seeking any kind of wholesale access to books and records or to tax returns or any other kind of information that we could not get under the present statute.

We are seeking to make some amendments in the procedures that have to be followed to get that information in order to make it more readily accessible to the prosecutors so that we can pursue the organized criminals and narcotics dealers more effectively.

I should add, too, that I do not want to mislead this committee into thinking that if these adjustments are made or really any adjustments are made that that is going to be a panacea in our pursuit of those sophisticated criminals. It is going to be a difficult match.

But with the law as it is now we are severely handicapped and we are asking for modest adjustments to ease those handicaps to make our job a little bit easier and to make the benefits to law abiding society better.

Senator Weicker is exactly right. It will apply to all taxpayers and we will be obliged if we want to get the tax returns to go to court and show that we are conducting a criminal investigation of that individual and what specific crime we allege has been committed and precisely how we think those tax returns would be relevant to that investigation.

It would be a neutral magistrate or judge who would say, "Yes, you are entitled to it" and the service should turn over those tax returns.

Mr. GIBBONS. Under your proposal, wouldn't the taxpayer have the right to be informed?

Mr. NATHAN. No, it would be an ex parte proceeding. We wouldn't make a change in that regard. But we would have to show ex parte, to the judge, what the investigation is about, what the specific crime is we allege, how far we are along in it—that kind of thing—and why we think the tax information would be pertinent to that investigation of the commission of that offense.

It would not be for collateral matters. It would be solely for trying to prove that offense was committed by this individual.

I will give you an example of it in terms of the narcotics dealers. If we have information that an individual has been making large amounts of money from narcotics trafficking and we can get access to his tax return which shows that he is declaring large amounts of income from miscellaneous sources, refusing to reveal what that source is, that income tax return would be highly probative evidence in a trial of his narcotics trafficking to show that he has an unexplained source of large amounts of revenue.

It is that kind of information which we seek to use in these proceedings. We have used this information in some cases, but the difficulty has reduced our ability to secure this information and the number of tax returns we have received is dramatically down as a result of the Tax Reform Act.

Now, if I could continue in response to the specific questions that the subcommittee posed, with respect to redisclosure of tax information, the administration proposal contains no specific redisclosure provisions. We are satisfied both with present law and the Nunn bill which relates to use at the Federal level—it would be used by those people at the Federal level for investigating and prosecuting the commission of Federal crimes—those people who are necessary to that.

We do not support the provisions that relate to access by State and local law enforcement officials. We think that is an area where there has been abuse in the past and I would point out that so far as we are aware there has not been any abuse in the past, prior to the 1976 statute, by Federal prosecutors who obtained information on tax returns.

The legislative history of the 1976 statute pointed to potential abuses within the White House where they were seeking tax returns of political enemies, aides of President Nixon who sought the information, but no instance where the Department of Justice had sought the tax returns or obtained tax returns for use in criminal proceedings. In no case was information then used for political or any other improper purpose.

With respect to State and local officials, we think that they are so numerous that it would be hard to monitor how that information would be used; we do not support that part of the proposed bill.

We do propose certain changes, and these are really quite minor, with respect to the admissibility of tax information at trial or in other proceedings. We simply say that once the information has been provided to the prosecutor of the Department of Justice, its admissibility in any proceeding should be governed by the Federal Rules of Evidence like any other information which is in our hands.

We also do not support the use of this information in civil proceedings generally. The administration proposal is that in forfeiture

proceedings, which are civil proceedings related to criminal enforcement proceedings, the tax information could be utilized.

With respect to the civil penalty provisions of the Tax Reform Act, as you know the present statute subjects individual IRS employees to civil liability, which means that any individual can bring a lawsuit against the individual IRS agent. He is required to get an attorney and depending on his conduct, to have all of his assets subject to attack and be placed in jeopardy by some irate individual who may not be a very reliable person.

We propose that the civil penalty be amended to conform with the administration's proposed amendments to the Federal Torts Claims Act and the Right to Privacy Act which would restrict civil damage actions to those against the Federal agency.

So what would happen is if a claim was made against an individual, the agency would be substituted for that individual and the agency would be required to bear the cost of the litigation and furnish government attorneys and to defend the lawsuit.

Of course, if it is found that the individual acted improperly, he would be subject to administrative actions. He could be fired by the Service and further there are criminal penalties that could be considered.

With respect to the summons provision, I will leave that to Mr. Csontos from the Tax Division.

But I would like to say, in summary, that financial information is often important with respect to the investigation and prosecution of crimes involving large amounts of money such as we have in narcotics trafficking and organized crime.

Many times the tax information represents the best and sometimes the only information—the only evidence of crucial financial transactions. Further it is widely recognized that the highly trained investigators of the Internal Revenue Service are the best in the Federal Government at piecing together complex financial puzzles.

We think that the statute has gone well beyond the intent of sponsors of the 1976 act and has had a significant adverse effect on coordination and cooperation between the Service and the Department.

Commissioner Kurtz and the Department have met over a substantial period of time and a number of substantial administrative steps have been taken to mitigate the problems. We are very hopeful that they will cure a large number of the problems that we have faced in the last 3½ years, particular with respect to delay.

But beyond those administrative changes the administration believes that legislation is needed to achieve a little better balance between privacy interests and the public interest in the administration of justice.

We believe the amendments that we have described today would achieve that balance and we are deeply grateful to this subcommittee for turning from your many other pressing duties to conduct these hearings. We stand ready to help your staff and you in any information or assistance we can provide you.

Mr. GIBBONS. What is the status of the administration's suggestions? Have they been reduced to a written proposal yet? If so, I am not aware of it.

Mr. NATHAN. We have described in great detail in the Senate Finance Committee and here as well exactly what we propose. Essentially what we are doing is working off the Nunn bill. In large measure we support the Nunn bill. There are differences which we have described.

Mr. GIBBONS. Do you have a set of amendments prepared?

Mr. NATHAN. Yes, we have a set of amendments prepared and further I should tell you that Senator Nunn has suggested that his proposals are not cast in concrete and he is prepared to compromise and we are working with him to try and develop one proposal that both he and the administration can fully support. We are not far apart.

Mr. GIBBONS. Is there any kind of markup going on in the Senate? I hate to ask you that question because I should know.

Mr. NATHAN. I am not aware that there has been. There has been a hearing before the Senate Finance Committee and extensive hearings have been held, but beyond that I am not aware of what that subcommittee is doing.

Mr. GIBBONS. Sometimes there is a slip between the amendment and its enactment. You know the reason we are having these hearings, it is getting near the end of the session and we are used to the fact that some important legislation comes floating over here from the Senate without a lot of prior work on the House's part, and we want to be in shape for this one. But you do have a specific set of amendments?

Mr. NATHAN. Yes.

Mr. GIBBONS. Does our staff have these amendments? I wonder if you could let us have them so that we can examine them because eventually we are going to have to operate in this area. Out of an abundance of caution I want to make sure we do not foul up something.

Mr. NATHAN. I wanted to make this clarification. While we do have in legislative form the administration proposals, we at the same time have been trying to work with Senator Nunn and his staff and the Senate Finance Committee to compromise whatever differences there are between Senator Nunn's bill and the administration's position.

We are hopeful that we will be able to complete that process within a matter of days. So while we can give you the administration position in bill form, within a matter of days we will be able to provide slight adjustments to that which, as I understand it, Senator Nunn may find acceptable.

Mr. GIBBONS. We are going to need a lot more coordination on our side on that because the 1976 act—were you here when that was passed?

Mr. NATHAN. No, I was not. I take no blame for it.

Mr. GIBBONS. It was a delightful experience. Most of us found out what had happened a few months after it happened even though we had sat there and unraveled the pieces of it. It was very confusing about what happened. We would like not to repeat the same act twice.

Mr. NATHAN. We will work very closely with the staff, sir.

Mr. GIBBONS. All right. Mr. Jenkins, would you like to inquire?

Mr. JENKINS. I have no questions.

Mr. GIBBONS. We will have Mr. Kurtz next.

STATEMENT OF JEROME KURTZ, COMMISSIONER, INTERNAL REVENUE SERVICE, ACCOMPANIED BY N. JEROLD COHEN, CHIEF COUNSEL

Commissioner KURTZ. Mr. Chairman and members of the committee, I am pleased to appear before you to discuss the disclosure and third-party summons provisions of the code. I am accompanied by N. Jerold Cohen, Chief Counsel of the Internal Revenue Service.

I would like if I may to highlight some portions of my statement and submit the whole thing for the record.

As you know, ours is a self-assessment tax system that depends substantially on voluntary compliance by taxpayers. The Secretary of the Treasury has broad authority to require all taxpayers to file tax returns and keep records necessary to a determination of their tax liability.¹

In addition, the Secretary is authorized to examine books, papers, records, or other data relevant or material to the determination of tax liability.² These powers are essential to enable the Internal Revenue Service to obtain by administrative action information necessary for tax administration.

The scope and complexity of the tax laws require the Internal Revenue Service to make a broad range of inquiries of taxpayers, both on the returns they file and during examinations and investigations.

Last year we received more than 136 million returns from taxpayers and audited more than 1,800,000 individuals. We also initiated nearly 9,800 criminal investigations. As a consequence, the Service probably has more information concerning the lives and affairs of individuals than any other agency of the Federal Government.

The needs of law enforcement and the needs of tax administration are in some respects difficult to reconcile. The balancing of these considerations is a delicate process. We acknowledge that it is difficult to strike a precise balance between the competing policy considerations, but believe that the balance struck by the administration is appropriate and preferable to the other proposals before the subcommittee.

The administration believes that H.R. 6826 fails sufficiently to protect the legitimate privacy interests of individuals in that it would require evidence of criminal activities contained in individual taxpayers' books and records to be given to law enforcement agencies by the Internal Revenue Service.

We believe that individuals are entitled to a high degree of privacy protection in these records which they are required to maintain to meet their tax obligations and, therefore, that this information should be available only under a court order proceeding initiated by the Justice Department.

Corporations generally do not have privacy interests equal to those of individuals. Accordingly, the administration's proposal, as would H.R. 6826, requires such disclosure of criminal activities to be made in the case of certain corporations.

¹ Sec. 6001 of the Internal Revenue Code. (Unless otherwise specified, all references are to the Internal Revenue Code of 1954, as amended.)

² Sec. 7602.

Furthermore, the administration would propose amendments to section 6103 which would have the effect of decentralizing from the Washington offices of the Department of Justice to responsible law enforcement officials in the field the authority to request information, thus significantly improving the timeliness and responsiveness of such requests.

Another significant improvement proposed by the administration is to correct a problem in the existing statute which could be interpreted to require law enforcement officials to know in advance the contents of taxpayer return information before making a request for disclosure.

We also believe that the administration's position to improve the summons legislation by requiring taxpayers who oppose process against third-party recordkeepers to contest those summonses in courts will alleviate unwarranted delays in tax examinations and investigations. The administration's proposal would alleviate a substantial burden on Government with no impact on legitimate taxpayer interests.

CURRENT LAW

Section 6103 permits disclosures of tax information for Federal nontax criminal enforcement purposes subject to certain safeguards, but generally does not permit such disclosures for Federal nontax civil enforcement purposes and permits no disclosures for State nontax criminal or civil enforcement purposes.

Section 6103 creates a distinction between returns filed by taxpayers, "returns," and information furnished to the IRS by the taxpayer or his representative, "taxpayer return information," on the one hand, and information from sources other than the taxpayer, "return information," on the other.

In the case of returns and taxpayer return information, the Department of Justice and other Federal agencies must obtain a court order to obtain this information for nontax criminal enforcement purposes. To obtain the order the Department or other Federal agency must show that there is reason to believe that a specific criminal act has been committed, that there is reason to believe that the information sought is probative evidence of the matter in issue and that the information sought cannot be reasonably obtained elsewhere unless such information constitutes the most probative evidence.

In the case of return information other than taxpayer return information, disclosure is permitted to the head of a Federal agency, or to the Attorney General, the Deputy Attorney General, or an Assistant Attorney General in response to a written request setting forth certain specific information, including the specific reasons why the disclosure is or may be material to the nontax criminal proceeding or investigation.

In addition, in the case of return information other than taxpayer return information, the Secretary is authorized to volunteer evidence of a possible violation of a Federal criminal law to the head of the agency charged with enforcing that law.

SUGGESTED REVISIONS TO EXISTING LAW

In the remainder of my testimony I would like to mention two differences between H.R. 6826 and the administration's position that

are of particular importance to tax administration, discuss further the change proposed to the third-party summons provision, summarize certain changes in our administrative procedures and program emphasis, and respond to the seven questions which accompanied your letter of invitation.

SECTION 6103

One: Disclosure of returns and return information to the States for nontax purposes: The administration proposal continues the existing prohibitions on disclosures of returns or return information to the States for nontax criminal and civil enforcement purposes.

Under present law returns and return information may be disclosed to the States only in connection with the administration of State tax laws.¹ Similar restrictions were contained in the law before 1976.

To assure that tax information given to the States for tax administration purposes was not used for other purposes Congress required States to adopt safeguards to protect the tax information they received and to permit a review of the safeguards they established.²

The administration opposes the provision of R.H. 6826 that would permit redisclosure of returns and return information to State law enforcement agencies for investigations and proceedings involving State felonies. There are more than 19,000 State and local police agencies in this country. Such a widespread dissemination of tax information for nontax purposes would be extremely unwise, particularly since most police agencies are very small—more than 50 percent have 10 or fewer employees—and would be ill-equipped to provide even minimal protection for the information they secure.

Accordingly, we believe the longstanding prohibition on disclosures to State agencies for nontax purposes should be maintained.

Two: Disclosures for Federal nontax civil purposes: With certain specific exceptions section 6103 now prohibits the disclosure of returns and return information for Federal nontax civil enforcement purposes.

The administration's proposal would continue the general prohibition of disclosure of tax information for Federal civil purposes but would make clear that such disclosures could be made to provide evidence in any administrative or judicial proceeding involving a civil forfeiture related to the enforcement of a Federal criminal statute. There has been no showing that any broader change is necessary.

SECTION 7609

Section 7609 requires the Internal Revenue Service to provide the taxpayer with notice in connection with service of summons on certain specified "third-party recordkeepers." Following receipt of this notice the taxpayer has 14 days to notify the summoned party not to comply with the summons and to furnish a copy of that notification to the Service. If the taxpayer does so, the Service must then obtain a court order to obtain the summoned records.

At the time of its enactment, both the Service and the Department of Justice seriously questioned whether section 7609 should be enacted because we believe that the provision extended no additional substantive rights to taxpayers and offered opportunities to those who wished to delay or defeat tax investigations and examinations.

¹ Sec. 6103(d).

² Sec. 6103(p)(4).

While acknowledging the validity of these arguments, Congress enacted section 7609 in the belief that the taxpayer himself would be more likely to assert whatever defenses to summons enforcement were available under existing law than would the third-party recordkeeper.

Whatever procedural or substantive protections may be accorded taxpayers by the third-party summons procedures, it is clear that permitting taxpayers to stay compliance by simply sending a written notification to the summoned party imposes a substantial burden on the Federal Government that is not justified to protect the legitimate interests of taxpayers.

There have been very few instances in our 3½ years of administration of this statute where taxpayers have raised valid defenses to summons enforcement. Legitimate taxpayer interest would be equally protected if the taxpayer were required to file a motion to quash with the Federal District Court.

RECENT ADMINISTRATIVE CHANGES

In its testimony on April 22, 1980, before the Treasury, Postal Service and General Government Subcommittee of the Senate Committee on Appropriations, GAO noted that IRS could reduce the time required to process requests for returns and return information pursuant to court orders issued under section 6103(i)(1) by decentralizing our disclosure approval authority.

GAO made a similar suggestion regarding decisions to disclose evidence of possible nontax crimes obtained from third parties pursuant to section 6103(i)(3).

Under the then-existing procedures, all such disclosures required review and approval by the Disclosure Operations Division in our national office. Although GAO had found that the Service was generally as timely as possible in its response to court orders and requests for disclosures under sections 6103(i)(1) and (2),¹ it found this national office review needlessly delayed the dissemination of requested information.

I would like to summarize certain changes in our administrative procedures and program emphasis and respond to the seven questions which accompanied your letter of invitation.

On June 1, 1980, we revised Delegation Order 156 to permit district directors and assistant district directors to make direct disclosures of returns and return information to the Department of Justice and other Federal law enforcement agencies without national office approval.

In the same delegation order we authorized regional commissioners to make disclosures of possible violations of Federal nontax criminal statutes under section 6103(i)(3).

These changes in procedure are also reflected in revisions to the Internal Revenue Manual published on June 16, 1980. Among other things, these revisions establish specific timeframes for responding to both routine and emergency requests for returns and return information, and require district, regional and national office officials to be come personally involved when those time frames are not met.

¹ See "Disclosure and Summons Provisions of 1976 Tax Reform Act—Privacy Gains With Unknown Law Enforcement Effects" (G.G.D. 78-110) (Mar. 12, 1979) and "Disclosure and Summons Provisions of 1976 Tax Reform Act—An Analysis of Proposed Legislative Changes" (G.G.D. 80-____) (June 18, 1980).

I have attached to my statement a chart¹ which compares the procedures now in place with those that were used before June 1, 1980. To facilitate the transition to the new procedures, we have trained our regional and district disclosure personnel, coordinated our planning efforts with the Department of Justice and established a "hotline" between the Department of Justice and our Disclosure Operations Division to handle any problems that may arise.

In addition, we have established an IRS/Department of Justice Coordinating Committee to assure active and ongoing cooperation between the agencies, and instructed our field officials to contact their U.S. attorney and offer to brief them on the new procedures.

Finally, we are establishing procedures to identify all requests for returns and return information under sections 6103(i) (1) and (2) as priority items in requests to Federal Records Centers where much of the information requested is stored.

To improve the efficiency of our cooperation with other law enforcement agencies in joint criminal investigations, we also revised our grand jury approval procedures. Timeframes have been established for each level of managerial approval of the request: 10 workdays for the Chief of the District's Criminal Investigation Division, 5 workdays for the District Director, 5 workdays for the Regional Commissioner and 10 workdays for the Regional Counsel.

Approval authority for grand jury requests has been delegated to our regional commissioners, who may redelegate that authority to the assistant regional commissioners—Criminal Investigation. These approvals must receive the concurrence of the Regional Counsel. Expansions of existing grand jury authorizations now may be approved by District Directors with the concurrence of the Deputy Regional Counsel—Criminal Tax.

In addition, we believe that recent and anticipated changes in our criminal enforcement program will result in increased Service participation in the prosecution of those whose criminal activity involves both tax and nontax laws.

Our limited criminal enforcement resources are allocated, like other Service enforcement resources, to all segments of our society in an attempt to assure compliance by all types of taxpayers. In the past, 25 to 30 percent of our total criminal enforcement effort has been devoted to our special enforcement program.

This program includes investigations of organized crime figures, strike force targets, and narcotics traffickers. In the next fiscal year we are considering increasing the special enforcement program allocation to between 35 and 45 percent of the total program, with particular emphasis on the narcotic program and an increased utilization, in appropriate cases, of interagency grand jury investigations.

Moreover, we have recently revised our memorandum of understanding with the Drug Enforcement Administration to increase the volume and quality of DEA referrals to our Criminal Investigation Division. Under the revised agreement, DEA is to furnish the Service quarterly listings of all high-level drug traffickers and financiers that are identified as DEA "class I" or "class II" violators.

On June 5, 1980, DEA furnished a list of approximately 14,000 leads, which have been distributed to our field offices for association

¹ Exhibit A.

with available information and evaluation as to their tax potential. These leads will be tracked under established procedures to permit us to assess the value of these expanded referrals. We are also working with DEA to improve the liaison between our respective field offices.

In the aggregate, we believe these changes will result in a substantial increase in the level and quality of assistance and cooperation between the Internal Revenue Service and other Federal law enforcement agencies. We also believe that the administration's legislative proposals will enhance cooperative law enforcement efforts.

SPECIFIC SUBCOMMITTEE INQUIRIES

As you requested in your letter of invitation we address the seven specific questions proposed in the appendix to your letter as follows:

One: How should the standards of an ex parte order be changed?

Under present law, the court order can be obtained only upon a showing that (1) reasonable cause exists to believe that a specific criminal act has been committed, (2) there is reason to believe that the return or return information is probative evidence of the matter in issue related to the commission of the criminal act, and (3) the information sought either cannot reasonably be obtained from another source or constitutes the most probative evidence of the matter in issue.

The third of these requirements could be interpreted to require law enforcement officials to know in advance the content of the taxpayer return information before seeking a court order.

The administration's proposal would require a showing that (1) there is reasonable cause to believe that a specific criminal act has been or is being committed, (2) the information sought is sought exclusively for use in a Federal criminal investigational proceeding concerning that criminal act, and (3) there is reasonable cause to believe the information may be relevant to a matter relating to the commission of the criminal act.

Two: What level of administration official should be allowed to request disclosure from the IRS under section 6103(i)(2) of the Internal Revenue Code?

Under existing law, such a request can be made only by the head of a Federal agency for use in enforcement of a specifically designated Federal criminal statute, by the Attorney General, the Deputy Attorney General, or an Assistant Attorney General.

The administration's proposal would continue to permit heads of agencies to make requests in connection with enforcement of a specific Federal criminal statute. The administration's proposal would also permit such requests by the Inspector General of any such agency.

Moreover, the administration's proposal would permit the Attorney General or his designee to request information pursuant to section 6103(i)(2). This change would have the effect of decentralizing the authority to request such information from the Washington offices of the Department of Justice to responsible law enforcement officials in the field who are not a part of the investigating team.

Together with our own administrative action decentralizing the disclosure authority to our field offices, we believe this change would improve the timeliness of requests and responses while assuring

appropriate levels of review within both the Department and the Service.

Three: Should there be an affirmative duty on the IRS to disclose certain types of return information to law enforcement agencies? If so, how should this duty be defined and under what conditions should it apply? Should the IRS be authorized to seek an ex parte order to disclose tax returns and, if so, when and under what conditions?

The administration believes there should be an affirmative duty on the IRS to disclose return information, other than taxpayer return information, evidencing a possible violation of a Federal criminal law to the head of the agency charged with enforcing that law.

The administration does not believe that there should be any affirmative duty on the IRS to initiate a court order procedure to disclose returns or taxpayer return information to law enforcement agencies.

With respect to this information, the administration believes that the taxpayer is entitled to essentially the same protections that would exist if the taxpayer himself continued to hold the information.

We believe that these protections are appropriate both because ours is a self-assessment tax system that depends substantially on voluntary compliance by taxpayers and because individual taxpayers are entitled to a high degree of privacy protection in the records which they are required to maintain to meet their tax obligations.

The administration believes that these interests are best protected by requiring any court order proceeding to be initiated by the Department of Justice under the disclosure standards I described earlier.

A provision allowing the Service to initiate a court order procedure to disclose taxpayer return information for nontax criminal investigations would leave taxpayers in the dilemma of complying with the tax laws at the risk of prosecution for nontax criminal violations.

Four: Should corporate taxpayer return information and corporate return information be treated differently from individual taxpayer return information and individual return information insofar as disclosure restrictions are concerned? Among corporations, should different standards apply as between corporations required to register with the Securities and Exchange Commission and those which are not, that is, as between publicly held large corporations and others?

The needs of law enforcement and the needs of tax administration are in some respects difficult to reconcile. Although we believe there is a value to the tax system in protecting the returns and return information of both individuals and corporations, corporations generally do not have privacy interests equal to those of individuals, and therefore, the administration's proposal requires that disclosure of criminal activity be made in the case of certain corporations.

Five: Is there a need to change present law to allow the recipient to whom tax information has been disclosed, by court order, by written request or by IRS initiative, to redisclose to others and, if so, when and under what conditions?

Necessary redisclosures are permitted under existing law. Accordingly, the administration sees no need for change in this area.

Six: What changes, if any, should be made to present law concerning civil and criminal penalties for unlawful disclosure?

