The Citizen as Taxpayer

APPENDIX 2
TO

The Report of
The Privacy Protection Study Commission

July 1977

The Report of the
Privacy Protection Study Commission

Personal Privacy in an Information Society
(Stock No. 052-003-00395-3)

Appendix 1:
Privacy Law in the States
(Stock No. 052-003-00421-6)

Appendix 2:
The Citizen as Taxpayer
(Stock No. 052-003-00422-4)

Appendix 3:
Employment Records
(Stock No. 052-003-00423-2)

Appendix 4:
The Privacy Act of 1974: An Assessment
(Stock No. 052-003-00424-1)

Appendix 5:
Technology and Privacy
(Stock No. 052-003-00425-9)

Copies of each of these volumes may be ordered from the:
Superintendent of Documents
U.S. Government Printing Office
Washington, D.C. 20402

PRIVACY PROTECTION STUDY COMMISSION

Chairman

David F. Linowes
Certified Public Accountant, New York City, and
Boeschenstein Professor of Political Economy
and Public Policy, University of Illinois

Vice Chairman

Dr. Willis H. Ware
The Rand Corporation
Santa Monica, California

William O. Bailey, President
Aetna Life & Casualty Company
Hartford, Connecticut

William B. Dickinson
Retired Executive Editor,
Philadelphia Evening Bulletin
Philadelphia, Pennsylvania

Congressman Barry M. Goldwater, Jr. of California
Washington, D. C.

Congressman Edward I. Koch of New York
Washington, D. C.

State Senator Robert J. Tennessen, Attorney
Grose, Von Holtum, Von Holtum, Sieben & Schmidt
Minneapolis, Minnesota

PRIVACY PROTECTION STUDY COMMISSION — STAFF

Carole W. Parsons
Executive Director

Ronald L. Plesser
General Counsel

Louis D. Higgs
Deputy Executive Director and Director of Research

Office of the Executive Director

Susan J. Bennett, *Special Assistant*
Arthur A. Bushkin, *Staff Technical Advisor*
Commander Walter E. Conner,[1] *Administrative Officer*
Pamela S. Ellsworth, *Administrative Assistant*
Mark F. Ferber, *Special Consultant to the Executive Director*
Christopher E. Heller, *Senior Research Associate*
Justine V. R. Milliken, *Assistant to the Chairman*
James F. Sasser,[2] *Administrative Officer* (September 1975 to February 1977)
Alan F. Westin, *Special Consultant to the Commission*

Office of the General Counsel

Christopher J. Vizas, II, *Special Staff Counsel*
John A. Turner, Jr., *Assistant General Counsel*
Stephen C. Nichols, *Assistant to the General Counsel*
Shirley A. Lewi, *Administrative Assistant*

Office of Public Information

Mark F. Ferber, *Director*
John F. Barker, *Director* (September 1975 to April 1977)
Eleanor B. High, *Assistant*

Project Management

Lois Alexander,[3] *Research and Statistics*
Susan J. Bennett, *Public Assistance, IRS, Social Security Number*
Arthur A. Bushkin, *Privacy Act Assessment, Technology Assessment*
William H. Foskett, *Education*
Christopher E. Heller, *Credit, Credit-Reporting, and Depository Institutions*
Joan Holloway,[4] *Medical Records*
David M. Klaus, *Investigative Agencies*
Christopher J. Vizas, II, *Government Access*
Jane H. Yurow, *Employment and Personnel*

---

[1] On detail from the Department of Defense.
[2] On detail from the Department of Health, Education, and Welfare (DHEW).
[3] On detail from the Social Security Administration, DHEW.
[4] On detail from the Division of Hospitals and Clinics, U.S. Public Health Service.

Professional Staff and Consultants

Arthur J. Altenberg
Donald Bartlett
Joan Berry
Timothy B. Braithwaite[5]
Joe S. Cecil
Nancy H. Chasen
Claire Dalton
Warren O. Davis[6]
Priscilla DeGasparis
Major William R. Elliott, Jr.[5]
David Galbraith
Timothy Gay
Charles Grezlak
Charles Gustafson
Claudia R. Higgins
Florence B. Isbell
Mary Kay Kane
William R. Klamon
Charles R. Knerr
John Langton, III
Donald Letourneau
Abe Levin
Michael Liethan
Daniel H. Lufkin
Kenneth E. Mannella
Ruth Matthews
Justine V. R. Milliken
Hubert A. Mitchell
William B. McMahon
Margaret A. Neel
David Nierenberg
G. Russell Pipe
Bruce Ransome
Ira Reed
James B. Rule
Francis M. Rush, Jr.[5]
Cynthia E. Schaffhausen
Arden Schell
Harold D. Skipper
Joyce R. Starr
J. Michael Taylor[7]
Patricia Tucker
Rein Turn
Philip Vargas
Alease M. Vaughn
Fred W. Weingarten[8]

Administrative Staff

Phyllis R. Anderson
A. Kristen Austin
Zemphria Raymond Baskin
Mary K. Chin
Alice Cumberland
Louise Goldstein
Debbie J. Graham
Emily Hanis
Lori J. Haselhorst
Jeanne L. Holmberg
Fran Hoyle
Susan Kaslow
Alan C. Luckett
Nancy Mathes
Nina A. Mohay
Joanne Robinson
Mary Scott

Research Assistants

Phyllis R. Anderson
Zemphria Raymond Baskin
Laura Bonn
Vernease Herron
Brenda Reddix
Catherine J. Rodgers
Adrienne Taylor
Roger S. Tilton
Helene Toiv
Michael S. Turchin

[5] On detail from the Department of Defense.
[6] On detail from the Bureau of the Census.
[7] On detail from the Department of Labor.
[8] On detail from the National Science Foundation.

Table of Contents

Preface

Few, if any, of the record-keeping relationships examined by the Privacy Protection Study Commission during the two years of its existence are more sensitive than the subject of this volume. The intimate details revealed on our tax returns, the importance to American society of maintaining confidence in the integrity of the tax system, and the compulsory nature of tax reporting requirements call for the careful balancing of individual privacy interests against government's needs for information.