The administration believes that the civil penalty should be amended to provide that the Internal Revenue Service, rather than individual employees, be liable in cases where the employee knowingly, or by reason of negligence, discloses a return or return information in violation of section 6103.

Seven: Are there any objections to the proposals in pending legislation and by the administration for amending the administrative summons provisions in present law? If so, please explain.

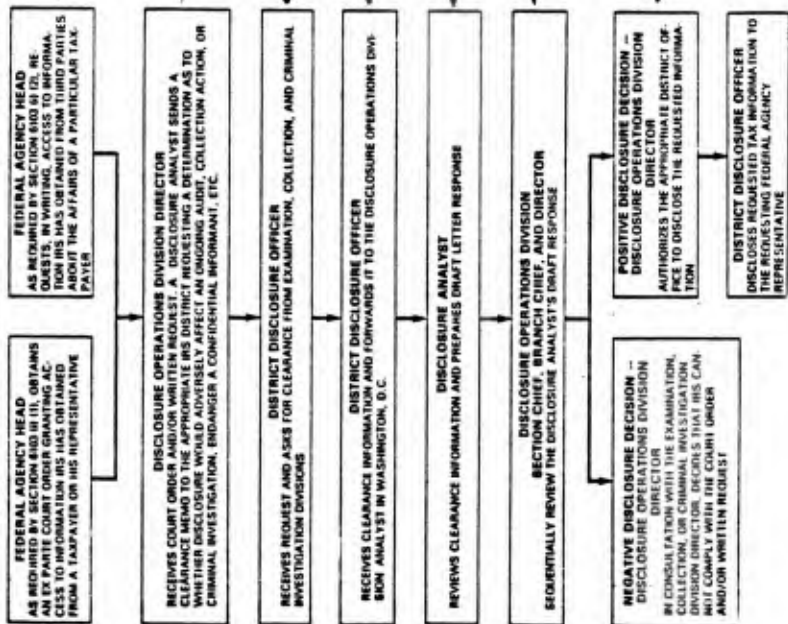
We support proposals to amend the administrative summons provisions in present law with the modifications suggested by Assistant Attorney General Ferguson in his testimony before the Finance Committee's Oversight Subcommittee.

Mr. Chairman, that concludes my testimony. We would be pleased to respond to your questions.

[An attachment to the statement follows:]

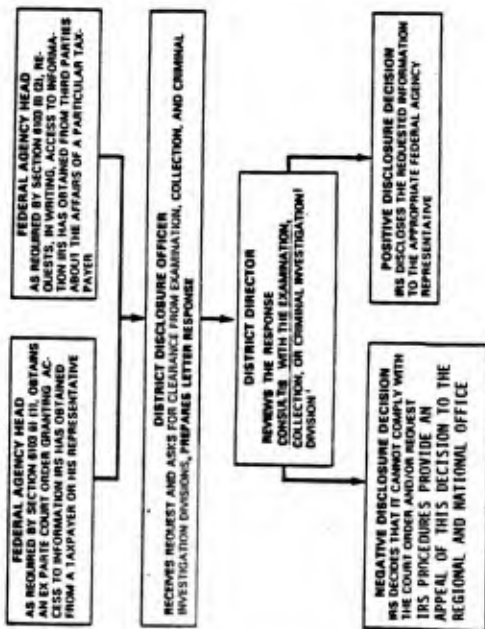
PREVIOUS PROCEDURE - 1/1/77 to 5/31/80

PROCESS FOR DISCLOSURING INFORMATION UNDER I.R.C. §103 (1) AND (2)



PRESENT PROCEDURE - EFFECTIVE 6/1/80

IRS ADMINISTRATIVE PROCESS FOR DISCLOSING INFORMATION UNDER I.R.C. §103 (1) AND (2)



**STATEMENT OF STEPHEN J. CSONTOS, LEGISLATIVE COUNSEL,
TAX DIVISION, DEPARTMENT OF JUSTICE**

Mr. CSONTOS. I also welcome the opportunity to discuss with the subcommittee the summons provisions of the Internal Revenue Code as amended in 1976. I have a prepared statement and I don't propose to read that to you this evening.

Mr. GIBBONS. It will be made a part of the record.
[The prepared statement follows.]

**STATEMENT OF STEPHEN J. CSONTOS, LEGISLATIVE COUNSEL, TAX DIVISION,
DEPARTMENT OF JUSTICE**

Mr. Chairman and members of the subcommittee, thank you for the opportunity to discuss tax summonses issued by the Internal Revenue Service to financial institutions and other third-party recordkeepers. I know we all share the common goal of lessening the enormous delays which now exist in obtaining financial records necessary for tax audits and investigations. At the same time, all of us are eager to maintain taxpayers' interests to the maximum extent possible.

As you no doubt know, the current Section 7609 was enacted by Congress in 1976. Its purpose was to give each taxpayer a notice that records pertaining to him had been summoned from a bank or other recordkeeper, and an opportunity to challenge the summons in court.

Shortly after the enactment of Section 7609, it became apparent that these statutory procedures were causing unnecessary delays. Indeed, when the Right to Financial Privacy Act—which governs similar summonses issued by non-tax agencies—was proposed in 1978, Congress recognized the infirmities in Section 7609 and established new procedures which were designed to minimize delays in enforcing nontax summonses.

It is clear that the current Section 7609 procedures excessively delay the activities of the Internal Revenue Service in obtaining records and proceeding with the tax investigation. These needless delays occur in litigating and obtaining court enforcement of the summons—the activity in which the Tax Division is directly involved—and also in obtaining the records and proceeding with the tax investigation—which of course are the responsibilities of the Internal Revenue Service.

Our aim is to find the proper balance between the interests of taxpayers with respect to their financial records, and the legitimate law enforcement needs of the Internal Revenue Service. We believe that the current Section 7609 provisions unnecessarily delay the Service's access to financial records which are necessary for tax audits and investigations. At the same time, it is apparent that procedures could be drafted which allow taxpayers to protect their interests without delaying tax law enforcement.

The principal cause of delay under the present statute stems from the provision which allows a taxpayer merely to send a letter of objection in order to stay summons compliance, when records pertaining to him are summoned from a recordkeeper. This procedure encourages taxpayers to obtain letter-stays in all cases because the letter procedure is so informal, and no specific grounds for objection need be stated in the letter. The letter has the same effect as a judicial restraining order, and the Service is then faced with the task of reviewing the entire file and forwarding the case to Justice for the filing of an enforcement action in district court. In the meantime the revenue or special agent's investigation has been impeded if not halted.

Most of the letter objections are sent solely to obtain the stay (and the resulting investigation delay), as is demonstrated by statistics set forth in a recent GAO Report.¹ GAO estimated that taxpayers stayed 2,313 summonses by letter in the 13-month period immediately following enactment of Section 7609. Yet taxpayers only exercised their rights to intervene in 217 summonses enforcement proceedings filed in court by the Government in that period. Thus an enormous number of

¹ Report by the Comptroller General on "Disclosure and Summons Provisions of 1976 Tax Reform Act—Privacy Gains with Unknown Law Enforcement Effects," p. 32 (Mar. 12, 1979).

investigations are halted by letter-stays, even though only a small proportion of the summonses are actually contested in court. This situation is aggravated because under present law, the statutes of limitations for criminal and civil tax purposes keep running during the letter-stay, and the running of the limitations period is not suspended until the Government formally files in court its enforcement petition.

The motion-to-quash procedure, which is used in H.R. 6764 and is derived from the Right to Financial Privacy Act, is the key to eliminating these stays by letter and the attendant unnecessary delays. Under the motion-to-quash procedure, a taxpayer would be notified as at present when records pertaining to him are summoned from a recordkeeper. But the summons would only be stayed initially for 14 days. During this time, the taxpayer would have to file in federal district court a motion to quash in order to obtain any further stay of compliance. H.R. 6764 also contains provisions designed to expedite the motion-to-quash proceedings, and thus cut delays in summons compliance to a minimum.

For the reasons which we shall set forth, we enthusiastically welcome the introduction of H.R. 6764 and support it. However, we believe several refinements of H.R. 6764 may enable it to better accomplish its objectives. With the Chairman's permission, I would like to submit for inclusion in the record a draft statute which formally incorporates these suggested refinements.

First, we agree with the H.R. 6764 requirement that the taxpayer's motion to quash contain sworn facts demonstrating his basis for objecting to the summons, but would add a provision allowing the court to deny the motion forthwith if the taxpayer's affidavits do not make out a prima facie case that the summons is unenforceable for any reason. This requirement would deter a great many taxpayers with frivolous or totally groundless objections from even filing a motion to quash. The result would be a speedier resolution of tax issues to the mutual benefit of taxpayers and the Government.

Second, H.R. 6764 should contain a provision specifically authorizing the district court to summarily deny those motions to quash which fail to establish a prima facie case—such as in most tax protester cases. This provision would cut delays considerably by eliminating the need for time-consuming hearings, briefs from the parties, and the like. H.R. 6764 does not specifically address this point.

Third, under current law a bank or other recordkeeper must often appear in court when the taxpayer challenges a recordkeeper summons, even though the recordkeeper has no objection to the summons. H.R. 6764 properly relieves recordkeepers of the burden by requiring the taxpayer to initiate and litigate the motion to quash. We suggest that a provision be added which would relieve recordkeepers of all liability to any person when they produce customer records in good faith compliance with judicial or administrative orders issued under the statute. Further, we would like to have an additional provision which would require the recordkeeper to intervene in the motion-to-quash proceeding if it wished to assert its own objection to the summons—for example, the alleged burdensomeness of the summons. Under H.R. 6764, it would be possible for the recordkeeper to sit out the taxpayer's motion-to-quash proceedings, and then delay the summons later by litigating its own objection in a separate proceeding. Of course, this suggested procedure would not require the recordkeeper to appear in any proceeding if it wished to comply with the summons.

Fourth, we would suggest adding a provision to make it clear that federal magistrates may conduct all proceedings in recordkeeper summons cases, thus relieving the crowded dockets of the district courts and expediting the proceedings. With the consent of the parties, the magistrate would be allowed to enter the final decision without any review by the district court. In general, such a provision would apply the jurisdictional provisions of the Federal Magistrate Act of 1979 Public Law 96-82, to tax recordkeeper summonses.

We believe that H.R. 6764, with these proposed refinements, would drastically decrease the number of recordkeeper summonses which are stayed and the number which are litigated. As a result of the enactment of Section 7609 in 1976, the number of summons cases brought by the Justice Department tripled. While it is difficult to make anything more than rough estimates, we believe that adoption of these motion-to-quash procedures would dramatically decrease the number of recordkeeper summonses which are stayed, and would expedite the remainder. Figures appearing in a GAO Report indicate that the Government obtained enforcement in 765 out of 771 recordkeeper summons cases in the first 16 months after Section 7609 went into effect.² Manifestly, the only benefit of forcing the

² *Id.*, p. 46.

Government to court in most of these cases was to impede and delay the Government's tax investigation. Few taxpayers will likely be willing to burden the courts with groundless cases if they could be disposed of quickly by a judge or magistrate, with little delay in summons compliance. Under a similar motion-to-quash procedure, only 15 motions to quash were filed under the Right to Financial Privacy Act in the first eight months it was in effect.³

I would like now to discuss the H.R. 6764 appeal procedures. The GAO statistics make it apparent that the appeal procedures would affect only relatively few cases. However, when appeals do occur, they can have considerable importance because of their potential for delaying the investigation for years, and because of the important substantive rights that may be involved. The appeals provisions must also be carefully considered because they raise other important issues respecting the administration of the revenue laws.

Under H.R. 6764, if a taxpayer is denied a motion to quash in a final decision of the district court, the recordkeeper is obligated to turn over forthwith the summoned records to the Government. The taxpayer may not immediately appeal the denial of his motion to quash. Instead, in order to appeal he must wait until either he or the Government files a substantive tax action—viz, a criminal proceeding or collection action filed by the Government; a refund suit or Tax Court action filed by the taxpayer; or bankruptcy proceedings. The taxpayer may then press the allegedly improper denial of his motion to quash as a basis for appealing the substantive tax action. If he prevails on the appeal, the taxpayer is entitled to damages and attorneys' fees. If no substantive tax action is brought, the taxpayer would lose his right to appeal the summons question.

We submit for your consideration a somewhat different approach, which would allow every taxpayer an opportunity for immediate appellate review of the final denial of his motion to quash. After the district court denied the motion to quash, the taxpayer would be required to obtain a stay of the order from the court of appeals within 10 days in order to stop the recordkeeper from complying. The court of appeals would apply the usual stay requirements, which include a demonstration of the taxpayer's irreparable injury plus a showing that the taxpayer is likely to prevail. Only if the stay were granted could the taxpayer proceed with his appeal, because in the Government's view the turnover of the records moots the appeal. The appellate stay—and thus the time period for deciding the appeal—would be limited to six months.

The appeal procedure we suggest would contain a valuable provision for expediting district court proceedings. H.R. 6764 has provisions requiring the court to enter its decision 10 days after the Government's response is filed. Similar deadlines in the Right to Financial Privacy Act and Code Section 7429 have consistently been ignored, however. Accordingly, we suggest that, if the district court or magistrate does not issue a final decision within 30 days of the filing of the Government's response to the motion to quash, the Government should be able to issue an administrative order—a so-called certificate of compliance. If the taxpayer did not obtain an appellate stay of such certificate within 10 days, the recordkeeper would have to turn over the records to the Government. This procedure would be somewhat similar to that in Section 3310 of the Internal Revenue Code, which provides for prompt enforcement by the Internal Revenue Service of certain orders of the Secretary of Labor, unless a stay is obtained from the court of appeals. This provision would provide extra assurance that the district court or magistrate would quickly adjudicate motions to quash.

We believe that the immediate appeal procedure which we suggest is preferable to the delayed appeal procedure in H.R. 6764 for several reasons.

First, we would like to see a continuation of the current procedure of allowing taxpayers an opportunity to have an immediate appellate review before any turnover of records to the Government, with certain expediting refinements. By contrast H.R. 6764 follows the Right to Financial Privacy Act model, which requires deferred appeals in recordkeeper summons cases, even though immediate appeals would still be allowed in all other tax summons cases. We submit that it may be preferable to allow immediate appeals in all summons cases, and think it is possible to do so.

Second, we would prefer to have provisions which would give all taxpayers who lose in the district court an opportunity to obtain appellate review of the summons

³ Administrative Office of the United States Court, "Report on the Applications for Delays of Notice and Customer Challenges under Provisions of the Right to Financial Privacy Act of 1978."

issue in recordkeeper cases, as they can in all other summons cases. We recognize that H.R. 6764 has departed from the Right to Financial Privacy Act in this regard, presumably in recognition of the difficulties in drafting and administering analogous appeal provisions because of the multiplicity of types of tax litigation. Nonetheless, the immediate appellate review which we suggest, which is somewhat more limited than that under the current Section 7609, which seem to be workable while allowing all taxpayers and intervenors the right of appeal, and yet avoiding the difficulties which H.R. 6764 properly anticipates.

Third, we think that there is much merit in the current summons procedure of allowing taxpayers an opportunity to obtain appellate review in virtually all cases before the records have to be turned over to the Government, and suggest that this procedure be continued if possible in the appeals provisions. H.R. 6764 defers the taxpayer's appeal until after the records are turned over to the Government, which of course has the obvious effect of assuring the delays end when the trial court issues its decision. Nonetheless, we think that appellate stay provisions can be drafted which would dispose of groundless taxpayer appeals within a few days, but which would assure that taxpayers, financial institutions, and the Government would have the benefit of a prompt appellate decision in taxpayer or intervenor appeals raising important and substantial issues.

Fourth, we think that it would considerably expedite summons litigation if the statute contained a provision allowing the Government to issue the administrative certificate of compliance requiring turnover of records within 10 days, if the district court unduly delayed its decision and the taxpayer or intervenor was denied an appellate stay of the certificate. We think that some such procedure is necessary, because experience under the Right to Financial Privacy Act and other statutes indicates that trial courts frequently do not heed time limitations on decisions, such as the 10-day limit in H.R. 6764. Such a certificate of compliance would probably only be practicable if the statute contained immediate appeal provisions along the lines which we recommend.

Two other points should be mentioned. Under current law, the statutes of limitations for tax purposes are suspended from the time the Government brings the summons enforcement action until the litigation has been concluded. H.R. 6764 would continue this pattern, suspending the limitations period for the period from the time the taxpayer files the motion to quash until such litigation has been concluded. Because frequently a significant amount of time elapses after conclusion of litigation before the records are turned over to the Service, we suggest that the suspension period be extended until such turnover is complete. Moreover, we urge that the H.R. 6764 statute of limitations period be applied to Section 7602 nonrecordkeeper summonses as well. We fear that if H.R. 6764 eliminates delays from recordkeeper cases, taxpayers might try to delay investigations by protracting nonrecordkeeper summonses, absent a limitations suspension provision.

We also wish to note that H.R. 6764 defines the persons who are entitled to receive the notice and file a motion to quash somewhat differently from current law. H.R. 6764—like the Right to Financial Privacy Act—excludes from the terms of the statute corporations, and partnerships containing more than five persons. We agree with this exclusion, because such corporations and partnerships are normally more commercial in character, and have less basis for protecting their financial records from disclosure.

In conclusion, we believe that H.R. 6764—particularly if it can embody some or all of the refinements we suggest—will go a long way toward eliminating major delays in the tax investigation process, thereby enabling the Internal Revenue Service to make better use of its investigative resources. These changes should also reduce court congestion and expedite trial and appeal of cases challenging recordkeeper summonses.

S. 2403 WITH PROPOSED REFINEMENTS

(a)(1):

(a) Notice.—

(1) *In General.*—If—

(A) any summons described in subsection (c) is served on any person who is a third-party recordkeeper, and

(B) the summons requires the production of any portion of records made or kept of the business transactions or affairs of any person (other than the person summoned) who is identified in the description of the records contained in the summons.

then notice of the summons shall be given to any person so identified within 3 days of the day on which such service is made, but no later than the 14th day before the day fixed in the summons as the day upon which such records are to be examined. Such notice shall be accompanied by a copy of the summons which has been served and shall contain directions for staying compliance with the summons under subsection (b)(2). Such notice shall be accompanied by a copy of the summons which has been served and shall contain directions for filing a motion to quash the summons under subsection (b)(2). [Current law with last sentence as added by S. 2403.]

(a)(2):

(2) *Sufficiency of Notice.*—Such notice shall be sufficient if, on or before such third day, such notice is served in the manner provided in section 7603 (relating to service of summons) upon the person entitled to notice, or is mailed by certified or registered mail to the last known address of such person, or, in the absence of a last known address, is left with the person summoned. If such notice is mailed, it shall be sufficient if mailed to the last known address of the person entitled to notice or, in the case of notice to the Secretary under section 6903 of the existence of a fiduciary relationship, to the last known address of the fiduciary of such person, even if such person or fiduciary is then deceased, under a legal disability, or no longer in existence. [Current law.]

(a)(3):

(3) *Definitions.*

(A) "Third-party recordkeeper means—

(i) any mutual savings bank, cooperative bank, domestic building and loan association, or other savings institution chartered and supervised as a savings and loan or similar association under Federal or State law, any bank (as defined in section 581), or any credit union (within the meaning of section 501(c)(14)(A));

(ii) any consumer reporting agency (as defined under section 603(d) of the Fair Credit Reporting Act (15 U.S.C. 1681a(f));

(iii) any person extending credit through the use of credit cards or similar devices;

(iv) any broker (as defined in section 3(a)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(4));

(v) any attorney; and

(vi) any accountant.

(B) "Persons entitled to notice" means any individual or partnership of not more than five individuals. [As amended by S. 2403.]

(a)(4):

(4) *Exceptions.*—Paragraph (1) shall not apply to any summons—
 (A) served on the person with respect to whose liability the summons is issued, or any officer or employee of such person,
 (B) to determine whether or not records of the business transactions or affairs of an identified person have been made or kept, or
 (C) described in subsection (f). [Current law.]

(a)(5):

(5) *Nature of Summons.*—Any summons to which this subsection applies (and any summons in aid of collection described in subsection (c)(2)(B)) shall identify the taxpayer to whom the summons relates or the other person to whom the records pertain and shall provide such other information as will enable the person summoned to locate the records required under the summons. [Current law.]

(b)(1):

(1) *Challenge to Summons.*—

Within fourteen days after the day notice is given in the manner provided in subsection (a)(2), a person entitled to notice of a summons under subsection (a) may file a motion to quash the summons with copies served upon the person summoned, upon the Attorney General and the United States Attorney for the district where the motion is filed, and upon such person and to such office as the Secretary may direct in the notice referred to in subsection (a)(1). Service shall be made under this subsection by delivering or mailing by registered or certified mail. A motion to quash a summons shall be filed in the United States district court for the district in which the person en-

titled to notice resides. Such motion shall contain an affidavit or sworn statement stating—

(A) that the movant is the person to whom the records sought by the summons relate; and

(B) the reasons that the records sought are not relevant to a legitimate tax inquiry or any other legal basis for quashing the summons. [Subsection (b)(2), paragraph one, of S. 2403, as modified.]

(b)(2):

(2) If the court finds that a person entitled to notice under subsection (a) has complied with subsection (b)(1), it shall order the United States to file a response within 20 days. The United States may file a response whether or not it is ordered to do so. [Subsection (b)(2), paragraph two of S. 2403, as modified.]

(b)(3):

(3) Within ten days after the motion to quash is served, the person summoned may file a motion to intervene containing an affidavit or sworn statement setting forth the specific grounds therefor, with service upon the United States as prescribed in subsection (b)(1). Failure to intervene in the motion-to-quash proceeding shall be deemed a waiver of the objections of the person summoned to enforcement. The person summoned may object to the summons on any legal basis. The court may order the United States to file a response to the motion to intervene. The response shall be due within 20 days. The United States may file a response whether or not it is ordered to do so. [New.]

(b)(4):

(4) If the court is unable to determine the motion to quash or the motion to intervene on the basis of the parties' initial allegations and response, the court may conduct such additional proceedings as it deems appropriate. All such proceedings shall be completed and the motion or application decided within ten days after the filing of the response of the United States to the motion to quash, or the response of the United States to the motion to intervene, whichever is later. [Subsection (b)(2), paragraph two, of S. 2403, as modified.]

(b)(5):

(5) The challenge procedures of this section constitute the sole judicial remedy available to a person entitled to notice under subsection (a) to oppose disclosure of records summoned pursuant to this section. [Subsection (b)(2), paragraph four, of S. 2403, as renumbered.]

(b)(6):

(6) Nothing in this section shall entitle a person entitled to notice under subsection (a) to assert the rights of a third-party. [Subsection (b)(2), last paragraph of S. 2403, as renumbered.]

(c):

(c) *Summons to Which Section Applies.*—

(1) *In General.*—Except as provided in paragraph (2), a summons is described in this subsection if it is issued under paragraph (2) of section 7602 or under section 6420(e)(2), 6421(f)(2), 6424(d)(2), or 6427(g)(2) and requires the production of records.

(2) *Exceptions.*—A summons shall not be treated as described in this subsection if—

(A) it is solely to determine the identity of any person having a numbered account (or similar arrangement) with a bank or other institution described in subsection (a)(3)(A), or

(B) it is in aid of the collection of—

(i) the liability of any person against whom an assessment has been made or judgment rendered; or

(ii) the liability at law or in equity of any transferee or fiduciary of any person referred to in clause (i).

(3) *Records; Certain Related Testimony.*—For purposes of this section—

(A) the term "records" includes books, papers, or other data, and

(B) a summons requiring the giving of testimony relating to records shall be treated as a summons requiring the production of such records. [Current law.]

(d):

(d) *Restriction on Examination of Records.*—No examination of any records required to be produced under a summons as to which notice is required under subsection (a) may be made—

(1) before the expiration of the 14-day period allowed for the motion to quash under subsection (b)(2), or

(2) upon the filing of a motion to quash pursuant to subsection (b)(2) except in accordance with an order of the court, or a certificate of compliance issued pursuant to subsection (j). [S. 2403, as modified.]