Section 5(c)(2)(B)(ii) of the Privacy Act of 1974 directed the Commission to consider whether the Internal Revenue Service should be prohibited from disclosing Federal tax returns and related information to other Federal agencies and to agencies of State government. This appendix to the Privacy Protection Study Commission's final report contains the Commission's analysis and recommendations to the President and the Congress regarding Federal tax return confidentiality.

Part I was previously published in June 1976 as an interim report entitled *Federal Tax Return Confidentiality*. This permitted the Commission to make its findings available to the President and the Congress at a time when they were considering legislation dealing with a general reform of the tax system, including tax return disclosure policy.

Part II compares the Commission's recommendations and the statutory provisions governing the disclosure of Federal tax information contained in the Tax Reform Act of 1976. Originally included as Chapter 14 of the Commission's final report, *Personal Privacy in an Information Society*, released on July 12, 1977, it contains a number of new recommendations on issues not fully addressed in the June 1976 interim report.

Part III summarizes the results of an accounting of disclosures of Federal tax information made by the Internal Revenue Service to other Federal agencies for non-tax purposes during April, May, and June 1976. This accounting, which was maintained by the IRS at the request of the Commission, is reported here for the first time.

Many contributed to the completion of the Commission's IRS project. We are, however, especially grateful to Susan J. Bennett, the Project Manager, to Professor Charles Gustafson of the Georgetown University Law School, who prepared the initial drafts of Parts I and II, and to David B. H. Martin, Research Director of the Administrative Conference of the United States, who gave the Commission staff helpful advice.

The Commission also wishes to express its deep appreciation for the gracious cooperation of former IRS Commissioner Donald C. Alexander, and Meade Emory, Assistant to the IRS Commissioner.

David F. Linowes
Chairman

Part I

Federal Tax Return Confidentiality[1]

INTRODUCTION

The Privacy Protection Study Commission was created by Section 5 of the Privacy Act of 1974 (P.L. 93-579). The Commission is required to report to the President and the Congress on

> whether the Internal Revenue Service should be prohibited from transferring individually identifiable data to other [Federal] agencies and to agencies of State governments. (Subsection 5(c)(2)(B)(ii) of P.L. 93-579)

The Commission has nearly completed its examination of disclosures to other agencies by the Internal Revenue Service, and has reached conclusions with respect to a majority of the issues. One segment of its study still unfinished concerns the extent to which information submitted to the IRS by the taxpayer should be treated in the same way for the purpose of disclosure as information about the taxpayer which the Service obtains from other sources. The Commission, however, considers it important to make public the conclusions it has reached, because of the important policy questions that tax return confidentiality issues raise.

RATIONALE FOR THIS STUDY

There are many reasons why the authors of the Privacy Act of 1974 singled out the disclosure of tax returns and related IRS information about taxpayers for special examination. The Federal tax system depends on the collection of substantial amounts of personal information both from the individual taxpayer himself, and from other, "third-party," sources. Moreover, it is in fact a compulsory system. Although it could not function if individual taxpayers did not willingly comply with its requirements, substantial criminal and civil sanctions may be levied against a taxpayer who fails to satisfy the reporting obligations it imposes. Much of the information the Internal Revenue Service obtains from third-party sources is also compelled, in that for the most part it is either derived from the filings of other taxpayers or gathered through the use or threat to use forms of compulsory authority uniquely available to the Service.

[1]Part 1 of this volume is the Commission's June 1976 interim report on *Federal Tax Return Confidentiality.*

At the time the Privacy Act was being drafted, there were many reports of the dissemination of information maintained by the IRS to other government agencies for purposes wholly unrelated to tax collection. There were also allegations that tax returns had been used improperly by a number of Presidents, and that Internal Revenue Service resources were being used to investigate violations of Federal law unrelated to tax collection. Tax information had come to be regarded, in effect, as a "generalized government asset."

The statute that now governs the disclosure of Federal tax returns and related information by the Internal Revenue Service is Section 6103 of the Internal Revenue Code. Subsection (a)(1) thereof provides that:

> returns . . . shall constitute public records but . . . they shall be open for inspection only upon order of the President and under rules and regulations prescribed by the Secretary [of the Treasury] or his delegate and approved by the President.

By enacting this provision, Congress delegated to the Executive branch substantial discretion to decide to what extent, and under what conditions, tax returns and other information about taxpayers would be disclosed by the Service to other government agencies.

The Executive branch has used this discretion to make tax information available to a steadily increasing number of government agencies through a series Executive orders and regulations. Currently, for example, individually identifiable data about taxpayers is made available by the Service to State and local government agencies for tax administration purposes; to the Bureau of the Census for statistical purposes; to the Social Security Administration for use in administering Title II of the Social Security Act; to the Federal Parent Locator Service for use in locating "absent parents"; and to the Department of Justice and United States Attorneys for use in investigating and litigating both tax-related and nontax-related offenses. Under existing regulations, information about taxpayers may be provided by the Service to the head of any Federal executive agency, for use in "matters officially before" him or her. Information about individuals maintained by the Internal Revenue Service may also be made available to the President and to Committees of the Congress.

The Commission was required to consider the propriety of these disclosures in part because the Privacy Act does not constrain them effectively. The Privacy Act establishes the general proposition that a record about an individual should not be disclosed by a Federal agency without the consent of the individual to whom the record pertains. The Act, however, also specifies a number of situations in which such prior consent is not necessary. One of these arises where the disclosure is for a purpose which "is compatible with the purpose for which [the record] was collected."[2] While this would appear to constrain disclosures of data about taxpayers for purposes unrelated to tax administration, the Internal Revenue Service appears not to have interpreted it as prohibiting disclosures of records about

[2]Subsections 3(a)(7) and 3(b)(3) of P.L. 93-579.

individuals currently authorized by regulation. The principal reason for this appears to be uncertainty about the relationship between the Privacy Act and other preexisting Federal confidentiality statutes governing the disclosure of agency records about individuals. Section 6103 of the Internal Revenue Code is one such statute and the Service has deferred to it in setting its disclosure policies under the Privacy Act of 1974. Accordingly, the Commission focussed its study of IRS disclosure policy on whether and how Section 6103 of the Internal Revenue Code should be amended.