(e):

(e) *Suspension of Statute of Limitations.*—If any person is a party to a summons enforcement action brought under section 7602 or a motion to quash proceeding brought under subsection 7609(b), and such person is the person with respect to whose liability the summons is issued (or is the agent, nominee, or other person acting under the direction or control of such person, or the attorney, accountant, or partner of such person, or a corporation of which such person is a controlling shareholder), then the running of any period of limitations under section 6501 relating to the assessment and collection of tax) or under 6531 (relating to criminal prosecutions) with respect to such person shall be suspended for the period consisting of (1) the time when there is pending a proceeding, and appeals therein, with respect to any litigation relating to the summons, plus (2) the additional time until all production orders of the court, and any certificate of compliance issued pursuant to subsection (j), are satisfied. [S. 2403, as modified.]

(f):

(f) *Additional Requirement in the Case of a John Doe Summons.*—Any summons described in subsection (c) which does not identify the person with respect to whose liability the summons is issued may be served only after a court proceeding in which the Secretary establishes that—

(1) the summons relates to the investigation of a particular person or ascertainable group or class of persons,

(2) there is a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provision of any internal revenue law, and

(3) the information sought to be obtained from the examination of the records (and the identity of the person or persons with respect to whose liability the summons is issued) is not readily available from other sources. [Current law.]

(g)(1):

(g) *Special Exception for Certain Summonses.*—

(1) In the case of any summons described in subsection (c), the provisions of subsections (a)(1) and (b) shall not apply if, upon petition by the Secretary, the court determines, on the basis of the facts and circumstances alleged, that there is reasonable cause to believe the giving of notice may lead to attempts to conceal, destroy, or alter records relevant to the examination, to prevent the communication of information from other persons through intimidation, bribery, or collusion, or to flee to avoid prosecution, testifying, or production of records. [Current subsection (g), as renumbered.]

(g)(2):

(2) If the court or magistrate issues an order under subsection (g) 1), it shall have jurisdiction to enter an *ex parte* order prohibiting the recordkeeper from disclosing that records have been obtained or that a request for records has been made. [New.]

(h):

(h) *Jurisdiction of District Court.*—

(1) The United States district court for the district within which the person to be summoned resides or is found shall have jurisdiction to hear and determine proceedings brought under subsections (f) or (g). The determinations required to be made under subsections (f) and (g) shall be made *ex parte* and shall be made solely upon the petition and supporting affidavits. An order denying the petition shall be deemed a final order which may be appealed.

(2) Except as to cases the court considers of greater importance, a proceeding brought for the enforcement of any summons, or a proceeding

under this section, and appeals, take precedence on the docket over all cases and shall be assigned for hearing and decided at the earliest practicable date. [Current law.]

(i):

(i) *Duty of Third Party.*—Upon receipt of a summons described in subsection (c), the third-party recordkeeper shall, unless otherwise provided by law, proceed to assemble the records requested and must be prepared to produce the records pursuant to the summons on the day upon which the records are to be examined, or in the event a motion to quash has been filed, within ten days after entry of (1) the final order of the district court or magistrate, or (2) the issuance of the certificate described in subsection (j). Any third-party recordkeeper, or agent or employee thereof, making a disclosure of financial records pursuant to this section in good-faith reliance upon a certificate described in subsection (j), or an order of a court requiring production of records, shall not be liable to any customer or other person for such disclosure. [S. 2403, as modified.]

(j):

(j) If a final order of the district court or magistrate has not been filed within 30 days after the last response of the United States described in subsection (b)(4), the United States may certify in writing to the recordkeeper described in subsection (c) that it has complied with the applicable provisions of this section. The recordkeeper shall produce the summoned books or other data ten days thereafter, unless prior to that time the district court or magistrate quashes the summons or a stay is obtained pursuant to subsection (k). [New.]

(k):

(k) *Denials of Motion to Quash; Jurisdiction of Courts of Appeals.*—The courts of appeals, or a judge thereof, shall have jurisdiction, pending a hearing by the court:

(1) to stay an order of the district court or magistrate under this section ordering or staying compliance with a summons;

(2) to stay a certificate of compliance issued pursuant to subsection (j); or

(3) to modify or dissolve an order staying a certificate of compliance issued pursuant to subsection (j).

Such order of the court of appeals shall be filed within ten days after there has been filed in the court of appeals either (i) an application for stay, or (ii) an application for modification or dissolution of a district court stay.

The total period during which the court of appeals may stay an order requiring compliance, or a certificate of compliance, shall not exceed 6 months.

(l):

(l) *Jurisdiction of Magistrates.*—

(1) A United States magistrate, when designated or requested pursuant to section 636(b)(3) and (c)(1) of Title 28, may exercise jurisdiction over all proceedings under this section, and submit a recommended final decision or final order to the district court.

(2) A United States magistrate, when designated or requested pursuant to section 636(b)(3) and (c)(1) of Title 28, may exercise jurisdiction over all proceedings under this section, and issue a final decision or final order, where the parties to the litigation consent to jurisdiction pursuant to the procedures in section 636(c)(1) and (2) of Title 28. [New.]

Mr. CSONTOS. I would like to briefly discuss the issues involved. In 1976 when the legislation was enacted, the committee was concerned about the use of the administrative summonses by the Internal Revenue Service and their effect on the civil rights of taxpayers including the right to privacy. The committee realized IRS could not do its job in investigating the civil and criminal provisions of the Internal Revenue Code without this necessary tool.

The objective was to provide taxpayers with a reasonable and speedy means to challenge summonses when appropriate, and the mechanism that the Congress adopted was to provide a taxpayer with notice that a summons would be issued to a bank or other third-party record-

keeper. He didn't have that right before. You gave him the right to stay compliance with that summons. He didn't have that right before. You gave him the right of standing. In other words his arguments could be heard by the court in the enforcement proceeding. This was also a right that he did not previously have.

No we are not here to suggest to you that you take away any of these three rights that you gave in 1976. What we are telling you is that the procedure is too informal; it is too easy; and too many people are taking advantage of it when they don't desire to participate in a court proceeding. You gave taxpayer these rights so that they could get court protection and you didn't give it to them so they could solely be used for delay. The letter objection procedure—by that I mean the taxpayer merely has to send a letter to the bank saying "I want you to not comply with the summons"—is just too informal. There are no grounds that must be stated and yet it has the effect of a judicial injunction because the bank cannot turn the records over and the IRS cannot accept them.

What happens at that point is that the investigation is stymied, blocked, and impeded. The investigator turns the matter over to the lawyers at the IRS who then turn the matter over to the lawyers of Justice for the preparation of a suit to enforce the summons. We prepare a petition for enforcement of a summons. We prepare an affidavit of the investigator describing the investigation and the need for the records. We prepare a proposed show cause order which the judge would then review and sign. Typically, the order would direct the bank to appear at a hearing to present its objections or otherwise to notify the court if it had no objections.

Of course at that proceeding the taxpayer under the 1976 legislation has the right to intervene to assert his rights. What we have found is that in most cases taxpayers who stay compliance by sending a letter to the bank don't have any interest in showing up in court and defending their rights. What we are suggesting is that the subcommittee and the full committee consider changing these procedures without modifying the basic rights that you gave taxpayers in 1976. The administration's position is that the Congress found a better way to solve the problem in the Right to Financial Privacy Act enacted in 1978. The taxpayer would still get notice, would still be able to keep the IRS from getting the records or the bank from turning them over, and would have standing in a court proceeding to raise his arguments. But he would have to start the court proceeding.

Now the benefit of this approach is twofold. First, the customer would have to demonstrate that he intended to participate in the court proceeding because he would be the one that started the proceeding. We would not have to go through the process of preparing the legal papers, having them reviewed by a district court judge, and then finding that our time and his time was wasted because the taxpayer stayed at home. Second, the taxpayer would have to set out his objections.

I am sorry that representatives of the American Bar Association Tax Section are unavailable this week and weren't able to testify before you, because over on the Senate side they fully supported our suggestion for enactment of the motion of quash procedure. The ABA,

of course, represents the attorneys on the other side of the fence—when we seek to enforce a summons, they try to protect the taxpayer and keep the IRS from getting the information.

The ABA along with us believes that present procedure needs technical change that will not take away these rights that you gave the taxpayer in 1976.

There have been some concerns voiced about the question of whether the taxpayer should be allowed an immediate appeal where the court denies a motion to quash. The legislation that Senator Nunn introduced and H.R. 6764, the bill pending in the Ways and Means Committee, would provide that there would not be any immediate right of appeal. Those provisions are patterned after the Right to Privacy Act.

Over on the Senate side some of the witnesses voiced objections to that proposal and argued that there should be an immediate appeal.

Mr. JENKINS. Could I interrupt right there. You could always raise that question, I assume, in a motion to suppress?

Mr. CSONTOS. Under the present law you can to the extent that the taxpayer has standing. That would also depend upon how the bill was drafted. A provision of the Right to Privacy Act suggests that you would not be able to raise the matter simply in a motion to suppress, but would have to raise it under the procedures of the act. Under present law relating to IRS summonses, you are correct to the extent that standing exists.

However, if you appeared in a summons proceeding and you lost at that stage, there is some court precedent for the proposition that you cannot relitigate that matter in the criminal proceeding.

But that is under present law where there is a right of appeal to the circuit courts. There is no total answer on this right of appeal. I find it interesting that the Privacy Commission, when it issued its report on privacy matters in general, agreed that there should not be an immediate right of appeal. The idea is clearly not that far fetched in view of the Privacy Commission's recommendation that there should not be an immediate right of appeal.

The administration's proposal does allow an immediate right of appeal, but has a limitation on the time in which the court could consider the matter. That proposal is not carved in stone and there may be other acceptable approaches.

There are some problems of delay in the courts of appeal. In the fifth, sixth, and ninth circuits, it can sometimes take 2 to 3 years to get a decision. On the other hand in the summons enforcement area now, we have been fairly successful in convincing district courts or courts of appeal that they should not stay the effect of a court order enforcing a summons, and as a result, there is no hearing in the court of appeals.

At the district court level I might add, the courts are also quite overburdened and it does take some time under present law to get those cases heard. The time varies greatly from district to district. It could be 3 months in some districts and it could be 9 months in others. I think that problem may become exacerbated when the full impact of the Speedy Trial Act is felt in the courts, with the courts having to give priority to criminal cases.

In conclusion, I would like to reiterate that we are not proposing to take away the right of notice, and we are not proposing to allow

the IRS go get access to records and banks to turn them over before the court has had the opportunity to hear the matter. We are not proposing that the taxpayer should not have the right to be heard. We are suggesting that if the taxpayer wants to be heard, he should start that proceeding, he should participate in it, and he should not have the opportunity to simply delay the investigation by sending a letter telling the bank not to comply.

Mr. GIBBONS. How much time would you give the taxpayer? Somebody has to notify him. How much time after you notify him would he have?

Mr. CSONTOS. The proposal pending before the committee and our own proposal would give 14 days. That is taken from the provisions of the law that enacted in 1976, section 7609, under which the taxpayer must send a letter to the bank within that period of time. The time period is also identical to the time provisions of the Right to Privacy Act, which apply when any other Federal agencies besides the IRS, until a few months from now the SEC, tries to get financial information. Thus, there is precedent for the 14-day period.

Mr. GIBBONS. How would any of those proposals affect the little session that you and I participated in during an oversight hearing on May 20? Do you remember, Mr. Commissioner, we had a taxpayer from Alaska, I think it was, who came to the hearings and said he wanted you to testify about his tax return. I told the subcommittee that he wanted you to testify about his tax return and in fact he put his waiver of disclosure in writing. We put this waiver in the record that he wanted you to testify about his tax return and the tax return information. Then you said you couldn't.

Commissioner KURTZ. I think that there is nothing that would change that. Perhaps it would be useful if I take just a minute to point out that there are a number of differences between Senator Nunn's bill and your bill and the administration's bill. Some of them are a little hard to see because they start from somewhat different places. But I think there is one overwhelming essential difference which I think really goes to the heart of the matter. That is the question of what rights a taxpayer has, an individual taxpayer has in his books and records, has under existing law as well as under the administration's suggested revisions to existing law, as to information or evidence of a nontax crime. That is, we find in an individual's books and records, or whatever we may look at during the course of that examination provided by him, and not third parties, we get from him in examining those documents and whatever else we examine in connection with the audit of his tax return, if we find evidence of a nontax crime, that resides with us.

That does not go to the Justice Department on our own. The Justice Department can get that information if it has some reason to believe that there is a crime that it is investigating and a reason to believe that that can be relevant. They can apply for a court order and get that information. But during the course of an examination, we do not spontaneously volunteer whatever evidence of a nontax crime we may find. In Senator Nunn's bill that protection extends only to the tax return and the supporting schedules that may be filed with it. So that if we were to examine an individual's return and in the course of that examination find from his own records evidence of a nontax

crime, we would be obligated under that bill to turn it over to the Justice Department. That really is the central issue, it seems to me, that differentiates the two bills. There are issues and there are a number of them that are really peripheral to that central issue.

Mr. NATHAN. If I could add a footnote to that, I understand from Senator Nunn's testimony here and also his response to questions in the Senate Finance Committee that he would be willing to reexamine that question and provide judicial protection to those kinds of underlying financial records submitted by a taxpayer to support the tax return. So I don't think that that is a fundamental difference.

Mr. GIBBONS. We are talking about an individual taxpayer?

Mr. NATHAN. Yes.

Mr. GIBBONS. How about a corporation?

Commissioner KURTZ. Under existing law corporations and individuals are treated the same.

Mr. GIBBONS. That is under the 1976 law?

Commissioner KURTZ. Yes, and corporations have the same level of protection that individuals have. The administration's proposal would change that as to certain corporations and as you heard there is some flexibility as to which corporations, but we will change that and provide that information evidencing a nontax crime that is developed from a corporation's books and records in the course of an examination would be turned over to the Department of Justice.

Mr. NATHAN. It would not be all of the books and records of the corporation that would be submitted in support of the tax return. It would be only when the Internal Revenue Service found evidence of a significant Federal nontax crime. That information, not all of the books and records, but only that information constituting evidence of the crime, would be turned over.

Mr. GIBBONS. Would it apply to a labor union?

Commissioner KURTZ. As the administration policy now stands, it will apply only to corporations other than one person corporations. That is one shareholder corporations. Other entities would have the same protection as individuals.

Mr. GIBBONS. What is a labor union? Is it a corporation or what is it?

Commissioner KURTZ. It is a nonprofit association or corporation.

Mr. GIBBONS. So it would include the unions' records?

Commissioner KURTZ. They are not shareholder corporations. The proposal as it now stands is directed to shareholders, to commercial corporations.

Mr. JENKINS. Under existing law, if a Senator, let us say, lists on his income tax return that he has received a \$200,000 bribe and listed it as a bribe, you cannot reveal that?

Commissioner KURTZ. Not spontaneously, but if the Justice Department were to say "We are investigating whether Senator X received a bribe; we would like to see his tax return," and applies for a court order, then it would be turned over.

Mr. JENKINS. Under the administration's proposal, you still could not reveal that information?

Commissioner KURTZ. It would be the same.

Mr. JENKINS. Under Senator Nunn's proposal, it would be an affirmative action.

Commissioner KURTZ. Under Senator Nunn's proposal you still could not if it is on the return. But let us assume the return says "miscellaneous income \$200,000" and we happen to examine Senator X and discovered in the course of the examination that the \$200,000 miscellaneous income was a bribe, under Senator Nunn's proposal we would then be obligated to turn that information over. Under existing law we would not.

Mr. NATHAN. Under the administration's proposal you would be able to get that information if it came from something other than the Senator's own books and records.

Mr. JENKINS. If in fact he listed it on the return?

Mr. NATHAN. We would not have it unless we had an ex parte court order.

Commissioner KURTZ. And the theory behind that is that he is obligated as a matter of law to in fact report that income. To have a rule otherwise, you then put the individual in the dilemma of either committing a second crime, namely tax fraud, or confessing to the first crime.

Mr. JENKINS. And by the same token, of course, if that narcotics trafficker listed on his individual return X number of dollars for narcotics from an individual, you could not reveal that.

Commissioner KURTZ. Not spontaneously.

Mr. JENKINS. When you say "spontaneously," what is that?

Commissioner KURTZ. That is without a request, that is at our own initiative we could not, that is correct.

Mr. JENKINS. Or disclose that some IRS employee after examining a return had orally told the Department of Justice or provided the information really without a request, when could that defendant contest that? In other words, you have an agent who picks up the phone and calls the Department of Justice.

Commissioner KURTZ. Well, the employee himself would have violated section 6103 and therefore might be liable for civil and criminal sanctions.

Mr. JENKINS. But under the administration's proposal you are going to take that away?

Commissioner KURTZ. Civil liability.

Mr. NATHAN. The taxpayer who was aggrieved would still have a right to file a lawsuit against the Government and to recover his actual damages or the statutory damages. It just would not be the individual who would be a defendant. It would be the Internal Revenue Service or the executive branch.

In addition, that individual, if the tax information were to be utilized in a criminal prosecution, could make a motion, I think, to suppress that information. That is because it was improperly obtained by the Department of Justice.

Mr. JENKINS. The only thing I want to make sure in my own mind is that a taxpayer, a defendant, at some point has the right of appeal, whether it be in a motion to suppress, or at some point in the criminal proceedings. I think it is important that his right of appeal be absolutely protected.

Mr. NATHAN. He would have the right to bring that matter to the district court's attention to suppress the tax information. Of course

if he were convicted, if he lost the motion in the district court, if he were convicted, he would have the right to appeal that.

Commissioner KURTZ. The answer to that question is not all clear, though, that is whether the evidence would actually be excluded.

Mr. COHEN. There is not a constitutional right. This is a statutory right. I have some real question as to whether that evidence would be excluded at the subsequent criminal trial.

Mr. JENKINS. I would think he ought to have the right of appeal to bring this question up.

Mr. GIBBONS. To have the evidence suppressed as being illegally obtained?

Mr. JENKINS. I know the hour is running late but you indicated that a lot of taxpayers simply write a letter of objection. Do you have any figures on that that you could give us? Do you have any statistics which bear that out?

Mr. CSONTOS. I do not have any at the Justice Department. I notice in Senator Nunn's statement refers to a study in which 80 percent of the taxpayers did not show up in court.

Mr. JENKINS. When you notify the taxpayer I assume that you advise him that he has the right to object to this by informing the bank?

Mr. CSONTOS. Yes.

Mr. JENKINS. And as a result of that advice most of the taxpayers write the letter?

Mr. CSONTOS. I think that I would if I were in that position as well. The taxpayer has nothing to lose at that point in my judgment.

Mr. JENKINS. That is what I would advise my client.

Mr. GIBBONS. For a 15-cent stamp you can get a lot of protection. In fact, I would tell him to hand deliver it over there.

Mr. PARNELL. I have one question that goes to the differentiation between the corporations. Has any thought been given by any of the administration witnesses to distinguishing between corporations that are required to register with the SEC and those that are not—drawing the line there, by saying that return information or tax returns of those corporations registering with the SEC are public? You would avoid the problem that was discussed earlier about one, two, and three shareholder corporations and the rest.

Mr. NATHAN. I think some consideration has been given to that. The problem is it does not relate to getting access to this information.

For example, if we are looking at narcotics dealings and we have, and this is a fact, we have some situations where you have small corporations which sell boats and airplanes or lease boats and airplanes or otherwise are involved in the periphery of narcotics trafficking and the books and records of those small corporations, which are not listed on the public exchanges and are not subject to the SEC, contain the information about large cash transactions with individuals and also contain perhaps indications of large cash payments to certain kinds of public officials who look the other way in terms of narcotics trafficking.

That kind of information which is on corporate books and records and could be in the hands of another Federal agency, namely the Internal Revenue Service, should be provided to the appropriate

Federal law enforcement agency for pursuit as to whether or not this is evidence of nontax crimes committed either by that corporation, by its officers or by customers of that corporation.

Mr. PARNELL. Commissioner Kurtz, do you have any comments?

Commissioner KURTZ. Yes, but I am here to support the administration's position.

Mr. GIBBONS. That is a good answer. Let me ask you a question. Under existing law, if an officer of a publicly held corporation came to me or anybody else and said, "I want to disclose to you some information on my corporation's tax return," could he disclose that to me?

Commissioner KURTZ. Yes. That applies to Government employees and others who get information through those channels.

Mr. GIBBONS. But under the present law, an officer could disclose the corporate tax return to me.

Commissioner KURTZ. It would not be a violation of 6103, and whether it would be any other violation I do not know.

Mr. JENKINS. There is another problem, in response to the corporate situation. There have been a lot of bankruptcy fraud cases or mail fraud cases where there were 50 or 60 corporations that were nothing more than conduits. Even under the prior law, often by the time the Justice Department times traced all of this through the series of corporations that were set up just for a criminal purpose, the defendant had died.

It took them so long, under the best of circumstances, to unravel all of the maze of corporate records. Under the present law I would say the job would be 10 times more difficult.

Mr. NATHAN. It doesn't make much sense to us, where information from corporate books and records in the hands of the Internal Revenue Service shows on its face that there is mail fraud or bankruptcy fraud or that these corporations are simply shells and are not legitimate enterprises and are essentially set up to cover up criminal activities, that that kind of information cannot be passed along to law enforcement officials.

There is no policy served by permitting that kind of information to go undisclosed. There is a policy when we are talking about individuals because you are asking those individuals to essentially forego their fifth amendment privilege and to talk honestly to the Internal Revenue Service and come forward with their tax liability.

But the corporation which does not have this right has not given anything up by showing these books and records to the Internal Revenue Service.

It seems on its face, if it shows evidence of serious Federal crimes, that ought to be turned over to appropriate officials.

Mr. PARNELL. I have just one question about that. It is true, I believe, that small businesses have the lowest rate of voluntary compliance with the tax laws, as shown in studies by the Internal Revenue Service, and if it is also true that the confidential status of tax returns and taxpayer information is to encourage honest and accurate reporting, it would seem that to remove confidentiality for small corporations would make a poor compliance record even worse.

Mr. NATHAN. I look at it from the opposite perspective. If what you say is true—

Mr. PARNELL. Assuming you are a law enforcement officer?

Mr. NATHAN. I am assuming that your facts are true, and I don't know that they are, but assuming that you have low compliance among small business and they presently have the complete coverage in terms of confidentiality, and that the Internal Revenue today, even if it found serious tax crimes on the books and records of small corporations, could not on its own initiative turn that over, then it seems that confidentiality has not enhanced the tax collection system for the small businesses. I would say, further, in respect to the point that Senator Weicker made, if it were true that there is a direct correlation between confidentiality, and compliance under our self-assessment system, there should be evidence of tremendous growth in the last 4 or 5 years—in the light of that statement—in tax compliance.

I don't think it has been suggested that there has been that outpouring. I think the evidence of any correlation between confidentiality—which we all support in terms of the privacy of taxpayers—there is little distinct or direct correlation between confidentiality and compliance.

Mr. GIBBONS. I have always felt that "voluntary compliance" was sort of like the volunteers we used to get in 1943. If a 21-year-old fellow told you he was a volunteer, he meant that he was a volunteer when the Draft Board breathed down his neck so hard.

Mr. Kurtz, I know you put a lot of emphasis on voluntary compliance, but if you didn't have a few criminal prosecutions that weren't well advertised now and then, I think voluntary compliance would slip something horrible. That would be my offhand guess; it would be like 1943 all over again as far as volunteers are concerned.

Mr. GIBBONS. I had some more questions but it would take a long time to go into them tonight. If we have to get into this field, we are going to need your active cooperation because it is a very technical field and one where we will need all of the help we can get.

Mr. NATHAN. We pledge all of our assistance to you.

Mr. GIBBONS. I hope you will be as candid as you can. I realize the administration does not always come forward united on an issue, and if you don't really thoroughly agree with us, we will try to work it out without causing embarrassment to you.

I am not sure we are going to get into this field, but we want to be prepared if we do. We will have some questions for you from our minority counsel.

Thank you very much.

The next panel of witnesses to help us understand this problem a little better is from the American Civil Liberties Union and from the Taxation With Representation Fund.

We will take you in the order in which you are listed on the agenda here. Mr. Shattuck, you may proceed first.

STATEMENT OF JOHN H. F. SHATTUCK, DIRECTOR, AMERICAN CIVIL LIBERTIES UNION, WASHINGTON OFFICE

Mr. SHATTUCK. It is a pleasure to appear here, despite the lateness of the hour, and to have the good fortune to appear before your subcommittee again. In fact, in 1977 when you were also considering

amendments to the Tax Reform Act I was pleased at that stage to appear.

Mr. GIBBONS. We had Attorney General Bell with us at that time, too, as I recall.

Mr. SHATTUCK. Mr. Chairman, my organization has long taken an interest in the matter of privacy and particularly taxpayer privacy.

Mr. GIBBONS. We are glad you have, and we think you have done a fine job.

Mr. SHATTUCK. Thank you very much.

I have submitted a lengthy statement for the record which I will summarize.

Mr. GIBBONS. We will put all of that in the record.

Mr. SHATTUCK. To jump right to the major point, I would respectfully submit that the case has not been made for many of the proposals that are under consideration by the subcommittee. That is not to say all of them. There are some that I think are reasonable, but there is little evidence that information about nontax crimes cannot be made available to the Justice Department under the Tax Reform Act, and there is also little evidence, in our view, that applications for court orders cannot be obtained by the Department for access to information that it is now entitled to under the Tax Reform Act of 1976.

In short, we think there is no reason for Congress to substantially cut back on the minimal privacy protections, and I stress the fact that they are minimal from a privacy standpoint, for tax information that were erected 4 years ago after very careful consideration by Congress.

The Tax Reform Act, as Senator Weicker pointed out to you, was the subject of extensive evidence that tax records over the years had, in fact, been generally made available and rather loosely made available to other agencies of Government that were putting pressure on the IRS.

This has been extensively documented in congressional testimony. I have summarized some of that in my statement, but I would simply state one point of contention with the Department of Justice witness who appeared just before me, that there were instances, and quite a number of them, in which tax returns were made available not just to the White House but also to other agencies of Government.

I think the FBI's use of tax returns with respect to its investigation of activists and antiwar and civil rights workers is a well-documented instance of abuse, something that we all deplore. It is behind us but it is by no means a matter that was limited to the White House. That is the record on which the Tax Reform Act was built.

The act was designed to remedy this, and although it is by no means stringent, it provides a minimum amount of protection for tax records; it requires the Government to meet a reasonable standard of proof to justify disclosure, and disclosures may be made following the independent judgment of a Federal judge, although the legislation would also allow magistrates to rule on disclosure applications and we would support that.

The IRS, as you are aware, has been given enormous unparalleled power by Congress over the years. There is really no investigative agency of Government that has the power that the IRS has to compel

information from all citizens about virtually every aspect of their lives. It is a very important power and we don't denigrate it by any means. It is a central power for the enforcement of the tax laws but because it is so broad it has been necessary to try to conform that power to constitutional guarantees, particularly the privilege against self-incrimination.

The way the Supreme Court has done that is by enunciating the so-called "required records doctrine" that allows the IRS to compel information from taxpayers under the assumption that that information is not going to be further disseminated and disclosed within the Government. Without that required records, exemption, the whole voluntary compliance scheme of our tax laws would be in serious jeopardy. This is a point made by Senator Weicker and it is a point on which the IRS itself agrees.

The cornerstone of that required records doctrine is the belief on the part of taxpayers that information that they have provided to the IRS is going to be confidential and not generally disseminated.

Senator Nunn in introducing his legislation, and in testifying on it this evening, stated the central premise of his proposal, which is that the IRS should become more actively involved in the war on illegal drugs and organized crime. I would respectfully submit and agree with Senator Weicker, that that is not the purpose of IRS.

The IRS was set up to collect the taxes. It was not set up to enforce the criminal laws of the United States. There is no other agency of Government that is charged with enforcing the tax laws, and if IRS loses some of its power as a result of sharing information with other agencies of Government there is not going to be anybody to pick up the pieces.

You have heard from the Department of Justice and from IRS itself that it is not at all clear that many of the proposals before you would, in fact, facilitate investigations of organized crime and illegal drugs, but I think we are very clear that they would have a substantial impact on the privacy of taxpayers. These are the broad considerations, Mr. Chairman, and I wanted to stress them at the outset, because I know it is often difficult in hearings like this to get through all of the details of the legislation and then remember what the major issues are.

I think that is the most important thing that we can bring to bear on your considerations.

We have six areas of major concern with respect to the proposals that are before you. Let me just very quickly summarize them and then give an opportunity for the other witness to speak.

In doing so, I hope I will also answer the questions that you submitted with the invitation.

First: The bill, H.R. 6767, collapses the three-tier classification of IRS information into two categories. This change would substantially diminish the protection afforded in IRS records. Under the existing system any taxpayer information or documents that are submitted with a taxpayer return which were provided by the taxpayer at some later stage are considered tax records within the meaning of the Tax Reform Act.

What the proposal would do would limit the protection solely to information on the return and all of the other information that might

be provided by the taxpayer would not be covered by the procedures of the ex parte court order procedure that would provide some protection.

We strongly oppose this weakening of the Tax Reform Act.

Second: The bill—and this is H.R. 6767—would substantially lower the standards of proof that an agency or the Department of Justice must meet in order to obtain access to taxpayers' information.

With respect to nonreturn information there would be no standard of proof whatsoever. As I have stated, the information would simply be available upon request and not subject to court order.

With respect to return information, the standard would be somewhat lower than it is under current law.

I should point out, Mr. Chairman, that the standard in current law, the Tax Reform Act of 1976, is significantly lower than the standard proposed by the Privacy Protection Study Commission which was the Commission that looked most closely at this and whose work underlies the Tax Reform Act. So we are not dealing with a terribly tough standard under current law.

Under current law the act requires a showing that (a) there is reasonable cause to believe that a specific crime has been committed and (b) the information sought is probative evidence of the matter related to that specific crime; and (c) the information cannot be obtained elsewhere.

Now, under H.R. 6767 the specific crime standard is eliminated. I am pleased that the Department of Justice and the IRS and the administration appear to be moving away from that position, and that is important, but if that standard were adopted the Department could be engaged in an ongoing investigation and it would be allowed to gain access to any tax records that might in any way be relevant to that investigation. No specific crime would have to be alleged nor any demonstration that the information is probative of a specific crime, nor does it appear that the taxpayer would have to be a suspect or even an associate of those who are suspect? If an ongoing investigation is underway into a criminal enterprise of some sort, the taxpayer would caught up in the access provisions.

We think that is a major erosion of the minimal protections of the act.

The third major problem area in H.R. 6767 is that it contains no check on the chain of dissemination of taxpayer information within the Government. The Government should have to meet, we think, a high burden of proof in order to justify disseminating information from one agency to another and from one enforcement purpose to another. This was a central provision of the Privacy Commission report, and a central feature of the Tax Reform Act, and it is something that should be maintained.

Fourth: The bill provides for disclosure of tax information to State law enforcement officials if the information is relevant to a prosecution or investigation of a State felony. Again, it is a major departure from the Privacy Commission, which recommended that disclosure of information to States be limited to the enforcement of the tax laws of the States.

Of course, that is an important purpose and it is central to the whole theory surrounding the enforcement of the tax laws, but disclosure of

tax information to the States for nontax investigations raises the same constitutional problems that we see with respect to disclosure of that information for nontax enforcement purposes of the Federal Government.

We strongly oppose that change.

I think I detect in the administration's position an evolution toward opposing that as well, although we haven't yet seen anything on paper in that regard.

The fifth area of major concern for us is that the bill would allow a government attorney to disclose taxpayer information if he believes that the information is relevant to any Federal civil litigation. Civil litigation, again, is not enforcement of the tax laws.

Now, if the whole purpose of the Tax Reform Act is to maintain the protection of information with respect to a tax enforcement, then disclosure for civil litigation, as opposed to even criminal litigation, in our view, has no place in the proposal. We have not seen any evidence to support the proposal to allow disclosure for civil litigation.

We would strongly oppose that.

Mr. JENKINS. Would that be primarily in civil forfeiture cases? Is that the purpose of that?

Mr. SHATTUCK. That is my understanding, Mr. Jenkins, but there has not been evidence or testimony on the subject and I think perhaps Senator Nunn might provide some further information about that.

The sixth problem is that the bill authorizes—and we see this as a major problem—disclosure of information to foreign governments with respect to whom the United States has mutual assistance treaties.

On the surface, that might seem very reasonable in terms of enforcing the drug laws, but if you think about it, the constitutional problems involved in that become enormous. Foreign governments or foreign countries may not have the same standards of evidence as the United States, and they may not even have the same criminal laws. There may be things that are crimes in Mexico that are not crimes in the United States. If Mexico can compel disclosure of tax information from IRS to enforce their laws simply because they have a mutual assistance agreement, it seems to us to raise major questions of due process with respect to citizens of the United States where the Federal Government is assisting a foreign country to enforce a law which is not a criminal law in the United States.

I also think the IRS seems to be moving toward opposition on this point.

Well, lest you think that we oppose everything, and I know that was your question to Senator Weicker as well, we do support some of the expediting procedures in the bills. We think it would be possible to streamline the procedures that are now in the Tax Reform Act to require much more rapid disposition of applications for court orders, to allow magistrates to rule on government applications and not simply Federal judges, and to allow the attorneys for the government, rather than the heads of agencies, to apply for disclosure.

In our view, that may even be a protection of civil liberties in the sense it would limit the disclosure to the Justice Department and not allow IRS records to go to all of the various agencies, which now appear to be able to get them under the Tax Reform Act.

But we are strongly opposed to any changes in the standards and any overturning of the minimal privacy protections that Congress set up in the 1976 act.

I would be happy to answer any questions that might arise from my statement after the other witness has had an opportunity to speak. [The prepared statement follows:]

STATEMENT OF THE AMERICAN CIVIL LIBERTIES UNION, WASHINGTON OFFICE

I am pleased to testify this morning on the privacy of taxpayer information, an issue of much importance to the American Civil Liberties Union. I am the Legislative and Washington Officer Director of the ACLU, a nationwide, non-partisan organization of more than 200,000 members devoted to the protection of individual rights and liberties. I am also the author of a textbook, *Rights of Privacy* (National Textbook Co. 1977).

For many years the ACLU has played an active role in the effort to safeguard individual privacy from broad intrusion by government and private record-keeping practices. Through a project on privacy and data collection which we sponsored from 1973 through 1978, the ACLU provided advice—and in some instances legal representation—to individuals whose rights and interests were adversely affected by the recordkeeping and dissemination practices of governmental and private institutions. We also sought to publicize in a monthly *Privacy Report* the many ways in which privacy has been eroded in a society where personal information is increasingly recorded by third parties and used for a wide variety of purposes, without the consent or even the knowledge of the person involved.

The ACLU is particularly concerned about the issue of taxpayer privacy, and has testified frequently in congressional and other hearings on this subject, including hearings of this committee when it was considering the Tax Reform Act of 1976. We were strong opponents of the Justice Department's earlier effort to amend the Act in 1977, and we oppose many of the proposed amendments before the Committee today.

PRIVACY OF TAX RECORDS

The disclosure and summons provisions of the Tax Reform Act of 1976 are the product of a grave concern for the privacy of tax records held by the IRS. The provisions were generated by revelations, over a period of several years, of a widespread pattern of abuse of IRS records by government agencies for non-tax purposes. Among the many improprieties that were revealed by various investigations of governmental intelligence operations were a number of projects initiated within the IRS as a result of pressure brought to bear on that agency by governmental law enforcement agencies. These projects included the Ideological Organizations Audit Project and the Special Service Staff (1969-73) which targeted more than 8,000 individuals and 3,000 groups for extensive investigation specifically because of their political activities. The SSS operated in secrecy and was abolished in 1973 when IRS Commissioner Donald Alexander learned of its existence. These internal IRS projects seriously threatened the constitutional rights of all taxpayers. The projects were the product of external pressures exerted by Congress, the White House and government law enforcement agencies who claimed that the IRS was not participating sufficiently in the governmental battle against crime.

More central to the origins of the disclosure provisions of the 1976 Act were the extensive revelations of abuse of IRS information by other agencies of the government which had solicited the information from the IRS. See Final Report, Book III, Senate Select Committee on Study of Governmental Operations with Respect to Intelligence Activities, 94th Cong., 2d Sess. [Church Committee] (1976). Between 1966 and 1974, the FBI, either directly or through the Justice Department made approximately 200 requests to the IRS for tax returns. Sixty-five percent of these requests were for two counter-intelligence (Cointelpro) programs conducted by the FBI—the Key Activist program aimed at leaders of the anti-Vietnam War movement, and the Key Black Activist program, aimed at leaders of the so-called Black Nationalist movement. In addition, the FBI made numerous ongoing requests to the IRS for lists of contributors to ideological organizations under investigation by the Bureau. In this manner, the FBI obtained information offered voluntarily to the IRS by groups to assist in enforcement of the tax laws. Between 1957 and 1972, the Central Intelligence Agency made a number of unofficial requests to the IRS for tax return information on persons the CIA was

investigating. Finally, the Senate Committee that investigated the Watergate burglary revealed extensive use of IRS records by the White House against political opponents of the Nixon Administration. Indeed, abuse of tax information was one of the central components of the Nixon Administration's broad pattern of intelligence operations aimed at harassing and intimidating political "enemies."

Before the Tax Reform Act of 1976, the IRS lacked any meaningful standards by which to judge the numerous requests for information it received from other government agencies. Though a procedure for determining the legitimacy of requests did exist, it was so vague, and so widely ignored as to be useless. Indeed, in 1968 when the Chief of Disclosure of IRS learned of the procedure, he termed it "illegal." The Church Committee found that in the absence of any meaningful guidelines, the IRS could not judge whether the request was legitimate. Consequently, the Committee noted, the "IRS had delegated the determination of the propriety of the request to the requesting agency." Final Report, Senate Select Committee to Study Government Operations. With respect to Intelligence Activities, Book III, p. 840.

The Tax Reform Act was designed to remedy this legacy of abuse of IRS information. Although the Act is by no means stringent, it provides a degree of protection of IRS records. It requires the government to meet a reasonable standard of proof to justify disclosure. Furthermore, such disclosure may only be made following the independent judgment of a federal judge. These safeguards were all designed with specific reference to known abuses of IRS information by government agencies.

SENSITIVE NATURE OF TAXPAYER INFORMATION

A person's tax returns, and the records of his financial transactions with a bank or another private entity, are a reflection of that person's life. Those records mirror, often in great detail, the personal habits and associations of individuals. The beginning of a tax return gives name, address, social security number, identity and dependents and the taxpayer's gross income. Various schedules may indicate political and religious affiliations and activities, medical or psychiatric treatment, union membership, creditors, investments and holdings. Additional documents compiled by the taxpayer and pertaining to statements made on a tax return but not filed with the return contain a similar wealth of sensitive personal information. In 1975, the then IRS Commissioner Donald Alexander noted that the IRS has "a gold mine of information about more people than any other agency in this country." Committee Print, Confidentiality of Tax Returns, House Committee on Ways and Means, September 25, 1975, at 3.

Apart from information related to tax returns, documentary materials routinely obtained by IRS for the enforcement of the tax laws also contain vast quantities of private information. Bank records, or similar records, reveal the political causes one supports, the books and magazines one buys, the organizations one joins, as well as one's style of life, tastes and habits. People assume that these matters are confidential, and that they do not sacrifice that confidentiality when they conduct financial transactions with the assistance of a bank. This assumption has been acknowledged and embraced by courts across the country. As one state court has noted:

"[I]t is impossible to participate in the economic life of contemporary society without maintaining a bank account. In the course of such dealings, a depositor reveals many aspects of his personal affairs, opinions, habits and associations. Indeed, the totality of bank records provides a virtual current biography * * * *Burrows v. Superior Court*, 13 Cal. 3d 238, 529 P. 2d 590 (1974)."

I make these opening observations so that it is clear that the privacy interest an individual has in his or her tax return and bank records is formidable, and must be taken fully into account. When he introduced the Senate equivalents of the bills now under discussion, Senator Nunn noted that "a balance must be struck between the privacy of tax returns and the legitimate needs of law enforcement agencies." Congressional Record, March 11, 1980, p. S2375. The hearings that generated these bills contained testimony principally from law enforcement officials concerning the asserted needs of law enforcement agencies. If the balance to which Senator Nunn referred is to be struck fairly and accurately, it is essential that the privacy interests of individuals be given equal weight.

THE EXTRAORDINARY POWERS OF IRS

The IRS is accorded enormous, unparalleled coercive power to obtain information from individuals concerning every aspect of their private lives. The IRS may,

without a subpoena or a warrant or any showing of probable cause, require an individual to divulge information. Because of the clear threat such broad powers hold to an individual's constitutional rights to be free from government coercion, the Supreme Court has carved a narrow "required records" exception to the Fifth Amendment, principally for the benefit of IRS. See *United States v. Sullivan*, 274 U.S. 259 (1927). This exception and the extraordinary authority which Congress has bestowed on IRS create a powerful presumption against any attempt to transfer that authority to other agencies of government.

The statutory authority of IRS to obtain information must not be viewed as creating some form of governmental asset which may then be transferred to other arms of the government pursuing legitimate governmental objectives. The information gained by the IRS does not in any sense "belong" to the Government. Rather, it is held in special trust by the IRS for its unique, important purpose of collecting taxes. Indeed, it is only the unique nature of the IRS function that justifies the extraordinary degree of intrusion that that agency is allowed to make into the lives of individuals. Dissemination of IRS information to other governmental agencies for non-tax purposes, however meritorious, is a violation of the IRS' special trust.

The central concern of the supposedly insufficient level of participation by the IRS in the government battle against organized crime and large drug trafficking. In our view, casting the question in that light fundamentally distorts the realities of the situation. The IRS is not designed to participate in that battle. Its extraordinary powers were granted for quite another purpose—the collection of revenue and enforcement of tax laws—and are limited to that purpose. To the extent that the IRS has, in the past, strayed from that purpose, it has operated outside its charter. Measures taken to remedy that impropriety are to be lauded; to portray the Tax Privacy Act of 1976 as withdrawing the IRS from the battle against crime is misleading and harmful.

Governmental agencies such as the Department of Justice, the Drug Enforcement Administration and the Federal Bureau of Investigation are not—and should not be—empowered to exercise the same authority as the IRS to compel and use personal records and other information about virtually the entire public. As the Privacy Protection Study Commission noted in its 1977 report:

"It is understandable that other agencies with important responsibilities want to use information the IRS has authority to collect, but they have not, in fact, been vested with the IRS' authority to compel such information." [Report at p. 540.]

We believe that dissemination of taxpayer information and records by IRS to other government agencies, and the summoning of financial records by IRS threaten the constitutional policy underlying the Fifth Amendment right to be free from compulsion of self-incriminating statements.

The Fifth Amendment protects an individual from government coercion in a criminal prosecution. In most instances, the government may not compel an individual to divulge information that might tend to incriminate him. The "required records" exception of the Fifth Amendment was created in part to allow the IRS to require individuals to divulge information that might otherwise be protected by the privilege against self-incrimination. Failure to provide information sought by the IRS is a felony punishable by statute (26 U.S.C. 7602). Alternatively, the government may issue a summons to the taxpayer or to third parties that will yield information to the IRS. In either case, the information is effectively obtained by IRS through compulsion. The use of that information in a non-tax criminal proceeding, therefore, is sharply at odds with the constitutional policy underlying the Fifth Amendment.

In order to promote fair and efficient administration of the revenue laws and collection of taxes, it is essential not to burden the filing of taxpayer returns with Fifth Amendment problems. If a taxpayer believed that the information he or she was providing the IRS might be routinely made available to other law enforcement agencies, he or she might be disposed to be less cooperative with IRS. The taxpayer would be put in the position of having to scrutinize all of the revelations on the return and determine their relevance to any possible criminal investigation. If as a result of this guesswork, the taxpayer determined the possibility of self-incrimination, he would, at that time, claim a Fifth Amendment privilege, for fear of losing it otherwise at a later stage. See *Garner v. United States*, 424 U.S. 628 (1976). This process would make the tax collecting process so complex and so cumbersome as to render it fundamentally ineffective. The Privacy Commission expressed concern for this result in noting that "widespread use of the information

a taxpayer provides to the IRS for purposes wholly unrelated to tax administration cannot help but diminish the taxpayer's disposition to cooperate with the IRS voluntarily . . . Such a tendency in itself creates a potentially serious threat to the effectiveness of the federal tax system." *Report of the Privacy Protection Study Commission*, p. 540.

These impediments are unjustified. Moreover, they are unnecessary. The number of potentially valid Fifth Amendment claims would be small in comparison with the total number of people filing returns. The more practical solution is to allow the tax return process to go unimpeded by Fifth Amendment considerations—and that is precisely why the "required records" exception to the Fifth Amendment was created, and why it was limited to circumstances such as revenue collection.

These broad questions of constitutional policy concerning the disclosure and dissemination of tax information provide the background against which the specific amendments under discussion today must be viewed. Because the IRS has been accorded special and extraordinary powers, we are fundamentally opposed to any dissemination of tax information within the government. If, in some extraordinary case, such dissemination is authorized by statute, we believe it is essential that in order to justify it, the government must meet a high burden of proof. From this perspective, we are not satisfied with § 6103 as currently written, but we strongly oppose any attempt to further dilute its protections of taxpayer privacy. We unequivocally oppose the placing of any affirmative duty on the IRS to disclose tax information to law enforcement agencies.

I will now highlight the specific objections we have to the proposed amendments. Most of them involve changes embodied in H.R. 6767.

NARROWING OF THE DEFINITION OF PROTECTED TAXPAYER INFORMATION

The bill collapses the current three-tier classification of IRS information into two categories. This change would substantially diminish the protection afforded the information in IRS records. Under existing law, the government must obtain a court order to gain access both to taxpayer returns and to what is called "return information." The latter category includes any information the IRS collects or obtains from the taxpayer with reference to the return. Such information might include documents substantiating claims for deductions, contributions or related expenditures. Current law protects this information with the court order requirement precisely because it is at least as sensitive as the information on the face of a return.

Under the proposed two-tier classification scheme of H.R. 6767, any taxpayer information or documents which are not taxpayer returns would be available to the government upon receipt of a written request by an attorney for the government. No independent judicial check on these disclosures is required. Moreover, the bill places on the IRS an affirmative duty to disclose any such information to the government which may be pertinent to a federal criminal investigation.

We submit that this change in definitions eliminates much of the protection of section 6103. The comment to the proposed change explains that the bill "enables us to separate those items which deserve a higher degree of privacy and hence a court order for disclosure, from those items that IRS, like any other investigative agency, uncovers in a typical investigation." This is misleading. It is by no means clear that the information on the return is the information deserving of a higher degree of privacy. Indeed, there is good reason to believe that other information compiled and maintained by IRS is of an even more private nature.

The proposed new definition of protected taxpayer information draws a distinction between an individual's tax returns and a corporation's tax returns, apparently on the assumption that a corporation's returns do not contain sensitive information concerning individuals. Such a premise is unjustifiable. A corporation's tax return can reflect a person's stock holdings, how he or she voted on internal matters and confidential communication between the corporation and an individual.

STANDARDS OF PROOF

H.R. 6767 would substantially lower the standards of proof that a government agency must meet in order to obtain access to taxpayer information.