Method of Study and Analysis

During the past several years, tax return confidentiality issues have been considered by a number of Congressional Committees. The Commission has studied the hearing record and reports resulting from their inquiries. The Commission has also benefited from the highly useful analysis of tax return confidentiality issues prepared as part of the study of Federal tax administration completed by the Administrative Conference of the United States in 1975.

The Commission staff has done empirical research on disclosures of individually identifiable tax data and has been in communication with IRS personnel, representatives of Federal, State, and local government agencies that receive tax information from the Service, and representatives of the public concerned with these issues. After reviewing the results of these efforts, the Commission adopted a series of draft recommendations on Federal tax return confidentiality at its January 22-23, 1976 meeting. These draft recommendations were circulated widely prior to the Commission's March 11-12, 1976 public hearings on them. A list of those who submitted written comments to the Commission, and of the witnesses who testified at the hearing, is attached hereto as Appendix A.[3]

The results of the staff's research, the testimony presented at the hearings, the written comments received on the draft recommendations, and information subsequently gathered by the staff were carefully analyzed by the Commission at its meeting on May 25, 1976. On June 5, 1976, the Commissioners authorized the Chairman to release this report.

Scope of Recommendations

Because of the objectives and underlying philosophy of the Privacy Act of 1974, the Commission has interpreted its mandate with respect to the disclosure of information in the files of the Internal Revenue Service as applying only to information about natural persons, i.e., individuals living or dead. Although the Commission understands that there are important policy questions regarding the disclosure of information the Service maintains on legal entities, such as corporations and trusts, it made a conscious determination to restrict the scope of its study, and thus of this report, to *identifiable information about individuals.*

[3]This list is not included in this volume. The interested reader is referred to the Commission's interim report, *Federal Tax Return Confidentiality.*

This determination should not be construed as indicating approval of the disclosure of IRS data on legal entities. The Commission simply takes no position on the matter, recognizing that there are arguments for and against consistency in the Service's disclosure policies. As the subsequent discussion will make clear, moreover, the Commission's decision to encompass within its recommendations all individually identifiable data maintained by the Service means that certain information in corporate and partnership returns would be subject to the disclosure restrictions the Commission recommends.

At one point the Commission considered restricting its inquiry to information about individuals that the IRS maintains in "systems of records" as defined by the Privacy Act. A "system of records" is defined by the Act as:

> a group of any records under the control of any agency from which information is retrieved by the name of the individual or by some identifying number, symbol, or other identifying particular assigned to the individual. (Subsection 3(a)(5) of P.L. 93-579)

This definition appears to reflect the Privacy Act's concern with the use of recorded information to make decisions about individuals. Such use seems most likely to occur where information is maintained in a form that makes it readily accessible to decision makers.

Although the "system of records" approach may thus have been satisfactory for the purposes of the Privacy Act, the Commission thought it inappropriate as a limitation on the scope of its study of IRS disclosure policies. The Privacy Act itself does not restrict the Commission's inquiry to "systems of records," but rather, directs the Commission to consider whether "individually identifiable data" maintained by the Service should be disclosed to other Federal and State agencies. Moreover, the Service does in fact maintain information about individuals that is not part of any "system of records." For example, information about an individual employee's withholding tax is reported to the Service each quarter by his employer and maintained by the Service for a short time before being transferred to the Social Security Administration. Likewise, individually identifiable information appears on tax returns filed by legal and business entities. None of these reports, however, is considered by the Service to be part of a "system of records," even though each may be a source of important information about individuals to one who knows the relationship of the individual to the entity filing the information.

Accordingly, the Commission's inquiry and the recommendations in this report should be understood to encompass all individually identifiable data the Internal Revenue Service maintains. That is, the recommendations apply to *all individually identifiable data in records made or obtained by, furnished to, or coming to the knowledge of, any officer or employee of the Internal Revenue Service while acting in his official capacity, or because of his official status, with respect to the administration of the internal revenue laws and other laws administered by the Internal Revenue Service, such as the Employee Retirement Income Security Act.*

Within this scope, however, it should be noted that the Commission's

inquiry has been limited in one important respect. Following precisely the charge given to it in Subsection 5(c)(2)(B)(ii) of the Privacy Act, the Commission has limited its study to disclosures by the Internal Revenue Service to agencies of Federal and State government. The Commission has, therefore, not addressed issues arising from the disclosure of IRS information to the President and the Congress, nor has it considered the extent to which tax information, such as private letter rulings, should be disclosed to the public. The Commission would urge, however, that the considerations reflected in this report be applied in determining the extent to which the President and the Congress should have access to individually identifiable tax data, and it approves of legislative proposals that provide that disclosures to the President and to the Congress be permitted only as authorized by statute.

NOTE ON THIRD-PARTY SOURCE INFORMATION

Some of the legislative proposals on Federal tax return confidentiality now being considered by the Congress make a distinction between information the Service collects from the taxpayer and information about the taxpayer the Service collects from other, third-party, sources.

As part of its inquiry into Internal Revenue Service disclosure policies, the Commission initiated a study to evaluate the extent to which these distinctions are useful in formulating new disclosure policies. To supplement the Commission's efforts in this regard, the Internal Revenue Service agreed to keep a detailed accounting of the kinds and sources of individually identifiable information it disclosed to Federal agencies for a one-month period beginning on April 1, 1976.

The research completed to date indicates that most current recipients of individually identifiable IRS data (e.g., States, the Bureau of the Census, the Social Security Administration) need and obtain little so-called "third-party source" information. Thus, for those recipients, it was not deemed necessary to create different rules for the disclosure of taxpayer-submitted and third-party source information. Instead, the Commission specified in the recommendations in this report the categories of third-party source information it believes those recipients should be permitted to obtain.

The one exception to this general finding is Federal law enforcement agencies that obtain tax information for use in the investigation and prosecution of violations of law having nothing to do with the tax system. It is on this type of disclosure that the Service's one-month accounting focussed. The results of this accounting reveal that although these agencies request and obtain far more taxpayer-submitted information than information the Service collects from third-party sources, they do in many instances obtain third-party source information.

Unfortunately, the Service's report on the April accounting period did not provide the Commission with enough data to allow it to recommend whether Federal law enforcement agencies should be required to satisfy one set of conditions when they seek taxpayer-submitted information from the IRS and another set when they seek information the Service has obtained

from third-party sources. Nor did the April accounting permit the Commission to consider whether law enforcement agencies should be permitted to obtain only certain types of third-party source information from the Service. Thus, the Commission made a preliminary judgment that the same disclosure standards should apply to both kinds of information in this instance. The Commission also believes it is important to determine the extent to which the April disclosures were typical. Thus, the Commission has asked the Service to continue its accounting for two more months so that the reliability of the April findings can be assessed.

The Commission's final report on IRS disclosure policy will contain the Commission's completed findings on the disclosure of third-party source information as well as any additional recommendations it considers warranted at that time.

GENERAL CONSIDERATIONS AND RECOMMENDATIONS

To fulfill the requirements of the Internal Revenue Code, the Internal Revenue Service collects and maintains vast amounts of information about all individual taxpayers. Congress has determined that the compelling societal need to finance governmental activities warrants the intrusion into the lives of individuals that compliance with the Internal Revenue Code inevitably entails. Moreover, the Congress has determined that extraordinary investigative powers, substantially in excess of those provided for other government agencies, are appropriate for the Internal Revenue Service because of the overwhelming importance of public revenue collection.

It is argued by some that because government resources are used to collect the information the Service maintains, it should be treated as a "generalized government asset." Such generalized use, it is contended, does not constitute a material violation of any interest of the taxpayer because the information is in the possession of the Federal government. The only disclosure constraint needed, say the proponents of this proposition, is one that will assure that any such use is limited to the pursuit of government agency objectives.

The Commission emphatically rejects these arguments for two reasons.

First, the Commission believes that the individual taxpayer is inherently at a disadvantage *vis-a-vis* other agencies that may have access to IRS information about him because so much of that information is obtained by the Service under at least the threat of serious punishment for failure to provide it. That fact alone, in the Commission's view, argues for carefully controlled dissemination, and in most cases, for no dissemination of IRS data on individual taxpayers. The Service's special powers of legal compulsion give it a unique ability to acquire information. The fact that other agencies with important responsibilities want to use such information is wholly understandable, but they, however, have not been vested with the Service's extraordinary powers to compel production of the quantities of information the IRS maintains.

Second, the Commission believes that the confidentiality of tax returns and related information is an essential element in preserving the effective-

ness of the tax system in this country. While no one has ever tried to measure the effect on an individual of knowing that his tax return is potentially available to other Federal and State agencies, the Commission believes that widespread use of the information a taxpayer provides to the Service for purposes wholly unrelated to tax administration cannot help but diminish the taxpayer's disposition to cooperate with the IRS voluntarily. This is not to say that the taxpayer will not cooperate; only that his incentive to do so may be weakened. That in itself creates a potentially serious threat to the effectiveness of the Federal tax system.

Recognizing that it bears a heavy responsibility to defend the individual's interest in the way institutions of all kinds collect, maintain, use, and disseminate personal information, the Commission considered whether to recommend an absolute prohibition on the disclosure of Federal tax data for non-tax purposes. The Commission, however, also recognized that in most instances, including this one, other needs have to be taken into account. Accordingly, while the Commission does not propose an absolute prohibition on IRS disclosures of tax information for non-tax purposes, it does believe that the manner in which such disclosures are authorized must assure that the individual's interest in confidentiality will be properly represented when competing demands for disclosure are being considered.

Therefore, the Commission strongly believes that the current methods of authorizing disclosures be abandoned. Under the system now in effect, the decision to allow a particular type of disclosure is generally made by the Executive branch and implemented through regulations issued pursuant to authorities granted by Section 6103 of the Internal Revenue Code. The Commission recommends that this procedure be supplanted by one in which the disclosure of information the Internal Revenue Service maintains on individuals will be allowed only in situations where the Congress by statute has expressly authorized the disclosure of specific categories of information.

In recommending that the Congress be the sole source of IRS disclosure authority, and that the Congress' exercise of its responsibility include attention to the categories of information for which disclosure authority is sought, the Commission recognizes that it is urging an additional burden on the legislative branch. The need to consider modifications in the Internal Revenue Code to provide authority for disclosures not now permitted will inevitably arise again and again. The Commission believes, however, that the Congress is the appropriate body to strike the necessary balance between the interests of the citizen and the viability of the tax system on the one hand, and the interests asserted by those desiring access to Internal Revenue Service files on the other.

A balancing of competing interests is required. No requesting agency should be expected to bear the balancing responsibility when, as is often the case, it considers its ability to perform a function of its own to be at stake. Nor should the Internal Revenue Service be put in the awkward position of unilaterally refusing to consider forcefully articulated requests of sister agencies on the grounds that it alone represents the interests of the taxpayer.

It is difficult to describe precisely how the balance should be struck.

The Commission looked for guidance on this question to the "conditions of disclosure" section[4] of the Privacy Act of 1974, which offers two criteria. The first is that a record may be disclosed without the consent of the individual to whom it pertains if the purpose for which the disclosure is made is clearly compatible with the purpose for which the record was originally created, on the theory that there should be a close correspondence between an individual's expectations as to how a record about him will be used, and the uses to which that record is actually put. The second is that when the disclosure being considered is for a purpose that is not clearly compatible with the purpose for which the record was created, it should be permitted without the individual's consent only if it would serve a societal objective that clearly overrides the individual's interest in controlling the uses to which information about him is put.

The Commission believes that these Privacy Act criteria constitute a reasonable starting point for deciding when the Internal Revenue Service should be authorized to disclose tax records for purposes other than Federal tax administration. However, the Commission also believes that authorizing the Service to disclose individually identifiable tax information to another agency for a purpose unrelated to the administration of a Federal tax law should seldom be defensible unless the Congress would be willing in principle to compel all citizens to disclose such information directly to the agency that wishes to obtain it from the IRS. In all cases, moreover, the burden of demonstrating the compelling societal need for disclosure should rest with the agency that seeks to have it authorized.