Prior to the enactment of the Tax Reform Act, the Privacy Commission recommended that when another government agency requests taxpayer information from IRS, the taxpayer be given notice, and an opportunity to contest the disclosure. Disclosure could then be authorized by a court only if it found:

(a) probable cause to believe that a violation of civil or criminal law has occurred; (b) probable cause to believe that the tax information requested from the IRS provides probative evidence that the violation of civil or criminal law has occurred; and (c) that no legal impediment to the applicant agency acquiring that information sought directly from the taxpayer exists.

Report of the Privacy Protection Study Commission, pp. 553-4.

The Tax Reform Act clearly fell short of these proposed safeguards. An ex parte proceeding requiring a demonstration of reasonable cause is considerably less rigorous than an adversary proceeding demanding probable cause. Further, the third consideration, that no legal impediment exist to direct solicitation from the individual, was overlooked altogether.

The proposal in H.R. 6767 would further undermine taxpayer privacy by eliminating altogether the requirement of a court proceeding, or demonstration of reasonable cause with respect to the disclosure of non-return information. Substituted for these safeguards would be the word of the government attorney that the information sought is material to an ongoing investigation. In short, the proposed legislation eliminates any protection of tax information held by the IRS, other than the tax return itself.

H.R. 6767 also reduces the standard of proof required to justify issuance of an ex parte order for dissemination by the IRS of the actual tax return. We oppose this further erosion of taxpayer privacy protection.

Section 6103 of the Tax Reform Act now requires a showing that there is reasonable cause to believe that: (a) A specific crime has been committed; (b) the information sought is probative evidence of a matter related to that criminal act; and (c) the information cannot be obtained elsewhere.

Again, these statutory standards fall short of the Privacy Commission recommendations. However, H.R. 6767 would further reduce the safeguards. Under H.R. 6767, the government need show only that: (a) The application is made in connection with a lawful judicial or administrative proceeding or an investigation that may result in such a proceeding; and (b) there is reasonable cause to believe that the information sought is material and relevant to such a proceeding or investigation.

While the "reasonable cause" language is retained, the bill affects several changes damaging to taxpayer privacy. There is no requirement of a specific criminal act; there is no requirement that the evidence be probative; there is no requirement that the information be otherwise unobtainable. Materiality to an ongoing investigation is considerably less than probative of a specific crime.

For example, if the Department of Justice were engaged in an ongoing investigation of a suspected criminal enterprise, the proposed standard would allow the Department to gain access to tax records of any individuals associated in any way with that enterprise. No specific crime need be alleged, nor any demonstration that the information is itself probative of a suspected crime. While it may be argued that the focus of the amendment is on drug trafficking and organized crime, it is too easy to forget that similarly loose standards created the enormous record of abuses of IRS disclosures prior to the enactment of the Tax Reform Act.

There is little factual documentation of the need for these changes in the standard of proof in the Tax Reform Act. When asked to supply such information, the General Accounting Office was unable to do so. In fact, in March 1979 the GAO issued a study of the disclosure and summons provisions of the Tax Reform Act, which concluded that "the adverse impact on coordination between IRS and other members of the law enforcement community as a result of the disclosure provisions has not been sufficiently demonstrated to justify revising the law." Report by the *Comptroller General, Disclosure and Summons Provisions of 1976 Tax Reform Act—Privacy Gains and Unknown Law Enforcement Effect*, March 12, 1979. Not only are the good intentions of the sponsors inadequate to justify legislation of such potentially harmful consequences, but there is no clear evidence that the proposals would achieve their intended goal.

REDISSEMINATION

H.R. 6767 contains no check on the chain of dissemination of taxpayer information within the government. Indeed, the bill explicitly provides that:

"The attorney for the Government may further disclose non-return information to such government personnel as he deems necessary to assist him * * *"

The comment to the bill notes that this provision is almost identical to the grand jury secrecy rules. This comment overlooks the crucial fact that in grand

jury proceedings, the government cannot compel self-incriminating testimony, at least without a grant of immunity. Since the fundamental issue here is the use of information that is coerced without a grant of immunity, the analogy the comment draws is inappropriate.

The government must meet an extraordinarily high burden to justify dissemination. Once that burden is met at the outset, the removal of all barriers to further dissemination is not justifiable. We suggest that in effect, walls be placed at every step of the process so that highly sensitive information not be disseminated throughout the government on the judgment of the government attorney.

DISSEMINATION TO STATE AGENCIES

The bill provides for disclosure of IRS information to state law enforcement officials if the information is relevant to investigation or prosecution of a state felony. This proposal is flatly at odds with a Privacy Commission recommendation that disclosure of tax information to the states be limited to tax related prosecutions. Indeed, the Commission was sufficiently concerned about the potential for abuse that exists in inter-governmental disclosure that it suggested limitations even on tax related disclosure. *Commission Report*, pp. 546-47. Dissemination of taxpayer information is an extraordinary invasion of the privacy of individuals, justified only in extraordinary circumstances. The provision allowing dissemination to state agencies is not justified by such circumstances. Rather, it treats inter-governmental disclosure as a routine matter of coordinating law enforcement, so as to make it more effective. Tax returns should not be treated as a common resource for criminal investigations at all levels of government.

DISCLOSURE FOR FEDERAL CIVIL LITIGATION

H.R. 6767 would allow a government attorney further to disclose information if the attorney believes that the information is relevant to any federal civil litigation. Again, the basic threat inherent in this provision is that disclosure of information that is sensitive, and has been divulged under governmental coercion, is treated not as the extraordinary matter that it is, but as a commonplace component of federal investigation.

The sponsors of these measures have touted them as essential to the federal government's fight against organized crime and large-scale drug trafficking. Even assuming the validity of that claim, it certainly does not justify this extraordinary additional measure of permitting disclosure for civil litigation. Furthermore, the proposal does not even require that the attorney seeking disclosure establish any connection between the criminal investigation for which the original IRS disclosure was justified, and the civil investigation for which disclosure is sought. The official comment to H.R. 6767 claims that GAO found that the government had "lost" federal civil cases of substantial size because of the disclosure provisions of section 6103. In fact, the GAO reported only one such case, and in that one case, it appears that the disclosure provision had nothing to do with the investigating agency's inability to obtain the information sought. GAO Report, p. 17.

DISCLOSURE TO FOREIGN GOVERNMENTS

H.R. 6767 also authorizes disclosure of information to foreign government⁵ with whom the United States has mutual assistance treaties. Apart from the objection we noted to disclosure to state officials, which applies with equal or greater force to this provision, such disclosure is problematic for another reason. A nation with whom the United States has a mutual assistance treaty could seek access to taxpayer records for use in a criminal investigation for which the standards of proof are dissimilar from those in the United States. Moreover, what is a crime in a foreign country may not be criminal in the United States. The extraordinary coercive powers of the IRS should not be used to gain information about individuals which would then be used for purposes not only different from those for which the information was obtained, but also unsupported by any legitimate United States interest.

SUMMONS PROCEDURES

As for H.R. 6764, which changes the administrative summons procedures under existing law (26 U.S.C. 7609), we have two objections. First, the bill would shift the burden in a summons enforcement proceeding from the government to the

taxpayer. This change reverses the basic presumption of our legal system, which is that the party seeking disclosure of information must bear the burden of going to court in order to justify that disclosure. Proponents of this change argue that H.R. 6764 simply brings the summons procedure into accord with procedures established by the Right to Financial Privacy Act of 1978 for all other agencies of the federal government. However, since IRS routine access to information about the financial dealings of individuals is vastly greater than any other agency, that analogy makes little sense. The special powers of IRS create a presumption against additional compulsory disclosure.

We also oppose the part of H.R. 6764 which would abolish the automatic stay provision of section 7609. Proponents cite the excessive delays which allegedly are created by existing law. However, the problem of time delays exists separately from the question of issuance of a stay to disclosure proceedings. Current law provides for automatic stays precisely because of the presumption against disclosure that exists as a basic component of the process. The question of time delays is properly dealt with by imposing time limits, which are provided for elsewhere in H.R. 6764, and not by altering a provision which enacts an important policy of privacy protection.

EXPEDITING PROCEDURES

We do support some of the proposed changes that would facilitate the use of judicial process, provided adequate standards of privacy protection are met. We endorse the imposition of time limits; the extension to magistrates of the authority to rule on government applications; the provision allowing attorneys for the government, rather than heads of agencies, to apply for disclosure; and the proposed changes in civil and criminal liability, allowing for a good faith defense to criminal prosecution, and governmental rather than individual liability for civil actions against unauthorized disclosures. In short, we endorse changes in the Tax Reform Act that will allow a constitutionally sound process, which respects individual rights, to proceed more expeditiously.

CONCLUSION

The claim that the proposed amendments put the IRS back into the fight against organized crime and drug traffic is a distortion. The IRS does not belong in that fight. Its special powers are not granted to facilitate law enforcement. To the extent that IRS in the past has been used as an investigative resource for other government agencies, its special authority was abused. The Tax Reform Act of 1976 was passed to correct those abuses. The current amendments threaten to undermine the Act by redefining the information that deserves protection, lowering the standard of proof necessary to justify disclosure and opening broader channels of dissemination. These changes carry with them an enormous potential for abuse and should not be adopted.

Mr. GIBBONS. We will get to you now, Mr. Thuronyi.

STATEMENT OF VICTOR THURONYI, LEGISLATIVE DIRECTOR, TAXATION WITH REPRESENTATION FUND

Mr. THURONYI. I appear here in line with the concern you expressed earlier in the evening about enacting badly or hastily drafted legislation.

I just have a couple of somewhat technical points that I would like to make clear before you get bogged down in the drafting.

One of these has to do with the definition in code section 6103 of the three categories of returns, return information and taxpayer return information. These categories were set up in 1976 and they are fairly clear. "Return" is obviously a return, and "return information" is anything that relates to the determination of the taxpayer's liability; and "taxpayer return information" is simply return information which was provided by the taxpayer himself to the Service.

The various procedural rules are applied to these three categories.

There is an exception to the category of "return information" and "taxpayer return information" and that is information that cannot be identified with a particular taxpayer.

The relevance of this exception is that for purposes of disclosing IRS information to the public. The IRS has various documents which are of great public interest but which cannot be associated with a particular taxpayer.

For example, the IRS issues private letter rulings. When a taxpayer wishes to engage in a transaction he asks the IRS whether it is OK, and these are very important in setting the precedent of the Service and lawyers would wish to consult these; and there are various other documents of this sort that the IRS is making available to the public.

For example, with your permission I would like to include the brief opinion in a suit which is now pending between us and the IRS, which discloses some of these documents general counsel's memoranda and actions on decision. It is an opinion by Judge Richey of the U.S. District Court in the District of Columbia. This decision would be overturned by the bills as they are now drafted.

Mr. GIBBONS. We will place that in the record.

Mr. THURONYI. There is another case, *Long v. Internal Revenue Service* (596 F. 2d 362 (9th Cir. 1979)), which would be overturned by the Nunn bill as it is now drafted because the Nunn bill for some reason does not include the exception for information that cannot be associated with a particular taxpayer.

What that means is that privacy protection would be given to virtually all documents in the Treasury Department and that documents like private letter rulings could no longer be disclosed. That would be very unfortunate and the GAO draft attempts to correct that, but it does so incorrectly, as far as I can see, as I point out in my prepared statement.

The basic message of this is that whatever is decided about what the IRS can disclose to the Justice Department, there is no reason not to operate with the existing categories. There is no showing that these categories are inadequate.

We ask if you submit a written question to the Commissioner that you ask them to specifically say what is the problem with this definition, because it is a definition that the courts have now had a chance to interpret and the IRS is familiar with and there doesn't seem to be any problem with it, and now there are various drafts floating around with different wording changes.

It would be much simpler to keep the present law and just operate with those categories. That is just a very simple point I would like to make.

The other point has to do with summons enforcement procedure.

Generally, the approach of the administration in the redrafting of the Nunn bill help a lot because the right of appeal is very important and that is helped in the administration version.

I think the other essential matter is that in a summons enforcement proceeding the district judge or magistrate hearing the case should be given discretion to hold an evidentiary hearing and grant discovery as under current law, and in that context I am a little uneasy about the time limit that is imposed. I don't see any problem

with the time limit in a case you can just decide on the pleadings but I think it would be important that the district judge have that discretion to order discovery.

I would like to make a point that hasn't been brought up in these hearings thus far. One of the reasons why people might see a problem in these summons proceedings, and one of the reasons that there are frivolous litigations is that the substantive law that applies is, I think, incorrect, in the sense that there is a doctrine most recently embodied in *United States v. LaSalle National Bank* (437 U.S. 298 (1978)), that denies the IRS the authority to use the summons for criminal investigations.

However, *LaSalle* turns around and applies a standard that is very liberal, so that the IRS can virtually always use the summons for a criminal investigation. There is nothing wrong with the IRS using a summons to investigate tax crimes. The IRS conducts criminal investigations which are closely bound up with the civil tax investigation. There is nothing wrong with that. Therefore, I propose in my written statement that it would take just a couple of words to give the IRS the authority to use the summons for criminal tax investigations.

I would also suggest if you submit questions to the Commissioner that you ask them, "Would you like us to do that?" Because I think the IRS would answer that they would like that. It would clear up the law and in doing so would eliminate a lot of frivolous complaints from these summons enforcement proceedings. But the thing is that under *LaSalle*, if you bring up the criminal purpose defense, under the *LaSalle* standard a taxpayer always loses, but the taxpayer has the benefit of delay and appeal and so on.

So the whole thing is ridiculous. The law should be made very clear so that at least this issue is just removed from the summons enforcement proceedings. That will help because it will reduce the number of cases and simplify them. That means that we won't have to be as draconian in cutting down the procedural rights of the taxpayer which are very important.

I think a statement by M. Carr Ferguson of the Justice Department made on April 22, 1980, before the Senate Committee on Appropriations, points out the danger of not amending the law in the way I suggest because what Mr. Ferguson says is that because of *LaSalle* the IRS and the Justice Department are now considering expanding the use of the grand jury in a combined nontax and tax investigation. Because the IRS can often not get, or is reluctant to get, information relating to tax matters when there is another grand jury investigation pending, what Justice and IRS now want to do is use the grand jury to do the work of the IRS and investigate taxpayer matters.

My point is that that should not be the function of the grand jury, that should be done through the administrative summons.

If we make it clear that the IRS has the authority to use the summons in these cases, we won't get the grand jury mixed up in a lot of cases that it shouldn't be in. It should be made clear that the IRS can use the summons in all tax investigations whether civil or criminal. It is that simple. In this way we don't get the problem of having people respond to grand jury subpoenas in tax investigations. That would be very inappropriate and cumbersome. It provides less protection to the

defendant because it is much more onerous to go before the grand jury than it is to answer an administrative summons.

So, I suggest that as one possibility, just to make really a clarifying change in the substantive law, to give the IRS that authority. I think that would help out a lot and simplify these summons cases.

Mr. JENKINS. Does Justice oppose that? Does it extend some protection or give some rights that are not now present? What is the problem? Do you know whether or not Justice has taken a position on that?

Mr. THURONYI. I think if you ask the Justice Department or IRS, they would favor it. I think they haven't wanted to get into the area but I don't understand why not, because it seems to me this is a good way to clean up a matter and settle an issue.

It is really a clarifying matter and I have a detailed article at the end of my statement explaining all of this, and why this is not really a big change from current law.

Mr. GIBBONS. It is a little difficult to ask questions after the many hours I have been sitting today, but I realize that this is very delicate pendulum that we are working with here and if you push too hard it can swing way out of the proper arc. I am glad that you don't oppose all of the proposed changes and I am glad that the Justice Department and the IRS are talking now better than we found them talking 4 years ago when we first discussed this.

When my mind is sharper and my other end is not as dull, I will read over your statements and try to propound some intelligent questions, but don't hesitate to let us know when we are getting to any markup what your suggestions are about this.

I would ask the staff to work with you two gentlemen, to make sure that your views are thoroughly considered in anything we come up with. The legislation I introduced, of course, was offered so we could get a debate started on it, and I must state that I am glad that I have someone like Mr. Jenkins here on the committee with me. It has been so many years since I either prosecuted or defended a criminal case, it would be a crime if I tried right now. I don't want to do that; but I recognize the delicacy of the matter and I do not want to trample on any of these rights.

[The prepared statement follows:]



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Statement

by

Victor Thuronyi, Legislative Director

and

Thomas F. Field, Executive Director

Taxation with Representation Fund

regarding

S. 2402 and S. 2403, relating to

DISCLOSURE OF TAX RETURNS AND RETURN INFORMATION

AND IRS SUMMONS ENFORCEMENT PROCEDURE

I. Disclosure of Returns and Return Information

The principal purpose of S. 2402 is to facilitate the disclosure of IRS information to other government personnel. We leave it to others to comment on the wisdom of this measure. Our concern is that this bill is being used as a means of restricting legitimate public access to IRS records. This restriction is being accomplished by changing the present law definitions of "return information" and "taxpayer return information."

As the following analysis will show, it is entirely unnecessary and inappropriate to change the definitions of these categories to accomplish the purposes of the bill. We therefore recommend that the definitions in section 6103(b) be retained, and that any changes in the procedure for disclosing these categories of information be made in terms of these existing categories.

A. The IRS and the Freedom of Information Act

The Internal Revenue Service has traditionally been among the most secretive of federal agencies. This secretiveness results from ingrained tradition, which has only been curbed by protracted litigation. Our own group (along with our predecessor organization, Tax Analysts and Advocates) has been a leader in this effort. Other notable contributions have been made by Public Citizen's Tax Reform Research Group, and by Philip and Susan Long of Seattle, Washington.

As a result of the combined efforts of these groups and individuals, the Internal Revenue Service has been forced, during the past decade, to make public its letter rulings and technical advice memos, the comments received from the public regarding its regulations, the Internal Revenue Manual, general counsel's memoranda, actions on decision, technical memoranda underlying regulations, and its taxpayer compliance measurement program documents.

None of these documents, in the form disclosed, contains information that can be associated with a particular taxpayer. In each of these cases, the courts have determined, first, that the public had a right under the Freedom of Information Act to the information contained in these documents, and, second, that release of this data would not jeopardize the work of the Internal Revenue Service. Our experience, and that of other groups, has confirmed the correctness of both these judgments by the courts.

Secrecy Legislation

However, the struggle with the Internal Revenue Service has not been confined to the courts. The Service has periodically tried to obtain from Congress more-or-less blanket exemptions from the Freedom of Information Act. The most recent instance of an effort along these lines came during the 1976 Tax Reform Act consideration of amendments to sections 6103 and 6110 of the Internal Revenue Code. The upshot of this legislative struggle was a compromise provision, under which modified definitions of the terms "return" and "return information" were incorporated into section 6103 of the Code, at the same time that detailed rules for the disclosure of IRS rulings and technical advice memoranda were enacted as section 6110 of the Code.

The language of S. 2402 suggests that the IRS wants to reopen the information disclosure question once again. One reason appears to be the Service's concern regarding our recent victory in the courts in our suit to obtain disclosure of general counsel's memoranda, actions on decision, and

technical memoranda; and the recent decision by the Ninth Circuit Court of Appeals that the Service must disclose the data underlying its taxpayer compliance measurement program, in response to a suit by Philip and Susan Long.

We have read the recent remarks of the Commissioner of Internal Revenue in an interview, expressing concern about both these decisions. While we have great respect for the Commissioner, we believe that his comments misconstrue the scope of our victory in our GCM, AOD, and Tech Memo suit. The Commissioner fears that this suit may inhibit internal decision-making in the IRS, and the free flow of advice from subordinate to superior. But the courts have repeatedly made it clear in Freedom of Information Act cases that the mandate of the Act does not apply to predecisional memoranda of advice, unless and until the agency begins to use those memoranda as the basis for subsequent decisions affecting the public. At that point, as the courts have repeatedly declared, the memoranda must be made available for public scrutiny, since, in the words of one of our Freedom of Information Act decisions, "secret law is an abomination."

Clearly, general counsel's memoranda, actions on decision, and technical memoranda -- which are carefully retained, classified, indexed, and consulted by the IRS -- constitute a body of secret law. Nothing should be done by this Committee that will jeopardize their prompt disclosure to the public in accordance with court order and with any deletions that may be necessary to preserve privacy.

Similarly, the data underlying the Service's Taxpayer Compliance Measurement Program is an appropriate subject for disclosure. In our view, the IRS kept secret for too long the data showing the rapid growth of the underground economy, thus slowing public consideration and debate regarding this serious problem.

In addition, secrecy regarding this data has made it difficult to analyze and critique discrepancies in IRS administrative handling of taxpayer audits and returns. Susan Long's work makes it very clear that some IRS districts are "tough" while others are "lenient" in their dealings with taxpayers. This critique, leading as it should to more equal inter-district treatment of similarly situated taxpayers, could not have taken place without the information that Ms. Long obtained under the Freedom of Information Act.

Information Restrictions Are Premature

This is not the time, in our view, to reopen the question of IRS compliance with the Freedom of Information Act. The ink is hardly dry on the 1976 amendments to section 6103, and the courts have only just begun to construe the new legislative language. There is no indication that their decisions, properly

read and interpreted, are likely to jeopardize IRS administration of the tax law. Speculation about possible future problems, from an agency that has determinedly refused to comply with the Freedom of Information Act in the past, is hardly a sound basis for overturning a statutory compromise that is less than four years old.

Accordingly, we recommend that the proposed provisions of S. 2402 which would establish a new, protected category of "nonreturn information," be dropped from the bill. Those provisions are a threat to court-ordered public disclosure and are non-germane to the main purposes of S. 2402. At a later date, after we have more experience regarding the scope and meaning of the 1976 information disclosure provisions, changes in the Code may be in order. But changes now are certainly premature.

B. The Proposed Redefinition Is Not Necessary to Accomplish the Bill's Objectives.

Current law dividea confidential IRS information into three categories: returns, return information, and taxpayer return information. Return information is defined by a list of items including such things as taxpayer identity, receipts, and deductions collected with respect to a return or with respect to a determination of liability. However, return information does not include "data in a form which cannot be associated with...a particular taxpayer." Finally, taxpayer return information means return information which is furnished to the IRS by a taxpayer.

S. 2402 does not substantially change the definition of returns, except for a wording change. However, instead of retaining the categories of current law, the bill amalgamates the categories of "return information" and "taxpayer return information," and rewords their definition. In two respects, the definition is broadened. First, nonreturn information includes "information...which the Secretary collects...with respect to a taxpayer." Since we are all taxpayers, presumably any information pertaining to anyone is collected with respect to a taxpayer. It is not clear why this phrase is needed, since the current definition includes information collected "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." This seems to be a broad and adequate definition and should not be changed unless the IRS makes out a case for change.

Second, and more important, the new category of nonreturn information leaves out the provision of current law that return information and taxpayer return information do not include "data in a form which cannot be associated with...a particular taxpayer." The purpose of this provision is to

make publicly disclosable information to which the public is entitled and which will not violate the privacy of a particular taxpayer. As noted in our argument in the preceding section, we strongly object to the deletion of the current exception.

Further, the change is not necessary to accomplish the bill's purposes. Since the category of "nonreturn information" is meant to subsume the existing categories of return information and taxpayer return information, the bill could be re-drafted to accomplish the same disclosure to governmental personnel by just substituting the term "return information or taxpayer return information" wherever the term "nonreturn information" occurs in the bill. Thus, the bill's objectives can be accomplished without upsetting the existing delicate balance in the area of disclosure to the public.

C. The GAO Draft

The GAO Draft (See Disclosure and Summons Provisions of 1976 Tax Reform Act, GAO Report No. GGD-80-76, June 17, 1980, Appendix II) also amalgamates two categories of existing law, but it consolidates returns and taxpayer return information and renames return information as non-return information. Under the draft, the same protection is extended to taxpayer return information as to returns. Again, it is difficult to see why the draft could not just keep the categories as they are, referring to returns and taxpayer return information in conjunction.