Finally, if the Congress were willing to compel a citizen to disclose the information directly to the agency requesting entitlement to it, the Commission would urge that provision for such direct disclosure be considered on the theory that a citizen's confidence in his government is likely to be greater where he must deal with an agency directly rather than through an intermediary.

From the Commission's analysis of the need for substantial reform in the way decisions to authorize disclosures of individually identifiable data maintained by the IRS have traditionally been made, it follows that the Congress must play a much stronger role in that decision-making process. Accordingly, the Commission makes four general recommendations.

First, the Commission recommends that no disclosure of individually identifiable data by the Internal Revenue Service be permitted without the prior, written consent of the individual to whom it pertains, except when such disclosure has been specifically authorized by Federal statute.

Second, the Commission recommends that the Congress provide by statute that the Commissioner of Internal Revenue may disclose to a Federal or State agency that is specifically authorized by statute to obtain individually identifiable information from the service only such information as that agency needs to accomplish the purpose for which such disclosure is made and, further, that the Commissioner of Internal Revenue adopt administrative

[4]Subsection 3(b) of P.L. 93-579.

procedures that permit public scrutiny of the Service's compliance with this statutory requirement.

Third, the Commission recommends that the Congress specify in each statutory authorization for disclosure the categories of information that may be disclosed and the purpose for which the information may be used.

Prohibitions on disclosure of irrelevant information are necessary to minimize the risk of unauthorized use of tax information. Further, adherence to a principle of limited authorization will tend to assure that an authorized user of one type of tax information cannot, without statutory authorization, obtain a different type for a wholly different and, therefore, unauthorized purpose.

The Commission's fourth general recommendation is a necessary corollary to the first three: **the Commission recommends that a recipient of individually identifiable tax information from the Service be prohibited from re-disclosing such information without the consent of the individual to whom it pertains, unless specific authorization for such re-disclosure has been expressly provided by Federal statute.**

The Commission's recommendations on penalties for unauthorized disclosure are set forth later in this report.

SPECIFIC RECOMMENDATIONS

The Commission has considered the various disclosures that occur under the present authorization system with a view to recommending which should be expressly approved by statute, using the approach suggested above, and which should be terminated. The result of these deliberations by the Commission are set forth below.

Disclosures for Purposes Related to Federal Tax Administration

Because the Department of Justice acts as the litigator for the Service in tax cases, it is necessary for the Service to disclose tax information to the Department in such instances. The Commission believes that the use of individually identifiable IRS data by the Department of Justice in connection with the investigation and prosecution of tax violations is clearly compatible with the purpose for which the information was originally acquired. Accordingly, **the Commission recommends that the Congress permit the Internal Revenue Service to disclose individally identifiable data to the Department of Justice for use in investigations and prosecutions of violations or tax laws, provided that the information pertains to a party to the actual or anticipated litigation.**

In some cases, the Department of Justice may wish to obtain information from the Service that is pertinent to issues in an actual or anticipated tax litigation to which the individual to whom the information pertains is not a party. The Commission believes that because of the interlocking nature of many tax returns, disclosure of relevant information in such circumstances is compatible with the purpose for which the

information was originally collected. Accordingly, **the Commission recommends that the Congress permit the IRS to disclose to the Department of Justice information about an individual who is not being investigated or prosecuted for a violation of the tax laws provided that the information disclosed is relevant to issues in an actual or anticipated tax litigation. In such cases, however, information about an individual should be considered relevant only if the treatment of an item on the return of a party to an actual or anticipated tax litigation, or the liability of such a party for any tax, penalty or interest, may be determined by reference to it.**

The Commission considered and rejected two other recommendations that would have permitted the disclosure of individually identifiable information to the Department of Justice for use in tax litigation. One of these would have allowed the disclosure of information about a witness in a tax proceeding which is not pertinent to any issue in litigation but which would serve to impeach the witness' testimony. The other would have sanctioned the use of IRS information in the selection of jurors in tax cases. The Commission considers both of these disclosures of tax information to be clearly incompatible with the purpose for which such information was collected, and finds no compelling justification for permitting them to continue.

Disclosure to the Social Security Administration

The Internal Revenue Service and the Social Security Administration share responsibility for the administration of the Federal Insurance Contributions Act. Also, the Internal Revenue Service and the Social Security Administration (along with the Department of Labor and the Pension Benefit Guaranty Corporation) are jointly responsible for the administration of the Employee Retirement Income Security Act (ERISA). These shared responsibilities have required the sharing of information for purposes that are clearly compatible with the purposes for which it was originally collected.

Thus, **the Commission recommends that the Congress permit the Internal Revenue Service to disclose to the Social Security Administration (SSA): (1) employers' quarterly tax returns and income tax returns for self-employed individuals, for the purpose of administering Title II of the Social Security Act; and (2) registration statements that pension plan administrators are required to file with the Internal Revenue Service for the purpose of carrying out SSA's responsibilities under ERISA.**

The Social Security Administration also obtains from the IRS name and address information about potential applicants for Title II (Old Age Assistance) benefits and uses this information to notify the potential applicants of their eligibility. This use of tax information is not compatible with the purpose for which the IRS collects it. Nonetheless, the use to which it is put by SSA is wholly benevolent and therefore the Commission believes that an exception is warranted in this particular case.

Thus, **the Commission recommends that the Congress permit the Social**

Security Administration to obtain name and address information from the IRS for the purpose of notifying individuals of their eligibility for Title II benefits.

Disclosures to the Railroad Retirement Board

The Internal Revenue Service and the Railroad Retirement Board share responsibility for administering the Railroad Retirement Act. The Board needs to be able to compare information reported to the Service by employers with the Board's own records of creditable compensation. Because this use of individually identifiable IRS information is compatible with the purposes for which it is collected by the Service, **the Commission recommends that the Congress permit the Internal Revenue Service to disclose tax returns of employers subject to the Railroad Retirement Act to the Railroad Retirement Board for use in verifying compensation credited to an individual's account by the Board.**

Disclosure to States and Localities for Purposes of Tax Administration

There has been in the past, and is currently, a substantial degree of cooperation between the Internal Revenue Service and officials administering revenue laws in States and localities. Such cooperation is specifically countenanced by provisions of the Internal Revenue Code which, for example, provide that the Internal Revenue Service may use its broad collection powers to collect income taxes on behalf of a State. One other means of furthering this cooperation has been the exchange of individually identifiable IRS data pursuant to intergovernmental agreements.

The Commission believes that the disclosure of individually identifiable data by the IRS to a State taxing authority for use in administering a general revenue law of the State is not inappropriate in a Federal system. Where an individual is required to report the same or similar information to taxing authorities at different levels of government, nothing is gained by preventing the taxing authorities involved from verifying the accuracy of the information the individual has reported to each. The Commission also believes, however, that the information exchanged for verification purposes should be strictly limited to the minimum necessary for that purpose. Accordingly, **the Commission recommends that the Congress permit the Internal Revenue Service to disclose individually identifiable IRS data to a State agency responsible for tax administration or enforcement for the sole purpose of determining, validating, or enforcing a taxpayer's liability under a general revenue law of the State.** This recommendation would allow the Service to disclose relevant information to a State in connection with the enforcement of such general revenue laws as personal property taxes, even though there is no Federal personal property tax. Licensing and other regulatory laws which require the payment of a fee would not be considered to be general revenue laws for the purpose of the recommendation.

The Commission further recommends, however, **that the disclosure of tax information to State agencies for such purposes be limited to the**

information on a Federal income, estate, or gift tax return (Forms 1040, 1040A, 706, and 709) and accompanying schedules, and summary information regarding adjustments to such returns, that is necessary to determine taxpayer liability under a general revenue law of the State.

This corollary and essential recommendation is consistent with the Commission's general recommendation that each statutory disclosure authorization specify the categories of information that may be disclosed and that no more information should be disclosed than is necessary to achieve the purpose for which disclosure is made. This recommendation will require modifications in the way the Service presently provides information to the States, such as refinements in the Individual Master File tape provided to each State. Although the Commission has been advised that the necessary modifications will result in additional costs, it believes that such costs are fully justified by the reduced risk of unauthorized use.[5]

The Commission recognizes that the disclosure of individually identifiable IRS data to State taxing authorities creates the possibility that additional uses of such information will be made without the taxpayer's consent. Unlawful disclosures of Federal tax information by State officials have been rare. The Commission encountered only one instance in which a governor has sought to use Federal tax information for an unauthorized purpose. Nonetheless, the Commission believes that Congress should act to minimize the risk of such abuses. First, **the Commission recommends that Congress provide by statute that requests for the disclosure of individually identifiable IRS data be made in writing by the principal tax official(s) of a State.** Second, **the Commission recommends that the Congress stipulate in statute that a State which seeks to obtain individually identifiable IRS data must have enacted a statute with penalties substantially similar to those of Section 7213 of the Internal Revenue Code, prohibiting the disclosure for purposes other than State tax administration of Federal tax information obtained from the Internal Revenue Service, as well as information supplied by the State taxpayer that is a copy of or copied from his Federal tax return.**

The Commission believes that this recommendation, if adopted, would alleviate the difficulties that may arise in attempting to prosecute an individual for unauthorized disclosure of Federal tax information obtained from the IRS where that information has been commingled with similar information obtained directly from the State taxpayer. The Commission's recommendation need not interfere with a State legislature's authority to

[5]In April, 1976, the Commissioner of Internal Revenue made the following response to the Commission's inquiry on the cost of providing only relevant information to the States: "The Privacy Protection Study Commission's inquiry on providing selective IMF information to requesting states under the Federal/State Exchange Program has been interpreted to mean that we will have to make a determination, on a state by state basis, as to exactly what data will be needed by each requesting state for the enforcement of their tax law and provide only that data to the requesting state . . . . We . . . assume that (1) no new data would be entered on the master files for any state; (2) we would only extract from the data currently available on the master file . . . . Based upon this interpretation, we believe that it is feasible to provide for the extraction of selective data on a state by state basis and still have an annual extract. We estimate that this would cost the Service approximately $182,000 or some $72,000 more than the cost incurred in the calendar year 1975 program."

authorize the disclosure of State tax information that is not a copy of, or copied from, a Federal return, to another State agency.

The Commission expects that State governments will comply expeditiously with such a requirement. It recognizes, however, that the enactment of the required State law may take up two years in a State where the legislature meets biennially. Accordingly, **the Commission recommends further that a State be permitted to continue to receive Federal tax information for a period of two years after the adoption of the foregoing recommendations by the Congress pending the enactment of the necessary statute by its legislature. If, however, the necessary State legislation has not been enacted by the end of that two-year period, the Commission recommends that the Service be required to discontinue the disclosure of information to the State until the necessary statute is enacted.**

Although the existence of a State law providing penalties for the unauthorized disclosure of Federal tax information will serve as a deterrent to a State employee who contemplates making an unlawful disclosure, the Commission believes that additional safeguards are necessary to further reduce the risk that such disclosures will ever occur. Accordingly, **the Commission recommends that the Congress require a State that receives individually identifiable data from the IRS to institute reasonable physical, technical, and administrative safeguards satisfactory to the IRS to avoid the use or disclosure of such information for the purposes other than State tax administration.**

Because the Internal Revenue Service is primarily responsible for assuring that the information it collects and disseminates is not improperly used, the Commission also believes that the safeguards a State establishes should be reviewable by the Service. Therefore, **the Commission recommends that the Congress require the Internal Revenue Service to review the administrative, technical, and physical safeguards established by each State pursuant to the foregoing recommendation and empower the Commissioner of Internal Revenue to suspend temporarily a State's access to Federal tax information if an unauthorized disclosure is made or if the safeguard procedures in force are determined to be inadequate. The Commission also recommends that a procedure be established to permit a State to appeal a decision by the Service to suspend its access to Federal tax information.**