The GAO definition of non-return information is even broader than that contained in S. 2402. It includes "any information which the Secretary collects, obtains, or receives...which is not a return." This would make secret any information coming into the Treasury Department and is hence extremely overbroad. The GAO draftsman attempts to meet our concern about the omission of the qualification that return information should not include data that cannot be associated with a particular taxpayer. However, this qualification is grafted onto the definition of returns, but is omitted from the definition of nonreturn information. Since nonreturn information is defined as anything the Secretary receives that is not a return, anything that is excepted by the qualifying clause becomes nonreturn information, which may not be disclosed to the public.

The moral of the GAO exercise seems to be that the rather technical definitions that have been worked out in the 1976 law should be left as they are, absent a good reason for change. The GAO report (page II-2) asserts that the current definitions are unclear but gives only one example of an ambiguity: "It is not clear, however, whether information qualifies as taxpayer return information when, for example, the taxpayer's witness decides to testify

against the taxpayer and supplies information harmful to the taxpayer's case." If the only problem with the definitions of the three existing categories is the rather obscure possibility cited by the GAO report, then the definitions seem to be more airtight than many in the law. There are ambiguities in any definition, and there will be as many in the proposed changes as under existing law. To the extent that existing law is ambiguous, the courts should be given time to perform their traditional role of eliminating ambiguity through judicial construction -- but they cannot perform this role if the statute is subject to constant change. In the absence of a rather stronger showing of problems than that furnished by the GAO report, the definition should be left alone.

II. S. 2403: IRS Summons Enforcement Procedure

S. 2403 deals with the procedure for enforcing third-party summonses. These are summonses issued to a party not under investigation, such as a bank, to obtain records relating to a taxpayer under investigation. Section 7609 currently requires the IRS to give notice to the taxpayer at least two weeks before the day on which the third party's records relating to the taxpayer are to be examined. The taxpayer then has two weeks to stay compliance with the summons simply by writing the third party recordkeeper and sending a copy to the IRS. If the IRS wants to enforce the summons, it then has to go into court under section 7604 and initiate a civil action. Apparently, at this stage many taxpayers don't even show up in court, with the result that they have obtained a delay of at least several weeks. If the investigatee does show up, he does not have as broad rights of discovery as in the usual civil action. Rather, under Rule 81(a)(3) of the Federal Rules of Civil Procedure, the district court has discretion to grant limited discovery, and usually even limited discovery is granted only if a colorable claim is made out at an evidentiary hearing at which the IRS agent in charge of the investigation is deposed. After the district court issues an order enforcing the summons, the taxpayer may appeal, and can often have the court stay compliance with the summons pending appeal.

The problem with summons enforcement proceedings which the Nunn bill seeks to address is that most of them are not meritorious and are used as a technique for delay. In addressing this problem, the Nunn bill goes too far, and removes virtually all the procedural rights open to a taxpayer. By requiring the district court to enter an order within ten days of the filing of the government's response to the taxpayer's motion, the bill seems to contemplate the

abolition of any possibility of an evidentiary hearing in a context in which such a hearing, and in an appropriate case discovery from the IRS, is necessary in order to sort out the few cases that may have some merit from the many that are initiated solely for delay. In addition, the Nunn bill cuts off a taxpayer's right to appeal the district court's order. It is true that it leaves open the possibility of challenging the summons in a later proceeding in which information obtained through the summons is used. This challenge is unlikely to be of much use, however, unless the application of the exclusionary rule is to be greatly broadened.

It may be appropriate to streamline the procedures for enforcing a summons. But such streamlining should not eliminate the taxpayer's rights to an evidentiary hearing, to limited discovery, and to appeal from the order enforcing the summons. The denial of an appeal seems particularly offensive, since it seems under S. 2403 that while an order enforcing a summons is not appealable, an order refusing to enforce a summons is appealable by the government. This creates a "Heads I win, tails you lose" situation for the government that overcorrects for the problems that are now experienced in obtaining timely compliance with valid summonses.

We would like to suggest that one way of ameliorating these problems would be to redefine the substantive standards of what summonses are considered valid by means of a bright line test that would simplify enforcement proceedings and eliminate those proceedings that deal only with the criminal purpose issue.

The criminal purpose defense to an IRS summons grew out of court cases misconstruing the statute authorizing the issuance of IRS summonses. The enclosed excerpt from Developments in the Law -- Corporate Crime, 92 Harv. L. Rev. 1227, 1320-33 (1979) develops the argument in greater detail.

The basic point of that article is that under current law, the IRS does have the authority to conduct criminal tax investigations, and it uses the summons for this purpose up to the point that the case is turned over to the Justice Department for prosecution. This authority has been upheld by the courts, but in a way that still enables taxpayers to challenge summonses under the criminal purpose defense as a means of delay. There is no good reason not to give the IRS the authority it has already, but to do so in objective language that leaves open no possibility for taxpayer challenge on this ground.

If this is done, then persons challenging summonses on other grounds, such as harassment or overbreadth, will be able to proceed in the context of a docket that has been

cleared of the worthless criminal purpose issue. Judges will then be able to concentrate on the grounds for challenge that may actually be of some merit, and cases will be able to proceed more expeditiously, without any abridgment of procedural rights. If this change is insufficient to move cases along with the requisite speed, then some procedural streamlining may also be appropriate, but it will not have to be as draconian as proposed in S. 2403. We would note also that the suggested change would be applicable to ordinary summonses (where the taxpayer is summoned directly) as well as third party cases, and so would have a beneficial effect on and treat equally all IRS summons cases.

Draft of Suggested Substantive Amendment

The substantive amendment to the IRS's investigatory authority suggested in the accompanying article is very easily drafted. Section 7602 of the Internal Revenue Code should be amended by inserting after the words "for any internal revenue tax" the words "or the guilt of any person of a crime or offense defined in Chapter 75 of this Title." This clarifies the IRS's authority to use the summons to develop a criminal tax case.

B. Use of Administrative Summonses for Criminal Investigation

Agencies empowered to investigate violations of economic regulatory legislation may issue summonses to obtain testimony and documents.⁵⁶ When the result of the agency's investigation is a criminal prosecution (whether or not in addition to separate civil proceedings), responsibility for the criminal prosecution is vested in the Justice Department. Such criminal cases commence formally with the convening of a grand jury and, after an indictment is returned, are governed exclusively by the Federal Rules of Criminal Procedure.

This Section addresses problems which arise from the division of responsibility sketched above. Courts have supervised agency investigations implicating a potential or pending criminal prosecution by attempting to fix the point at which the criminal element of an investigation predominated, so that only the Justice Department, and not the agency, might proceed. Bound up with this determination are procedural issues of intervention and discovery at proceedings to enforce summonses, and standing to suppress evidence at trial.

⁵³ See p. 1315 & note 23 *supra*.

⁵⁴ The statement in text refers only to antitrust matters enforced by the Department of Justice. See generally 2 P. AREEDA & D. TURNER, *ANTITRUST LAW* ¶ 305c (1978).

⁵⁵ See 15 U.S.C. §§ 1311-1314 (1976).

⁵⁶ See 15 U.S.C. §§ 46, 49, 50 (1976) (FTC); 47 U.S.C. § 409(e) (1976) (FCC); 49 U.S.C. § 1484 (1976) (CAB); 29 U.S.C. § 657(b) (1976) (OSHA); 15 U.S.C. §§ 775(b), 77uuu(a), 78u, 79r, 80a-41, 80b-9 (1976) (SEC); 15 U.S.C. § 1714 (1976) (Office of Interstate Land Sales Registration, HUD).

1. *The Improper Purpose Doctrine.*—In the leading case of *United States v. O'Connor*,⁵⁷ Judge Wyzanski refused to enforce an IRS summons⁵⁸ issued after indictment and at the informal request of the Justice Department. He noted that the criminal process contemplated only one “agency of compulsory disclosure” — the grand jury — so that after indictment the government possessed no power to obtain compulsory discovery.⁵⁹ Thus, where issuance of a summons was not justified by a bona fide independent investigation,⁶⁰ the court would not allow the government to obtain discovery by this means.

In subsequent cases, some circuits began to develop a doctrine that an IRS summons issued *before* indictment would not be enforced if issued for the “improper purpose” of solely criminal investigation.⁶¹ The Supreme Court first gave full consideration

⁵⁷ 118 F. Supp. 248 (D. Mass. 1953).

⁵⁸ Because most litigation has arisen in connection with enforcement of IRS summonses, the analysis will focus on these. See generally Gilbert, *Emanations of the “Shift-of-Emphasis” Theory—The “Improper Purposes” Doctrine Revisited*, 5 SUFFOLK U.L. REV. 35 (1970); Lyon, *Government Power and Citizen Rights in a Tax Investigation*, 25 TAX LAW. 79, 79-85 (1971); Nuzum, *LaSalle National Bank and the Judicial Defenses to the Enforcement of an Administrative Summons*, 32 TAX LAW. 383 (1979); Saltzman, *Supreme Court’s LaSalle decision makes it harder to successfully challenge a summons*, 49 J. TAX. 130 (1978); Stroud, *The Criminal Prosecution Defense: A Defense to a Section 7602 Summons?*, 4 AM. J. CRIM. L. 152 (1975-1976); Wilson & Matz, *supra* note 13, at 653-83; *Symposium on Federal Civil and Criminal Income Tax Fraud Investigations*, 2 HOFSTRA L. REV. 129, 135-52 (1974); Comment, *Constraints on the Administrative Summons Power of the Internal Revenue Service*, 63 IOWA L. REV. 526 (1977); Comment, *Taxpayer Intervention at Summary Proceedings to Enforce an Internal Revenue Service Summons*, 32 MD. L. REV. 143, 150-55 (1972); Comment, *The Improper Purpose Challenge to the Section 7602 Summons*, 31 TAX LAW. 226 (1977); 54 TEX. L. REV. 1147 (1976).

Any IRS agent may issue a summons. See I.R.C. §§ 7602, 7701(a)(11)(B); Delegation Order No. 4 (Rev.), 22 Fed. Reg. 3894 (1957). A summons is not self-executing, so that if the person summoned refuses to comply, which he may do without penalty, see *Reisman v. Caplin*, 375 U.S. 440, 446-49 (1964) (as long as he does so in good faith, see *United States v. Murdock*, 290 U.S. 389, 397-98 (1933)), the agency must petition a district court for enforcement under I.R.C. § 7604.

⁵⁹ 118 F. Supp. at 250-51.

⁶⁰ The court argued that since the IRS agent did not have “any specific matter involving [the taxpayer]” pending before him, he could not claim authority to issue the summons under a statute which authorized issuance only for the purpose of investigation. See 118 F. Supp. at 250.

⁶¹ See *United States v. Morgan Guaranty Trust Co.*, 572 F.2d 36, 39-41 (2d Cir.), *cert. denied*, 99 S. Ct. 89 (1978). In *Boren v. Tucker*, 239 F.2d 767, 772-73 (9th Cir. 1956), an IRS summons was challenged on the ground that it was being employed for criminal investigation. In rejecting the challenge, the court distinguished *O'Connor* as involving a summons issued after indictment. See also *In re Magnus, Mabee & Reynard, Inc.*, 311 F.2d 12, 14-15 (2d Cir. 1962), *cert. denied*, 373 U.S. 902 (1963). Later, confusion was engendered by dictum

to this issue in *Donaldson v. United States*.⁶² There a taxpayer had sought to intervene in a proceeding to enforce a third-party summons, arguing that the summons should not be enforced because it was issued "in aid of an investigation that ha[d] the potentiality of resulting in" a criminal prosecution.⁶³ After denying intervention, the Court nevertheless went on to consider the merits of the challenge to the summons. Reviewing the statutory grant of investigatory authority, it concluded that "Congress clearly has authorized the use of the summons in investigating what may prove to be criminal conduct."⁶⁴ The Court adopted, however, the developing improper purpose doctrine, which it indicated was "applicable to the situation of a pending criminal charge" and perhaps to "an investigation solely for criminal purposes."⁶⁵ A summons would be upheld if "issued in good faith and prior to a recommendation for criminal prosecution."⁶⁶ Lower courts were left to decide, first, when the "recommendation for criminal prosecution" took place; and second, whether a prerecommendation summons issued "solely" for the purpose of criminal investigation would necessarily fail the good faith requirement.

Most courts which addressed the first issue decided that the relevant recommendation was referral from the IRS to the Justice Department,⁶⁷ rather than any recommendation within the IRS

in *Reisman v. Caplin*, 375 U.S. 440 (1964), a case not involving the criminal purpose issue, in which the Court said that a summons could be challenged "on any appropriate ground . . . includ[ing] . . . the defense that the material is sought for the improper purpose of obtaining evidence for use in a criminal prosecution," *id.* at 449 (citation omitted). Lower courts after *Reisman* assumed that this "improper purpose" defense applied to summonses issued before indictment, despite the citation of *Boren*, a case refusing to apply the doctrine before indictment. See *United States v. Erdner*, 422 F.2d 835 (3d Cir. 1970); *United States v. Roundtree*, 420 F.2d 845, 851 (5th Cir. 1969); *United States v. Michigan Bell Tel. Co.*, 415 F.2d 1284 (6th Cir. 1969); *DiPiazza v. United States*, 415 F.2d 99, 102-03 (6th Cir. 1969), *cert. denied*, 402 U.S. 949 (1971); *Wild v. United States*, 362 F.2d 206 (9th Cir. 1966). *But see* *Howfield, Inc. v. United States*, 409 F.2d 694, 697 (9th Cir. 1969).

⁶² 400 U.S. 517 (1971).

⁶³ *Id.* at 532. This is the argument to which the Court responded. In the district court, the taxpayer made the stronger argument that the summons was issued "for the express and sole purpose of obtaining evidence concerning any violations of the criminal statutes," *id.* at 521.

⁶⁴ *Id.* at 535.

⁶⁵ *Id.* at 533.

⁶⁶ *Id.* at 536.

⁶⁷ See *United States v. Hodge & Zweig*, 548 F.2d 1347, 1351 (9th Cir. 1977). In *United States v. Billingsley*, 331 F. Supp. 1091 (N.D. Okla. 1971), *rev'd and remanded*, 469 F.2d 1208 (10th Cir. 1972), the district court denied enforcement where the local special agent had in writing made a recommendation for prosecution, but the IRS regional office had taken "no action on the recommendation other than to request that the Special Agent in charge of the case make a

hierarchy.⁶⁸ On the second issue, the Second Circuit in *United States v. Morgan Guaranty Trust Co.*⁶⁹ suggested that the good faith requirement be limited to prevent abuses such as harassment,⁷⁰ and that the improper purpose inquiry therefore be restricted to an "objective test," under which a summons would generally be enforced if issued prior to referral for prosecution.⁷¹ Most courts, however, chose to read the ambiguous *Donaldson* opinion broadly to preclude enforcement of summonses issued prior to recommendation if "the sole purpose of the summons was to obtain evidence for a criminal prosecution,"⁷² or even if the investigating agent had formed a firm purpose to recommend prosecution.⁷³

The "objective test" can be justified by the practicalities of summons enforcement proceedings. Most challengers lose on the merits, but the delay involved in discovery and appeal can be of great advantage — it makes it less likely that an indictment will be brought within the statutory limitations period, and in general allows time for the occurrence of events which cause abandonment of the prosecution, such as loss of interest and changes in policy or personnel on the part of the prosecution. The "objective test," in cutting off many claims without discovery procedures, largely eliminates the advantage of opposing a summons solely for the purpose of delay. Motivated by the same concern to prevent abuse of litigation, courts rejecting an objective test have

supplemental investigation," 331 F. Supp. at 1092 n.2. The Tenth Circuit reversed, holding that "the 'recommendation' referred to in *Donaldson* occurs, at the earliest, when the Internal Revenue Service forwards a case to the Department of Justice for criminal prosecution," 469 F.2d at 1210.

⁶⁸ *But see* *United States v. Oaks*, 360 F. Supp. 855 (C.D. Cal. 1973), *remanded on other grounds*, 508 F.2d 1403 (9th Cir. 1974). *Oaks* held that prosecution is recommended when "the local special agent in charge of the case" recommends prosecution, "even if [the recommendation is] not final or reduced to writing." 360 F. Supp. at 858. There, a written recommendation for prosecution was not made until nine days after the defendant's arrest.

⁶⁹ 572 F.2d 36 (2d Cir.) (Friendly, J.), *cert. denied*, 99 S. Ct. 89 (1978).

⁷⁰ *See* 572 F.2d at 40-41 (discussing *United States v. Powell*, 379 U.S. 48, 58 (1964)).

⁷¹ *See id.* at 41. *See also* *United States v. Troupe*, 438 F.2d 117 (8th Cir. 1971).

⁷² *United States v. Weingarden*, 473 F.2d 454, 461 (6th Cir. 1973); *see, e.g., United States v. Zack*, 521 F.2d 1366, 1368 (9th Cir. 1975); *United States v. McCarthy*, 514 F.2d 368, 374-75 (3d Cir. 1975).

⁷³ *See* *United States v. Friedman*, 532 F.2d 928, 932 (3d Cir. 1976); *United States v. Wall Corp.*, 475 F.2d 893, 895 (D.C. Cir. 1972); *United States v. Oaks*, 360 F. Supp. 855, 858-59 (C.D. Cal. 1973), *remanded on other grounds*, 508 F.2d 1403 (9th Cir. 1974).

shortened enforcement proceedings by limiting the availability of discovery.⁷⁴

Last Term, in *United States v. LaSalle National Bank*,⁷⁵ the Supreme Court was faced with a conflict between the "objective test" and the decision of the court below, which determined "good faith" by looking to the state of mind of the IRS agent at the time he issued the summons. Steering a middle course, the five-to-four decision by the Court laid down a test which will fail to resolve confusion in the lower courts.⁷⁶ The opinion by Justice Blackmun, the author of *Donaldson*, retained but redefined the two-part test requiring that a summons be issued in good faith and prior to recommendation for criminal prosecution.

The Court first reviewed the statutory scheme authorizing investigations and affirmed the validity of civil investigations with criminal potential: "Congress has not categorized tax fraud investigations into civil and criminal components."⁷⁷ But as a matter of statutory construction, the Court held that since the statute contained no "affirmative grant of summons authority for purely criminal investigations,"⁷⁸ these were not authorized.

The Court relied on two policy concerns in restricting the availability of summonses even where seemingly authorized because of an ongoing civil investigation. Summonses were not meant "to broaden the Justice Department's right of criminal litigation discovery or to infringe on the role of the grand jury as a principal tool of criminal accusation."⁷⁹ These policy interests justified a "prophylactic" rule precluding enforcement of any summons issued after referral. The Court acknowledged that a line drawn at referral did not offer absolute protection against infringement of these interests. The potential for infringement exists earlier, when the investigating agent recommends prosecution, but the Court argued that such a possibility was "remote."⁸⁰ The point at which the prophylactic rule would apply was decided through a candid effort to balance the interest in civil IRS investi-

⁷⁴ See *United States v. Church of Scientology*, 520 F.2d 818, 824-25 (9th Cir. 1975); *United States v. Salter*, 432 F.2d 697, 700-01 (1st Cir. 1970); pp. 1330-31 *infra*.

⁷⁵ 437 U.S. 298 (1978).

⁷⁶ Compare *United States v. Serubo*, 460 F. Supp. 689, 695-99 (E.D. Pa. 1978) (pre-referral summons in course of joint civil and criminal investigation invalid because information shared with Justice Department) (dictum), with *United States v. Chemical Bank*, 43 A.F.T.R.2d 79-486 (2d Cir. 1979) (cooperation between IRS and Justice Department in a "strike force" investigation does not invalidate the IRS summons). Both cases relied on *LaSalle*.

⁷⁷ 437 U.S. at 311.

⁷⁸ *Id.* at 316 n.18.

⁷⁹ *Id.* at 312.

⁸⁰ *Id.* at 313 n.15.

gation⁸¹ against the competing policy interests identified by the Court.

While ruling that a summons issued after referral would not be enforced, the Court declined to accept the proposition that all summonses issued before referral were valid.⁸² The district court in *LaSalle* had found that the IRS agent who had issued the summons was solely interested in “unearthing evidence of criminal conduct,”⁸³ and had refused enforcement on this ground. The Supreme Court, however, felt that examination of the agent was insufficient to establish what it perceived to be the relevant consideration — “the institutional posture of the IRS.”⁸⁴ The Court noted that an agent’s recommendation to prosecute is reviewed at several layers within the IRS, and that “[a]t any of the various stages, the Service can abandon the criminal prosecution, can decide instead to assert a civil penalty, or can pursue both goals.”⁸⁵ Thus, even though the agent issuing the summons intends to use it only for criminal purposes, the possibility that the Service would change its mind and decide to use the evidence for civil purposes after all allows the summons to conform to the requirement that it be issued for civil investigatory purposes.⁸⁶ In order to block enforcement, the taxpayer must show that the IRS as an institution has abandoned the determination of civil tax liability. The Court’s ruling also serves to block out the boundaries of appropriate discovery. Arguing that inquiry into the agent’s motives leads to fruitless delay, the Court said that discovery must be limited to “an examination of the institutional posture of the IRS.”⁸⁷

The *LaSalle* rule is an unsatisfactory solution to the problems raised by the overlap of agency summons and criminal prosecution. The Court argued that a summons is validated by the possibility of a decision at a later step in the review process to seek

⁸¹ In most cases, action on the civil aspects of a case will be suspended after referral “until the criminal aspects are closed,” POLICIES OF THE IRS HANDBOOK, P-4-84, reprinted in 1 CCH INTERNAL REVENUE MANUAL 1305-10 (1978), so that the IRS’s interest in immediate summons enforcement is minimal. See also Office of the Chief Counsel, IRS, Civil Considerations in Pending Criminal Matters, Order No. 3050.1 (March 23, 1978).

⁸² See 437 U.S. at 316-17.

⁸³ *Id.* at 308.

⁸⁴ *Id.* at 316.

⁸⁵ *Id.* at 315.

⁸⁶ *But cf.* United States v. Procter & Gamble Co., 187 F. Supp. 55, 58 (D.N.J. 1960) (intent at time grand jury was called, not possibility of indictment in future, relevant factor in determining abuse of grand jury for civil purposes).

⁸⁷ 437 U.S. at 316. The Court did not make clear whether such an examination should involve inquiry into the particular agent’s motives. The agent’s motives may be more significant, the Court noted, in proving other sorts of lack of good faith, such as harassment, see *id.* at 316 n.17.

a civil penalty. It seems that the institutional good faith requirement can be failed only where the decision to proceed criminally has been made at the final layer of review within the agency.⁸⁸ As the Court acknowledged, only an "extraordinary departure"⁸⁹ from normal procedure could lead the IRS to fail the good faith test. Thus the practical effect of *LaSalle* is likely to be the same as if the *Morgan* rule had been accepted, in that all summonses issued before referral will be enforced, except that the investigatee will be given the chance to obtain some discovery. Such discovery, however, will be quite circumscribed,⁹⁰ since the only relevant concern is the final institutional recommendation.

As an exercise in statutory construction, *LaSalle* is unconvincing. While, as the Court noted, there is no explicit grant of authority for solely criminal investigation, there is also nothing in the legislative history to suggest that Congress intended to prohibit such use of the summons power.⁹¹ The Court should have more closely examined the policy interests it invoked. If the articulated interest of preventing destruction of the limits on criminal discovery or infringement of the role of the grand jury is nothing more than a desire to keep things separate out of a sense of judicial propriety or concern for appearances, it is inconsistent with the Court's own observation that Congress did not intend such a compartmentalization.⁹² The Court's concern to prevent infringement of the grand jury is also misplaced. Any differences between summons and subpoena in substantive scope or procedural protection operate in the direction of making the subpoena the more powerful tool for the government.⁹³ Thus, in terms of the protections provided by law, a defendant has nothing to complain of when investigated by summons rather than subpoena. True, a defendant may prefer that process be issued by a United States attorney rather than an agency employee, since the latter may be motivated by prior involvement to issue a summons in order to harass. Such motivation could be entirely vindictive or could arise from the desire to press settlement of a collateral civil matter. However, the danger of such abuse can best be dealt with under

⁸⁸ See *id.* at 315.