Disclosure for Use in Administration of Local Taxes

A number of State taxing authorities administer taxes for municipalities and use Federal tax information obtained from the IRS in doing so. The Commission believes that such use is appropriate, and **recommends, therefore, that Congress permit a State taxing authority to use for purposes of local tax administration any Federal tax information it could obtain for State tax administration provided, however, that such information is not disclosed to the locality.**

Currently some local governments use Federal tax information obtained from the IRS through their State tax authorities for local tax administration. This information, which is usually no more than name,

address, Social Security number, and type of return filed, is used primarily to identify individuals who may have failed to file their local government tax returns. Some commentators expressed concern that the potential for misuse increases when individually identifiable data is disseminated by the IRS to local governments. Nonetheless, the Commission found no evidence to support the conclusion that the availability of such information to local officials has led to widespread misuse, and is not persuaded that disclosure of the limited amount of information currently permitted materially increases the risk of abuse. Moreover, the Commission believes that the use of Federal tax information in local tax administration is compatible with the purpose for which such information was collected. Accordingly, **the Commission recommends that Congress permit the Internal Revenue Service to disclose to a local taxing authority the name, address, and type of return filed of all Federal taxpayers in that locality, provided, however, that the information is supplied directly to the locality by the Internal Revenue Service and that the locality has enacted and is enforcing an ordinance prohibiting the use of such information for purposes other than local tax administration. Additionally, the Commission recommends that the Congress also permit the Internal Revenue Service to disclose the Social Security numbers of Federal taxpayers in a locality if the locality had in force before January 1, 1975, a law allowing it to demand the Social Security number directly from such taxpayers for local tax purposes.**

Disclosure for Statistical Purposes

Of the four Federal agencies that currently use tax information about individuals for statistical purposes, only the Bureau of the Census clearly needs such information in individually identifiable form. The Bureau of Economic Analysis and the Federal Trade Commission only use tax information about legal and business entities.

Although the Census Bureau's use of individually identifiable tax information is not compatible with the purpose for which that information is collected, the Commission believes the Bureau's use should be permitted to continue for the following reasons. First, an individual is in no way directly affected by the Bureau's use of IRS data. Second, information gathered by the Census Bureau may not, by law, be disclosed to any person and the Bureau's record in safeguarding the confidentiality of individually identifiable information in its custody is exemplary. Third, important societal interests are served by this disclosure—namely, the development of population and per capita income estimates for use in allocating revenue sharing funds, and as a check against the statistical accuracy of information gathered directly from individuals by the Bureau itself. Finally, most of the information gathered for revenue sharing purposes is on the individual tax return, which contains a notice apprising the individual that such information will be used by the Census Bureau.

For all of these reasons, therefore, **the Commission recommends that the Congress permit the Internal Revenue Service to disclose to the Bureau of the Census information from individual income tax returns (Forms 1040 and**

1040A), provided that no more information is disclosed to the Bureau than is necessary for its purposes.

The Commission understands that the Assistant Secretary of Treasury for Tax Policy also uses information about individuals obtained from the IRS for statistical purposes, but it has not been able to determine whether it is necessary for the Assistant Secretary to obtain the information in a form that is individually identifiable. If the Office of the Assistant Secretary can clearly show that it needs individually identifiable IRS data for necessary statistical purposes, the Commission would sanction this disclosure for the same reasons it would justify disclosure to the Census Bureau.

Disclosure of IRS Information About Prospective Appointees

The President and the heads of Federal agencies may request tax information from the Service about prospective appointees to Federal positions. Under procedures currently in effect, the Service provides the following information for this purpose: whether the prospective appointee has filed income tax returns for the immediately preceding three years; owes any unpaid taxes and, if so, for what years; has been under any criminal tax investigation; and/or has been assessed a penalty for tax fraud or negligence.

Although most requests for this type of information come from the President, and thus fall outside the scope of the Commission's inquiry, a number of Federal agencies appear to make extensive use of this type of information. For example, the Department of Justice requested such information in 835 instances in 1974 in connection with the consideration of judicial nominees.

The purpose of these requests is apparently to avoid the embarrassment of appointing an individual with tax problems to an important government post. Although this may be a worthwhile goal, there appears to be no reason why a prospective candidate or nominee should not be asked to consent to the disclosure of such information about him or her. If such information is disclosed by the Service without the individual's knowledge, moreover, the individual might be penalized by losing the appointment without having had an opportunity to explain his situation. In light of these considerations, **the Commission recommends that the Congress not permit the Service to disclose information about prospective Federal appointees without the consent of the individual to whom the information pertains.**

Disclosure to the Parent Locator Service

The Federal Parent Locator Service (PLS) is a component of the Department of Health, Education, and Welfare. It was created primarily to assist State welfare agencies in establishing the most recent address and place of employment of individuals who are failing to meet their obligations to support their children. It replaces an arrangement in effect since 1967 wherein each quarter the Secretary of Health, Education, and Welfare provided the Secretary of the Treasury with a State-developed list of

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

The Federal Parent Locator Service, which has been in actual operation only since March 15, 1976, significantly expands this location capability by making it available to parents, relatives, and guardians of a child who is not being supported out of public funds and whose absent parent may not be the object of an outstanding support order. Moreover, Section 453 of the Social Security Act, which establishes the Federal PLS, authorizes it to demand the disclosure of whereabouts information "from any . . . department, agency, or instrumentality, of the United States." The only exceptions are for "disclosures which would contravene national policy or security interests of the United States or the confidentialtiy of census data."

The Internal Revenue Service is without doubt the best Federal source of recent address and place of employment information, and along with the Social Security Administration, is currently the PLS's chief source of such information.

The Commission plans to examine the operation of the Parent Locator Service in the context of its planned study of record-keeping practices in public assistance and social services programs. Moreover, because the PLS is so new, the Commission is doubtful that anyone is capable of making a judgment about its utility or about its ability to function if it were denied access to IRS information.

In principle, the Commission is troubled by the type of infringement upon the confidentiality of IRS records that the PLS represents. Clearly, the disclosure of such information for the purpose of locating an absent parent is not compatible with the purpose for which the IRS collects it. Yet the Commission recognizes that the Congress has expressly authorized this disclosure by statute and did so in a manner that indicated its intention to disregard the compatibility principle in this instance.