⁸⁹ *Id.* at 314.

⁹⁰ See *United States v. Marine Midland Bank*, 585 F.2d 36, 39 (2d Cir. 1978). But see 437 U.S. at 320 (Stewart, J., dissenting).

⁹¹ I.R.C. § 7602 authorizes issuance of a summons "[f]or the purpose of ascertaining the correctness of any return." Since filing an incorrect return (with the requisite *mens rea*) may subject the filer to criminal sanctions, see I.R.C. §§ 7201-7207, the statute can fairly be read to authorize an investigation solely designed to determine criminal liability, as such a determination involves "ascertaining the correctness" of the return.

⁹² See 437 U.S. at 311; p. 1324 *supra*.

⁹³ See pp. 1312-13 *supra*.

the rubric of harassment, an independent ground for refusal to enforce a summons.⁹⁴

The argument that administrative summonses should not be allowed to subvert limitations on criminal discovery, which apply after indictment, is more persuasive.⁹⁵ Discovery from the defendant is limited to items which the defendant intends to introduce in evidence.⁹⁶ Normally this excludes key evidence, since the defendant usually does not plan to introduce evidence which the government seeks in order to establish guilt. Further, discovery from the defendant is conditioned on the defendant's seeking discovery from the prosecution. As for discovery of evidence from third parties, the criminal rules provide for issuance of subpoenas,⁹⁷ but these are meant specifically to provide for evidence at trial.⁹⁸ Neither are depositions general discovery devices—they can only be used under limited circumstances to preserve evidence.⁹⁹ Thus the present limits on discovery in the criminal rules provide significant protection to the defendant, protection which should not be circumvented by the fortuity of agency investigation.¹⁰⁰

If the important consideration is limits on criminal discovery and not encroachment on the role of the grand jury, then the *La-Salle* rule is overinclusive, because it mandates an inquiry into good faith as to summonses issued before indictment, when the government's ability to investigate is meant to be nearly unlimited, as shown by the broad powers of the grand jury. It is under-

⁹⁴ See *United States v. Powell*, 379 U.S. 48, 58 (1964).

⁹⁵ Any such argument assumes that an agency will in fact turn over to criminal prosecutors the fruits of its investigation.

⁹⁶ See FED. R. CRIM. P. 16(b)(1)(A).

⁹⁷ See FED. R. CRIM. P. 17.

⁹⁸ See *United States v. Keen*, 509 F.2d 1273, 1274-75 (6th Cir. 1975); *United States v. Hedge*, 462 F.2d 220, 222-23 (5th Cir. 1972).

⁹⁹ See FED. R. CRIM. P. 15, Notes of Advisory Comm. on 1974 amendment (the rule "is not to provide a method of pretrial discovery").

¹⁰⁰ See *Application of Myers*, 202 F. Supp. 212 (E.D. Pa. 1962) (focusing on discovery limits and not the grand jury in refusing to enforce administrative summonses); Note, *Concurrent Civil and Criminal Proceedings*, 67 COLUM. L. REV. 1277, 1277-78, 1280-81 (1967).

Preventing unilateral prosecution discovery is, however, a limited concern. The practical effect of a rule preventing use of an agency summons to obtain discovery may just be to make prosecutors more careful to obtain all the evidence they need from the grand jury, and may even redound to the disadvantage of defendants if this leads to more extensive use of the grand jury.

In addition, although it should not do so, the government can evade limitations on discovery by using a grand jury to gather evidence after indictment. Under present law, based on judicial reluctance to interfere in the grand jury process, there is little a court can do to stop such abuse. See *United States v. Doe*, 455 F.2d 1270 (1st Cir. 1972); Rodis, *A Lawyer's Guide to Grand Jury Abuse*, 14 CRIM. L. BULL. 123 (1978). Thus a prophylactic rule to deter abuse in the summons area may simply shift abuses to the grand jury area.

inclusive because it does not fully protect the interest in limited discovery when an agency issues a summons before referral and in conformity with the *LaSalle* good faith test, but the person under investigation is under indictment for a separate offense.¹⁰¹ Even though the material sought might be of use to the government in the criminal case, a court following *LaSalle* would presumably grant enforcement.

Even after indictment a court should exercise discretion,¹⁰² weighing the danger that the government is employing the summons to obtain discovery for the criminal case against the legitimate government interest in the particular civil investigation. In assessing the likelihood that the information will find its way from the agency to the Justice Department, the court should inquire, for example, whether there are any statutory limits on such information sharing.¹⁰³ The government should have the burden of convincing the court to enforce the summons, since it possesses the evidence necessary to inform the court's exercise of its discretion.

It has been argued above that the criterion for automatic enforcement of a summons should be whether it was issued before indictment. Current law, which makes referral rather than indictment the cutoff point for automatic enforcement may be justified on the grounds that this decreases the chance that a summons will be returned after indictment. The defendant is in effect given a grace period between referral and indictment to challenge the summons and perhaps to appeal from a grant of enforcement. Whether indictment or referral is chosen as the cutoff point, the rights of the parties should be fixed at the time of the enforcement hearing in district court instead of issuance.¹⁰⁴ This is be-

¹⁰¹ See *United States v. Hodge & Zweig*, 548 F.2d 1347 (9th Cir. 1977); *United States v. Henry*, 491 F.2d 702 (6th Cir. 1974); *Venn v. United States*, 400 F.2d 207 (5th Cir. 1968).

¹⁰² This exercise of discretion is the only distinction between the test proposed here and the *Morgan* court's approach. See p. 1323 *supra*.

¹⁰³ See, e.g., I.R.C. § 6103.

¹⁰⁴ The problem of when to fix the rights of the parties has arisen in the context of a postindictment appeal from a decision to enforce a preindictment summons. Courts have usually resolved the question against the defendant, holding that the rights of the parties are fixed at time of issuance, thus making the subsequent indictment legally irrelevant. See *In re Magnus, Mabee & Reynard, Inc.*, 311 F.2d 12, 16 (2d Cir. 1962), *cert. denied*, 373 U.S. 902 (1963) (summons enforced where government forced to return indictment by running of statute of limitations); *United States v. Moore*, 485 F.2d 1165, 1168 n.4 (5th Cir. 1973); *United States v. Cromer*, 483 F.2d 99, 101 (9th Cir. 1973); *cf. Couch v. United States*, 409 U.S. 322, 329 n.9 (1973) (rights of parties fixed at time summons is served, so that transfer of documents after service is legally irrelevant). *But cf. United States v. Monsey*, 429 F.2d 1348 (7th Cir. 1970) (appeal taken by Government). Under an objective test (such as *Morgan* or

cause the relevant concern should not be whether the summons was issued for a proper purpose, but rather whether the effect of enforcement will be to obtain criminal discovery at a time when it would be improper.

LaSalle, like the "improper purpose" cases preceding it, was an IRS case. There is less litigation involving other agencies, probably because these issue fewer summonses,¹⁰⁵ and no cases could be found refusing enforcement on improper purpose grounds outside the tax area. *LaSalle's* applicability to summonses issued by agencies other than the IRS is uncertain. An important consideration under *LaSalle* is the extent to which the legislative grant of investigative authority can be interpreted to permit solely criminal investigation. In contrast to the vague provision in the Internal Revenue Code,¹⁰⁶ statutes authorizing investigation by Offices of the Inspector General¹⁰⁷ and by the SEC¹⁰⁸ seem to contemplate solely criminal investigation, although *LaSalle* has been held applicable to the SEC.¹⁰⁹ The test proposed here applies uniformly to all agencies,¹¹⁰ since it rests not on exegesis of vary-

the test proposed here) the appellate court's dilemma is eased, since any appeal based on improper purpose grounds will almost certainly be frivolous. In such a case, therefore, the desirability of discouraging frivolous appeals outweighs the concern about the integrity of criminal discovery.

¹⁰⁵ In 1976 the IRS issued approximately 3000 third-party summonses per month. See Wilson & Matz, *supra* note 13, at 679 n.138 (1977).

¹⁰⁶ I.R.C. § 7602.

¹⁰⁷ The Inspector General Act of 1978, Pub. L. No. 95-452, 92 Stat. 1101 (1978) (to be codified at 5 U.S.C. app.) created Offices of the Inspector General in 12 executive agencies. Under §§ 4(a)(1) and 6(a)(2) of the Act, OIG's enjoy broad investigative power, and may issue subpoenas in connection with these investigations under § 6(a)(4) which are enforceable by a district court. Investigations of criminal conduct—fraud and bribery—were clearly contemplated. See S. REP. No. 95-1071, 95th Cong., 2d Sess. (1978), *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 4406. As proposed by the Senate Committee, the Bill defined "investigation" as including investigation of "criminal activity," see 124 CONG. REC. S15869-70 (daily ed. Sept. 22, 1978), but the entire definition was deleted prior to passage on the grounds that "[i]nvestigation" is a term with a generally well-understood meaning," *id.* at S15873 (remarks of Sen. Eagleton).

¹⁰⁸ The SEC has the power to issue summonses in aid of "all investigations which, in the opinion of the Commission, are necessary and proper for the enforcement of [the Act]," 15 U.S.C. § 77s(b) (1976), and may transmit evidence of criminal violations to the Attorney General, see 15 U.S.C. § 77t(b) (1976).

¹⁰⁹ See SEC v. Dresser Indus., Inc., 453 F. Supp. 573, 575-76 (D.D.C. 1978). See also United States v. Handler, [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,519, at 94,025-26 (C.D. Cal. 1978) (SEC Special Counsel investigation); United States v. Bloom, 450 F. Supp. 323, 330-31 (E.D. Pa. 1978) (informal SEC investigation).

¹¹⁰ The improper purpose problem has not arisen in the antitrust area, where the Justice Department has responsibility for both civil and criminal investigation. Information obtained by Civil Investigative Demand (CID) may be used

ing statutory authority to issue a summons, but rather on the duty of courts to oversee activity which threatens to interfere with the safeguards erected around criminal trials. This duty is grounded on common agency statutes requiring a court order to enforce a summons.¹¹¹ Applying *LaSalle* to agencies which do not have a procedure for formal referral to the Justice Department¹¹² would require that courts search for a "recommendation" analogue. Lack of a definite point of referral poses no problems for the analysis advocated here, as the cutoff point for automatic enforcement in such cases could be indictment.¹¹³

2. *Summons Enforcement Proceedings and Suppression at Trial.*— Consideration of the procedural aspects of summons enforcement proceedings¹¹⁴ must start with rule 81(a)(3) of the Federal Rules of Civil Procedure, which provides that such proceedings are summary and that applicability of the rules—including the discovery and intervention provisions—may be limited at the trial judge's discretion.¹¹⁵ Under guidelines laid down by appellate courts, discovery (usually deposition of agency employees and production of investigative files) is allowed only if evidence substantiating allegations of criminal purpose has been

before a grand jury or otherwise for criminal cases. See 15 U.S.C. § 1313(d) (1976). Limitation of this tool to civil purposes would prove a minimal constraint on the Department, since it would simply require moving to the grand jury at the appropriate stage in the investigation. Indeed, a litigant would be foolish to challenge a CID on improper purpose grounds before indictment, because he would simply be faced with a grand jury investigation if he won the challenge. Such a shift is much less burdensome when it takes place within the Justice Department, rather than across agency boundaries.

¹¹¹ See statutes cited notes 56, 58 *supra*.

¹¹² For example, § 4(d) of the Inspector General Act of 1978, Pub. L. No. 95-452, 92 Stat. 1101 (1978), provides that the OIG "shall report expeditiously to the Attorney General whenever the Inspector General has reasonable grounds to believe there has been a violation of Federal criminal law." This requirement of expeditious reporting suggests a model of cooperative investigation at an early stage. See *Legislation to Establish Offices of Inspector General: Hearings on H.R. 8588 Before the Subcomm. on Governmental Efficiency and the District of Columbia of the Senate Comm. on Governmental Affairs*, 95th Cong., 2d Sess. 12, 28, 48-49, 65-66 (1978).

¹¹³ Indictment is in fact the point suggested by the analysis here, and referral is used as an easily ascertainable point prior to indictment in order to protect the defendant's opportunity to challenge a summons.

¹¹⁴ See generally *Symposium on Federal Civil and Criminal Income Tax Fraud Investigations*, 2 *HOFSTRA L. REV.* 129, 152-58 (1974); Comment, *Taxpayer Intervention at Summary Proceedings to Enforce an Internal Revenue Service Summons*, 32 *MD. L. REV.* 143 (1972).

¹¹⁵ See Advisory Comm. Notes on Rule 81 (1946) (Rule 81(a)(3) "permit[s] application of any of the rules in the proceedings whenever the district court deems them helpful").

presented at an evidentiary hearing.¹¹⁶ The articulated concern has been to prevent abuse of litigation through delay.¹¹⁷

Rule 81 has also been used to deny intervention to the potential defendant in proceedings to enforce summonses issued to third parties. A taxpayer who alleges that a summons is being used for an improper purpose has an interest in not being prosecuted or convicted on the basis of evidence obtained in an improper manner.¹¹⁸ The question is whether this interest is substantial enough to justify giving the taxpayer the opportunity to intervene in the summons enforcement proceeding against a third party. Before *Donaldson*, several circuits allowed the taxpayer to intervene as of right under rule 24(a)(2).¹¹⁹ In *Donaldson*, however, the Court qualified this reading of rule 24 with reference to rule 81, which makes the application of all the Civil Rules to summons enforcement proceedings discretionary. The Court recognized that a taxpayer had some interest in suppressing documents obtained for an improper purpose, but reasoned that such an interest was sufficiently protected by the taxpayer's ability to seek exclusion of such evidence at trial.¹²⁰

The subsequent decision in *United States v. Miller*,¹²¹ however, casts doubt on the availability of this protection. The defendant in *Miller* sought at trial to suppress evidence obtained from grand jury subpoenas which he claimed were technically de-

¹¹⁶ See *United States v. Salter*, 432 F.2d 697 (1st Cir. 1970). *Salter* has been generally followed, see *United States v. Interstate Tool & Eng'r Corp.*, 526 F.2d 59, 62 (7th Cir. 1975); *United States v. Church of Scientology*, 520 F.2d 818, 824 (9th Cir. 1975); *United States v. McCarthy*, 514 F.2d 368, 373 (3d Cir. 1975). In *United States v. Newman*, 441 F.2d 165 (5th Cir. 1971), even an evidentiary hearing was denied the summoned party where the allegations he made were not sufficiently substantial. See *id.* at 169. The Fifth Circuit has since moved to a position similar to that of *Salter*. See *United States v. Garrett*, 571 F.2d 1323, 1327 (5th Cir. 1978); *United States v. Wright Motor Co.*, 536 F.2d 1090, 1095 (5th Cir. 1976); cf. *Lynn v. Biderman*, 536 F.2d 820 (9th Cir. 1976) (no evidentiary hearing required in proceeding to enforce HUD subpoena when investigation initiated at request of aggrieved purchaser rather than agency due to small possibility of agency oppression in such a case).

¹¹⁷ See *United States v. Church of Scientology*, 520 F.2d 818, 824-25 (9th Cir. 1975); *United States v. Salter*, 432 F.2d 697, 700-01 (1st Cir. 1970).

¹¹⁸ The third party may itself argue the improper purpose point, as was the case in *LaSalle*.

¹¹⁹ See cases cited 400 U.S. at 530. Rule 24(a)(2) allows intervention to an applicant who

claims an interest relating to the property or transaction which is the subject of the action and [who] is so situated that the disposition of the action may as a practical matter impair or impede his ability to protect that interest, unless the applicant's interest is adequately represented by existing parties.

¹²⁰ See 400 U.S. at 531. See also *United States v. Genser*, 582 F.2d 292, 303 n.18 (3d Cir. 1978).

¹²¹ 425 U.S. 435 (1976).

fective. The Court denied standing to the defendant under the fourth amendment, reasoning that he had no expectation of privacy in the pertinent documents.¹²² The Ninth Circuit has relied on *Miller* to hold that evidence obtained by a third-party summons cannot be excluded on improper purpose grounds when the defendant lacks any fourth amendment interest.¹²³

The Third Circuit arrived at the opposite conclusion in *United States v. Genser*,¹²⁴ reasoning that *Miller* involved only fourth amendment objections to enforcement while civil summonses implicate the statutory limits of section 7602 of the Internal Revenue Code, and that to deny standing at trial would undermine the balance struck by *Donaldson*. *Genser's* reasoning is persuasive because the improper purpose doctrine rests on considerations which deserve protection independent of fourth amendment grounds.

Congress partially overruled the denial of intervention in *Donaldson* — and rendered largely moot the emerging split in the circuits — in the Tax Reform Act of 1976, which granted taxpayers the right to receive notice of certain third-party summonses and to intervene in the enforcement proceedings.¹²⁵ But this right extends only to summonses issued to "third-party recordkeeper[s],"¹²⁶ a category which includes most financial institutions but not all professionals. Because of Supreme Court decisions restricting fourth and fifth amendment protection in this area,¹²⁷ however, an intervenor's only successful arguments are likely to be based not on privacy, but rather on statutory grounds such as improper purpose. There thus seems to be little principled distinction between third-party recordkeepers and others from whom evidence is sought. With a view toward evenhandedness, courts exercising discretion under *Donaldson* should generally permit intervention.

Complicating this situation, however, is the risk that the taxpayer will be able to exploit a permissive attitude toward intervention for purposes of delay. Where the taxpayer intervenes under

¹²² See *id.* at 440-43.

¹²³ See *United States v. Sand*, 541 F.2d 1370, 1374 (9th Cir. 1976).

¹²⁴ 582 F.2d 292, 299-311 (3d Cir. 1978). The Eighth Circuit, in *United States v. Schutterle*, 42 A.F.T.R.2d 78-6077 (8th Cir. 1978), noted the problem but did not reach the issue.

¹²⁵ See I.R.C. § 7609.

¹²⁶ I.R.C. § 7609(a). Third-party recordkeepers include savings and loan institutions, banks, credit unions, brokers, attorneys, accountants, and "any person extending credit through the use of credit cards or similar devices," *id.* See generally *United States v. Exxon Co.*, 450 F. Supp. 472 (D. Md. 1978) (defendant not a third-party recordkeeper where business records sought were unrelated to issuance of credit cards).

¹²⁷ See *Fisher v. United States*, 425 U.S. 391 (1976); *United States v. Miller*, 425 U.S. 435 (1976); *California Bankers Ass'n v. Shultz*, 416 U.S. 21 (1974); *Couch v. United States*, 409 U.S. 322 (1973); p. 1289 & note 78 *supra*.

the 1976 amendment, the running of the statute of limitations for criminal tax violations is tolled.¹²⁸ Such is apparently not the case where intervention is granted under *Donaldson*, and putting such a premium on delaying tactics would be inconsistent with *Donaldson's* emphasis on the preservation of the summary nature of summons enforcement proceedings. The potential for delay would be a less significant problem under the analysis proposed here, since in most situations an improper purpose claim could be disposed of simply by determining whether the case had been referred to the Justice Department.

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

TAXATION WITH REPRESENTATION FUND, :
Plaintiff, :
v. : Civil Action No. 78-2304
INTERNAL REVENUE SERVICE, :
Defendant. :

FILED

JAN 23 1980

JAMES F. DAVEY, Clk

Appearances: For the Plaintiff: William A. Dobrovir, Esq.
For the Defendant: John J. McCarthy, Esq.
Donald J. Gavin, Esq.
Michael J. Salem, Esq.
Tax Division, Dep't of Justice

MEMORANDUM OPINION OF UNITED STATES DISTRICT JUDGE
CHARLES R. RICHEY

The complaint in this action was filed by the Taxation With Representation Fund under the Freedom of Information Act, 5 U.S.C. § 552, for access to records of the defendant Internal Revenue Service [hereinafter, "IRS"]. The records the plaintiff seeks are IRS General Counsel's Memoranda [hereinafter, "GCM's"], IRS Technical Memoranda [hereinafter, "TM's"], and IRS Actions on Decisions [hereinafter, "AOD's"], issued after July 4, 1967,¹ and IRS indices to these records. The plaintiff has exhausted its administrative remedies, and the Court has jurisdiction of this action pursuant to 5 U.S.C. § 552(a)(4)(B).

I. THE STATUTORY FRAMEWORK

Cases such as this one in which a party seeks what arguably can be called systems of interpretative law involve the interplay between three subsections of the Freedom of Information Act. First, there is section 552(a)(2)² which requires each federal agency to

1. July 4, 1967 is the effective date of the 1967 amendment to the Act. See Pub.L. 93-502 §4.

2.(2) Each agency, in accordance with published rules, shall make available for public inspection and copying --

(A) final opinions, including concurring and dissenting opinions, as well as orders, made in the adjudication of cases;

(B) those statements of policy and interpretations which have been adopted by the agency and are not published in the Federal Register; and

(C) administrative staff manuals and instructions to staff that affect a member of the public; [and]

. . . also . . . indexes [to such material].

make certain information available to the public. Furthermore, section 552(a)(2) requires the agency to maintain indices and make them available to the public. Thus, if records qualify under section 552(a)(2), not only are they subject to mandatory disclosure, the agency must create an indexing system and make that system available to the public.

As opposed to the limited language of section 552(a)(2), section 552(a)(3) is virtually all inclusive. This latter section requires agencies to promptly make available all reasonably described records which have been requested pursuant to the procedures set down by the agency. There is no requirement in section 552(a)(3) for the agency to create indices as there is under section 552(a)(2).

Finally, section 552(b) sets out nine exemptions from mandatory disclosure under the Act. Therefore, if records are encompassed within sections 552(a)(2) or (3), they are exempt from disclosure if described in section 552(b)(1) through (9). See National Labor Relations Board v. Sears, Roebuck & Co., 421 U.S. 132, 154 n.21 (1975).

In this case, all the parties agree that indices are already in existence with respect to the records at issue. Thus, the plaintiff need not invoke the authority of section 552(a)(2) to force the defendant to create indices. It is clear that all of the requested records as well as the indices to these records constitute records within the meaning of section 552(a)(3). Accordingly, there is no need to examine the question whether the records at issue fall within section 552(a)(2). Instead, this case turns on whether the records are exempt from mandatory disclosure under section 552(b).

II. GCM'S, AOD'S, AND TM'S ARE NOT EXEMPT FROM DISCLOSURE BY THE DELIBERATIVE PROCESS PRIVILEGE.

The defendant contends that the records at issue in this case are exempt from disclosure pursuant to exemption (5) of the Freedom of Information Act which protects "inter-agency or intra-agency

3. (3) Except with respect to the records made available under paragraphs (1) and (2) of this subsection, each agency, upon any request for records which (A) reasonably describes such records and (B) is made in accordance with published rules stating the time, place, fees (if any), and procedures to be followed, shall make the records promptly available to any person.

memorandums or letters which would not be available by law to a party other than an agency in litigation with the agency." It has long been recognized that exemption (5) "was created to protect the deliberative process of government, by ensuring that persons in an advisory role would be able to express their opinions freely to agency decision-makers without fear of publicity." Ryan v. Department of Justice, Case No. 79-1777 (D.C. Cir. January 7, 1980) at 1. Oftentimes, exemption (5) cases turn on whether the government action at issue is final. Exemption (5) does not apply to final actions of agencies. Thus, statements of policy and final opinions which have the force of law or which explain actions an agency has already taken are not within the scope of exemption (5). Ryan v. Department of Justice, supra at 16.

The most important case on this issue is National Labor Relations Board v. Sears, Roebuck & Co., supra. In the Sears case, the company sought certain memoranda known as "Advice Memoranda" and "Appeals Memoranda," and related documents generated by the Office of the General Counsel in the course of deciding whether or not to permit the filing with the National Labor Relations Board [hereinafter, "the Board"] of unfair labor practice complaints. Id. at 135-36. The Court noted that "[c]rucial to the decision of this case is an understanding of the function of the documents in issue in the context of the administrative process which generated them." Id. at 138. The memoranda in issue in the Sears case pertained to the General Counsel's decision whether a unfair labor practice complaint would issue. Id. If the General Counsel decided to issue a complaint, adjudication then occurs before the Board, and the General Counsel becomes an advocate in support of the complaint before the Board. Id. at 138-39. If the General Counsel decides not to issue a complaint, the statutory scheme completely precludes any proceeding before the Board. Id. at 139. The Supreme Court held that Advice and Appeals Memoranda which explain decisions by the General Counsel not to file complaints are "final opinions" made in the adjudication of cases and fall outside the scope of exemption (5), but that Ad-

vice and Appeal Memoranda which explain decisions by the General Counsel to file complaints and commence litigation before the Board are not "final opinions" made in the adjudication of cases and fall within the scope of exemption (5). Id. at 148.

The Court in Sears points out that the timing of the communications received by the decision-maker is crucial. Communications received by the decision-maker prior to the time the decision is made are protected because damage to the quality of the agency's decisions will result, and the public has little interest in communications which have not been accepted by the agency. Id. at 151-53. On the other hand, communications made after the decision is made by the agency and which are designed to explain it have little effect on the decision-making process and high public interest. Id. at 152. However, the Court noted that the public is "vitaly concerned with the reasons which did supply the basis for an agency policy actually adopted " id., and these reasons constitute the "working law" of the agency which is not protected by exemption (5). Id. at 162-63. The Court indicated that there is embodied in the Act a strong congressional aversion to secret agency law and an affirmative congressional purpose to require disclosure of documents which have the force and effect of law. Id. at 153. Accordingly, pursuant to the Supreme Court's decision in the Sears case, the task before the Court is to determine whether GCM's, AOD's, and TM's contain the reasons behind policy actually adopted by the IRS.

A. GCM'S

In support of the defendant's motion for summary judgment with respect to GCM's, the affidavit of Jerome D. Sebastian, the Director of the Interpretative Division, Office of Chief Counsel, of the Internal Revenue Service was filed. According to this affidavit, GCM's are legal memoranda from the Office of Chief Counsel to the Internal Revenue Service prepared in response to a formal request for legal advice from the Assistant Commissioner (Technical). Mr. Sebastian states in his affidavit that GSM's are primarily prepared by attorneys in the Interpretative Division of the Office of Chief

Counsel and usually addressed to the Office of the Assistant Commissioner (Technical) in connection with the review of proposed private letter rulings, proposed technical advice memoranda, and proposed revenue rulings of the IRS. According to Mr. Sebastian, the GCM's set forth the issues presented by whichever of these proposed determinations is under review, the conclusions reached and a brief factual summary. The body of the GCM's, according to Mr. Sebastian, contains a lengthy legal analysis of the substantive issues, and the recommendations and opinions of the Office of Chief Counsel. The Sebastian affidavit states that GCM's are often accompanied by a draft of the proposed determination that reflects the changes and modifications recommended in the GCM. According to this affidavit, GCM's are maintained by the Office of Chief Counsel and frequently cited in subsequent GCM's to insure consistency, avoid duplication of research, provide a reference source, and update earlier memoranda when a position on an issue is sustained, modified, or changed within the Office of Chief Counsel.

The defendant's answers to the plaintiff's interrogatories provide material and relevant information. In response to the plaintiff's Interrogatory No. 11, the defendant points out that IRS personnel who confer or negotiate on tax liability matters with taxpayers or taxpayer representatives may refer to GCM's for guidance as to the positions to take in such negotiations. Furthermore, the defendant states that the interpretation of law contained in prior GCM's are knowingly applied, distinguished, or rejected of application, as the case may be, in subsequent GCM's to insure consistency of position in the Office of Chief Counsel. This admission is made in the defendant's response to plaintiff's Interrogatory No. 7a.

Finally, the depositions of IRS personnel contain material and relevant information. Once a GCM is completed by the Office of the Chief Counsel, it is forwarded to the Office of Assistant Commissioner (Technical). The Office of Assistant Commissioner (Technical) will use the GCM as a guide as to what positions will be taken in the proposed revenue ruling, proposed private letter ruling, or proposed technical advice memorandum. According to the defendant, on occasion, differences may arise between the positions of the Office of Assistant Commissioner (Technical) and

the Interpretative Division of the Office of Chief Counsel. These differences are generally reconciled on an informal basis before the adoption of the revenue ruling, private letter ruling, or technical advice memorandum in question. Then a copy of the completed GCM is distributed and placed in the digest system to enable future reference. Defendant's Statement Of Material Facts As To Which There Is No Genuine Issue at ¶¶15-20 (July 27, 1979). Thus, the government admits that differences between the GCM and ruling are resolved before the GCM is considered complete and before it becomes available for future reference.

The Court finds that GCM's are not encompassed within exemption (5) of section 552(b). GCM's contain the reasons behind the adoption of revenue rulings, private letter rulings, and technical advice memoranda. As the Supreme Court made clear in Bears, it is just such records that are of vital concern to the public and their release offers little chance of interfering with the decision-making process of the agency. Furthermore, GCM's are indexed and have important precedential value in determining future tax questions. Accordingly, the Court concludes that completed GCM's are not protected by the government's privilege.

B. AOD'S

In support of its motion for summary judgment with respect to AOD's, the defendant has filed the affidavit of Edward Everett Pigg who is the Executive Assistant to the Director of the Tax Litigation Division, Office of Chief Counsel in IRS. According to this affidavit, AOD's are legal memoranda prepared by a Chief Counsel, National Office Attorney, approved by a supervisor, and directed to the Chief Counsel. AOD's are prepared, according to Mr. Pigg, in general, whenever the government poses an issue in a tax case either in Tax Court or in a federal district court. They are prepared by the attorney responsible for review of the case at the same time he or she prepares a formal recommendation to the Department of Justice as to whether this particular case should be appealed. The affidavit states that the AOD

sets forth the issue which was decided against the government, a brief discussion of the facts and the reasoning of the attorney behind his or her recommendation that the Commissioner either acquiesce or nonacquiesce in a decision of the Tax Court or of the federal district court. According to Mr. Pigg, the AOD is reviewed within the Tax Litigation Division and after approval it is sent to the Office of the Assistant Commissioner (Technical). Finally, if the Assistant Commissioner (Technical) is not in disagreement with the recommendation to acquiesce or nonacquiesce, the AOD is printed and distributed. The IRS does not release or publish for public dissemination any opinion behind its decision to acquiesce or nonacquiesce.

AOD's are made available to IRS personnel and are cited and applied by IRS personnel in later AOD's, and TM's to promote the consistent application of the tax laws. Defendant's Answers to Interrogatories ¶¶ 6, 7C.

The Court finds that AOD's are not exempt from disclosure by section 552(b)(5). AOD's contain the reasons behind the acquiescence or nonacquiescence of the IRS in court decisions. These reasons are of vital concern to the public and their release will not harm the decision-making process of the agency.

C. TM'S

In support of its motion for summary judgment with respect to TM's, the defendant has filed the affidavit of Robert A. Bley, the Director of the Office of the Chief Counsel, Internal Revenue Service. According to Mr. Bley, TM's are memoranda from the Commissioner of the Internal Revenue Service to the Assistant Secretary of the Treasury (Tax Policy). The Brey affidavit states that TM's are prepared by attorneys in the Legislation and Regulations Division or the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel in connection with the preparation of a proposed Treasury decision. According to the affidavit, TM's are attached to a draft of a proposed Treasury Decision. After consideration at several levels within the Office of Chief Counsel, a final draft of a notice of proposed rulemaking and the TM is forwarded to the Assistant Commissioner (Technical), the Chief Counsel, and the Commissioner for final approval. The

approved notice of proposed rulemaking is then published in the Federal Register and written comments are solicited. After consideration of the written comments and testimony at a public hearing if one is requested, an attorney in the Legislation and Regulations Division prepares a preliminary draft of a Treasury decision and accompanying TM. Then the proposed Treasury decision and the TM are approved in the same manner as to notice of proposed rulemaking and its accompanying TM. According to the Brey affidavit, generally, a TM summarizes or explains the proposed rules, provides background information, states the issues involved, identifies any controversial legal or policy questions, discusses the approach taken by the draftsman, and gives the reasons for the approach.

TM's are indexed, digested, and made available to IRS personnel in order to assure consistent treatment of taxpayers.

Defendant's Answer to Interrogatory ¶6.

The Court finds that TM's are not encompassed by exemption (5). TM's explain the reasons behind the adoption of the Treasury Decision. They are used by IRS personnel in determining the tax status of taxpayers. Accordingly, they are not deliberative material.

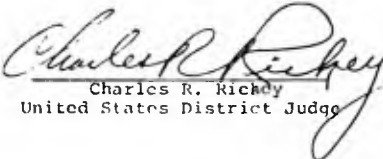
D. These Conclusions Are Supported By Two Recent District Court Decisions.

The conclusions of this Court with respect to the applicability of exemption (5) to GCM's, AOD's, and TM's are supported by two recent district court cases. In Pies v. Internal Revenue Service, 79-2 U.S.T.C. ¶ 9571 (D.D.C. Aug. 31, 1979), Judge Parker ruled that a TM was not protected from mandatory disclosure by section 552(b)(5). The Court found that the facts indicate that the IRS had adopted the reasoning of the TM. Id. at 88,082. Furthermore, the Court held that "[w]here the agency has by its own actions, left the status of deliberative material ambiguous, but clearly has used that material in some final formal way, the Court must strike the balance in favor of public disclosure rather than recognize an exemption under FOIA." Id. In this case, there is no dispute that the final TM which is placed within the IRS retrieval system is used by the agency as the formal statement of the rationale behind the adoption of the Treasury decision

In Falcone v. Internal Revenue Service, 79-2 U.S.T.C. ¶ 9683 (E.D. Mich. Oct. 30, 1979), the Court held that a GCM was not within the protection of exemption (5). According to the Court in Falcone, GCM's are not protected by the deliberative privilege because they "state current agency interpretations and note where the proposed ruling may differ." Id. at 88,514.

Finally, the Court finds that the material at issue in this suit is not protected by the attorney-client privilege and does not constitute protected attorney work product. See id.

An order in accordance with this Memorandum Opinion shall be issued of even date herewith.


Charles R. Richey
United States District Judge

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

TAXATION WITH REPRESENTATION FUND, :
Plaintiff, :
v. : Civil Action No. 78-2104
INTERNAL REVENUE SERVICE, :
Defendant. :

FILED

JAN 22 1980


ORDER

JAMES F. DAVEY, Clerk

In accordance with the Memorandum Opinion issued of even date herewith, it is, by the Court, this *17* day of January, 1980,

ORDERED, that the motion of the defendant for summary judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure be, and the same hereby is denied; and it is

FURTHER ORDERED, that the motion of the plaintiff for summary judgment pursuant to Rule 56 be, and the same hereby is, granted in that there are no issues of material fact genuinely in dispute, and the plaintiff is entitled to judgment as a matter of law.


Charles R. Richey
United States District Judge

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

FILED

APR 23 1980

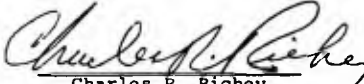
TAXATION WITH REPRESENTATION FUND, :
Plaintiff, : JAMES F. DAVEY, Clerk
v. : Civil Action No. 78-2304
INTERNAL REVENUE SERVICE, :
Defendant. :

ORDER

This action is before the Court on the motion of the defendant, the Internal Revenue Service, of the Court's Order of January 22, 1980. Essentially, the defendant contends that the records at issue may have portions exempt pursuant to other statutes. Nothing in the Court's Order of January 22, 1980 requires the defendant to release tax return information protected by section 6103 of the Internal Revenue Code of 1954. The defendant is hereby authorized to redact portions of documents which contain such information. In addition, the defendant contends that the Court's failure to pass on the applicability of 5 U.S.C. §552(a)(2) enables the defendant to withhold records created in the future which are identical to those involved in the current litigation. In order to prevent any such rigid reading of the Court's opinion, the Court shall take this opportunity to hold that the documents at issue also fall within section 552(a)(2). The analysis presented in the Court's opinion dated January 22, 1980 sufficiently supports this conclusion. Accordingly, the defendant will be assured of its continuing duty to make the records and indices to the records available.

Accordingly, it is, by the Court, this 22nd day of April, 1980,

ORDERED, that the motion of the defendant for reconsideration be, and the same hereby is denied except to the extent that the Court's holding is clarified in this Order.


Charles R. Richey
United States District Judge

Mr. SHATTUCK. If I could add a word to what I previously said, it is a cry of despair that the American Bar Association and the American Bankers Association were not able to attend this hearing, for various reasons, but I know that they feel quite strongly about the subject. I have had the privilege of appearing together with them on issues of taxpayer privacy before your subcommittee, and elsewhere, and I would hope that you would solicit their views on this.

Mr. GIBBONS. If we have another chance to have a hearing, we may hear them. It is kind of hard to get them not to go to Hawaii, you know.

Thank you very much, we appreciate your testimony so much. We appreciate the interest of all of the audience who was here tonight.

The meeting is adjourned.

[Whereupon, at 8:45 p.m., the hearing was adjourned.]

[The following was submitted for the record:]

International Association of Trade Exchanges
 5001 Seminary Road, Suite 310
 Alexandria, VA 22311
 (703) 379-2838

Paul Suplizio, Executive Director
 Joseph Weiss, Deputy Executive Director

STATEMENT OF THE
 INTERNATIONAL ASSOCIATION OF TRADE EXCHANGES

ON S.2403 & H.R. 6764
 (REGARDING THE ADMINISTRATIVE
 SUMMONS PROVISIONS OF THE CODE)
 SUBMITTED TO THE
 SUBCOMMITTEE ON OVERSIGHT OF THE
 HOUSE COMMITTEE ON WAYS AND MEANS

This is in response to a request for written comments on S.2403 which proposes to amend provisions of 26 U.S.C. Section 7609 dealing with the administrative summons provisions of the Internal Revenue Code.

The International Association of Trade Exchanges (IATE) wishes to express its opposition to S.2403. We believe the bill goes too far in the direction of revising third-party summons procedures at the expense of taxpayers' rights.

Although S.2403 leaves intact the notice provisions of section 7609, the bill proposes to (a) eliminate the automatic stay of compliance enjoyed by the noticee, and (b) remove the burden of enforcing summonses from the IRS. The effect of S.2403 would be to place the burden of proof on the taxpayer by having the noticee initiate a challenge to the summons through a motion to quash procedure. It is this proposed revision of section 7609 which we consider unfair.

Our interest in section 7609 provisions stems from IRS' selection of our

industry for a special examination project wherein section 7609 issues have been prominently raised. This special examination project, directed by Internal Revenue Manual Supplement 45G-324, dated March 11, 1980, is underway at the present time and has as its object obtaining records of financial transactions of every taxpayer who does business with a barter exchange.

The LATE represents the leading members of the over 200 organized trade or barter exchanges in the United States. The exchanges serve around 40,000 - 50,000 business owners and professionals who trade their products and services through the facility of organized barter exchanges. Our member exchanges record all transactions and modern accounting techniques and equipment are employed in the recordkeeping functions. A unit of account, commonly called a trade credit, is used to facilitate barter transactions. The gross annual volume of the barter exchange industry is estimated to be in the range of \$250 million.

Last year, as an outgrowth of interest in the underground economy, the IRS initiated an unreported income program. One of the projects, indeed the first project undertaken in this program, was the Barter Exchange Project. Procedural guidelines and instructions for carrying out the project are contained in the above referenced Manual Supplement. The instructions state that "during each examination of a barter or trade exchange, members of the exchange should be identified along with the amount of transactions for each member" [underlining added]. As this excerpt indicates, it is IRS' stated objective that members of barter exchanges are targets for examination along with the exchanges themselves. In other words, it is possible that a universe of approximately 40,000 - 50,000 individuals are subject to having their records examined simply because they barter goods and services through barter exchanges.

In carrying out this project, IRS has authorized the use of both administrative and John Doe summonses as investigative tools. As an example of the use of both types of summonses, we have enclosed as attachments 1 and 2 copies of two summonses served on one of our members. The first attachment is a copy of an administrative summons served on the Pittsburgh Trade Exchange in December 1979 and the second attachment is a copy of a John Doe summons served in April 1980 on the same Exchange in the tax liabilities of "John Does, Members of the Pittsburgh Trade Exchange". What these summonses demonstrate is that large numbers of taxpayers are being singled out for special examination. These summonses are being resisted in the courts with respect to their use to obtain the records of financial transactions of members of a barter exchange, and this matter is currently in process of litigation.

In addition, it is our belief that barter exchanges are third-party recordkeepers within the meaning and legislative history of section 7609. The IRS does not at the present time share this view, and we believe this point requires clarification. The fact is that barter exchanges do act as third-party recordkeepers.

Our concerns about S.2403 are real. If S.2403 becomes law, there is a strong likelihood that taxpaying small businessmen and women who belong to a barter exchange, and who have been notified that their records are being sought by the IRS from the exchange, will be effectively precluded from defending against such intrusion and requiring the IRS to demonstrate a proper grounds for requesting the records.

In the final analysis, when faced with the choice of retaining counsel, the inconvenience of the time expended, and the money spent and time involved in

mounting a successful motion to quash proceeding against a summons, the choice not to resist becomes an inevitable one for this small business person.

Based upon our experience with the IRS' barter exchange project, the small businessman who barterers and whose records are held by an exchange would not only^{be}/exposed to an enforcement effort of questionable legality, but would be required also, according to S.2403, to shoulder the burden to quash the summons for his records in order to block IRS access to them.

The IATE is concerned about reports of abuses and tactics of delay on the part of taxpayers in the summons enforcement process. But abuses, mistakes, and misjudgments are not limited and attributable solely to taxpayers. There must also be protections against these same manifestations on the part of tax compliance, collection and enforcement agencies of government. Our concerns, stemming from our direct experience with IRS' nationwide examination project, are for the majority of law-abiding taxpayers who would no longer be effectively safeguarded from misguided IRS summons requests. The protections of section 7609, we believe, are needed. Furthermore, as long as the burden of proof remains on the IRS to initiate a motion to enforce proceeding there is the likelihood that the IRS would more carefully consider the wisdom of going forward with a summons action. Being relieved of this burden opens the door to the IRS' becoming lax in reviewing the merits of particular summonses.

Speed and efficiency in summons enforcement actions are goals everyone shares, but certainly not at the expense of the rights of individual taxpayers whose records are held by third parties. We believe the provisions of S.2403 go too far. It is essential that the basic protections and procedures contained in section 7609 be retained. We are therefore opposed to S.2403.

Form 2039-A
(Rev. 3-77)

SUBPOENA

In the matter of the tax liability of
Pittsburgh Trade Exchange, Inc.
 1105 Washington Boulevard
 Pittsburgh, PA 15205

Internal Revenue District of Pittsburgh

Periods for the year ended June 30, 1978

The Commissioner of Internal Revenue

To Mr. Vincent E. Mannelli as President of Pittsburgh Trade Exchange, Inc.
and the Pittsburgh Trade Exchange, Inc.
 At 1105 Washington Boulevard, Pittsburgh, PA 15206

You are hereby summoned and required to appear before Me an officer of the Internal Revenue Service, to give testimony relating to the tax liability or the collection of the tax liability of the person described above for the periods shown and to bring with you and produce for examination the following books, records, papers, and other data:

SEE ATTACHMENT.

Business address and telephone number of Internal Revenue Service officer named above:

1000 Liberty Avenue, Pittsburgh, PA 15222 (412) 644-5630

Place and time for appearance:

at 1105 Washington Boulevard, Pittsburgh, PA 15206

on the 3rd day of January, 19 80 at 9:00 o'clock A. M.

Issued under authority of the Internal Revenue Code

this 17th day of December, 19 79

Marian H. Morrison
 Signature of Issuing Officer

Internal Revenue Agent
 Title

Ronald Karpuzka
 Signature of Approving Officer
 (if applicable)

Shoy Saperstein

Part A—To be given to person summoned

Form 2039-A (Rev. 3-77)

ATTACHMENT

Pittsburgh Trade Exchange, Inc.

All Books, Records, Invoices, Statements, or other records or data in your possession or control reflecting income, expenses, assets and liabilities for the above year, including, but not limited to the following:

- 1) All contracts entered into.
- 2) All Accounts Receivable and detailed listings for subsidiary ledger and or cards to reconcile such Accounts Receivable.
- 3) All Accounts Payable and detailed listings for subsidiary ledger and or cards to reconcile such Accounts Payable.
- 4) Credits due customers and or clients with each customer and or client identified and respective amount identified.
- 5) Date of each barter transaction arranged or completed, amount involved in each such transaction, and names of the person, corporation or other entities involved in each such transaction.
- 6) Names of all persons, corporations, or other entities from whom you received or accrued income or otherwise have done business with.

Form 2039-A
(Rev. 3-77)**Summons**

In the matter of the tax liability of
Members of the Pittsburgh Trade Exchange Inc.,
during the calendar years ending December 31,
1978 or December 31, 1979.

Internal Revenue District of Pittsburgh, PennsylvaniaPeriods for the years ended December 31, 1978 & December 31, 1979

The Commissioner of Internal Revenue

To Pittsburgh Trade Exchange, Inc.
1105 Washington Boulevard
At Pittsburgh, Pennsylvania 15206

You are hereby summoned and required to appear before Gerald P. Potoonak, an officer of the Internal Revenue Service, to give testimony relating to the tax liability or the collection of the tax liability of the person identified above for the periods shown and to bring with you and produce for examination the following books, records, papers, and other data:

- A) Rosters, membership lists, or other records which reflect the names and addresses of all persons who were members of the Pittsburgh Trade Exchange during the calendar years ending December 31, 1978 or December 31, 1979.
- B) Corporate books of account, ledgers, or other records of the Pittsburgh Trade Exchange which identify for each member every bartering transaction, the date, the participants, and the amount during the calendar years ending December 31, 1978 or December 31, 1979.

Business address and telephone number of Internal Revenue Service officer named above:

I.R.S., Federal Office Building, Room 1001, Pittsburgh, PA 412-644-5630

Place and time for appearance:

at I.R.S., Room 1001, 1000 Liberty Avenue, Pittsburgh, Pennsylvania 15222
on the 2nd day of April, 1980 at 9:30 o'clock A.M.

Issued under authority of the Internal Revenue Code

this 2nd day of April, 1980 at Pittsburgh, Pennsylvania
James J. Higgins Chief, Examination Div.

Signature of Issuing Officer

Title

Signature of Approving Officer
(if applicable)

Title

Part A—To be given to person summoned

Form 2039-A (Rev. 3-77)

IN THE UNITED STATES DISTRICT COURT FOR THE
WESTERN DISTRICT OF PENNSYLVANIA

In the Matter of the Tax
Liabilities of:)

JOHN DOES, Members of the
Pittsburgh Trade Exchange,
Inc., during the years
1978 or 1979)

HISC. NO. 7824

O R D E R

Upon the petition, the exhibits attached thereto, and the motion of the United States Attorney for the Western District of Pennsylvania, for leave to serve a John Doe summons, the Court has determined that the summons relates to the investigation of an ascertainable group or class of persons, that is, the members of the Pittsburgh Trade Exchange, Inc., during the years 1978 and 1979, that there is a reasonable basis for believing that such group or class of persons may fail or may have failed to comply with various provisions of the Internal Revenue Code of 1954 (26 U.S.C.); and that the information sought to be obtained from the examination of the records (and the identity of the persons with respect to whose liability the summons relates) is not readily available from other sources. It is therefore

ORDERED, ADJUDGED and DECREED that the Internal Revenue Service, through an authorized officer or agent, may serve the summons, attached to the petition, upon the Pittsburgh Trade Exchange, Inc. And it is further

ORDERED, ADJUDGED and DECREED that a copy of this Order be served with the summons.

DATED this 27th day of March, 1980, at
Pittsburgh, Pennsylvania.


UNITED STATES DISTRICT JUDGE