Thus, while the Commission reserves judgment for the time being on whether the Congress should permit the Federal Parent Locator Service (and the State Parent Locator Services to which the Federal Service relates) to continue to have access to IRS information, it does believe that if such access is permitted to continue, stronger safeguards than now exist are essential. Accordingly, **if the Congress permits the Federal Parent Locator Service to continue to have access to information maintained by the Internal Revenue Service, the Commission recommends that (1) such access be limited to instances in which the residence and place of employment information sought may serve to locate an individual against whom there is an outstanding court order for child support, the financial requirements of which are not being met, (2) there be a strict prohibition on the re-disclosure of taxpayer identity information by any Federal or State agency recipient entitled to receive it from the Parent Locator Service, and (3) the penalties of Section 7213 of the**

Internal Revenue Code for unauthorized disclosure of tax information shall apply to such recipients.

Disclosure of Taxpayer Identification Information to Other Federal Agencies

Certain other agencies of the Federal government have in the past received taxpayer identification information from the Internal Revenue Service. In such cases, the uses made of the information have more often than not been wholly incompatible with the purposes for which it was collected by the IRS and, in many instances, it has been used to facilitate taking adverse actions against individuals. The Commission believes that the government should not act positively to protect the anonymity of individuals who wish to avoid meeting their legal obligations. However, the Commission does believe that information with respect to the location of an individual is likely to exist in many forms that do not arise from compulsory reporting requirements. Accordingly, **the Commission recommends that no disclosures of taxpayer identification information by the IRS be authorized save those that would be permissible pursuant to the specific disclosure authorizations recommended in other sections of this report.**

Disclosure to Federal Law Enforcement Agencies for Non-Tax Investigations and Prosecutions

Information that taxpayers themselves provide to the Internal Revenue Service and information about taxpayers that the IRS obtains from other sources is disclosed by the Service to other Federal agencies for use in the enforcement of laws that have nothing to do with tax administration. The overwhelming majority of such disclosures are made to lawyers in the Department of Justice and to United States Attorneys engaged in the investigation and prosecution of criminal offenses under Title 18 of the United States Code, and to officers of the Securities and Exchange Commission engaged in the investigation of possible violations of the Securities Exchange Act.[6] However, disclosures for purposes unrelated to tax administration are also made by the Service to such agencies as the Department of Agriculture, the Civil Aeronautics Board, the Federal Communications Commission, the Federal Home Loan Bank Board, the Department of the Interior, the Interstate Commerce Commission, the United States Postal Service, the Small Business Administration, and the Veterans Administration for use in both civil and criminal proceedings.

In testimony before the Commission, representatives of Federal law enforcement agencies argued strongly for convenient access to information the IRS maintains about individuals because of the usefulness of such information in the investigation and prosecution of civil and criminal

[6]For example, in 1975, the Department of Justice made 320 requests for the inspection of 11,485 returns of 2,374 taxpayers. During the same period, United States Attorneys made 1,350 requests for 17,678 returns of 4,330 taxpayers, and the Securities and Exchange Commission made 16 requests for 119 returns of 39 taxpayers.

violations that have financial aspects. The Commission is, moreover, aware of the recent decision of the Supreme Court in *Garner v. United States* (Case No. 74-100, March 23, 1976) holding that the use of a tax return as evidence in a non-tax prosecution of the individual who filed the return did not violate his Fifth Amendment privilege against self-incrimination where that privilege was not asserted at the time the return was filed. However, neither the practical argument in favor of such disclosures by the IRS, nor the court's rejection of the Constitutional argument against them, requires the conclusion that they should be deemed appropriate as a matter of public policy.

Society's need for effective law enforcement is obvious. Nonetheless, the Commission believes that the use of individually identifiable IRS information in investigations and prosecutions of laws wholly unrelated to tax administration is not only incompatible with the purposes for which such information is collected, but also takes inappropriate advantage of the fact that taxpayers are required, under threat of criminal penalties, to submit information about themselves to the service.

Consistent with the Commission's view that information the Internal Revenue Service maintains about individuals should not be considered a generalized governmental asset, and given the fact that substantial harm can come to an individual as a consequence of the use of tax information about him for a non-tax law enforcement purpose, the Commission believes that no such use should be permitted unless a compelling societal interest can be shown to outweigh the arguments against it that have been articulated in this report.

The Commission considered a flat prohibition on the use of IRS records in non-tax investigations and prosecutions. The Commission realized, however, that a Federal law enforcement agency, using legal process available to it, is often able to compel a copy of a tax return directly from the taxpayer. Thus, it seemed anomalous to deny such an agency access to that return merely because the return has been given over to the IRS.

The Commission did observe, however, that when an agency seeks to compel tax information directly from the taxpayer, it must be able to show that the information is necessary to the investigation or prosecution of a violation of law. Further, the taxpayer is aware that the information is being sought and has an opportunity either to challenge the demand that he provide it or to suppress use of it once it has been obtained. Finally, if the taxpayer challenges the agency's right to obtain or use the information, the burden is on the agency to sustain the propriety of its action.

In the Commission's view, this observation brings into focus the central question, which is not whether a Federal law enforcement agency should be denied access to information about an individual just because the information has been given over to the IRS, but rather whether such an agency should have easier access to information about an individual maintained by the Service than it would have if it sought to compel the production of that information directly from the taxpayer himself.

The Commission concluded that a Federal law enforcement agency

should not have easier access from the Service than from the taxpayer, because so much of the information the Service acquires about an individual is obtained through the exercise, or threat to exercise, the compulsory authorities available to it. From this conclusion, moreover, it follows that the procedural protections for the taxpayer about whom information is requested from the Service for non-tax law enforcement purposes should be comparable to those the taxpayer would have if the requesting agency were demanding the information from him directly.

The questions presented are when does society's interest justify disclosure and who should participate in making the decision to disclose. The Commission believes that a satisfactory answer to the first question is most likely to be achieved if the Federal law enforcement agency seeking information from the Service is required to convince a court that there is probable cause to believe that a violation of law has occurred and that the tax information sought is relevant to an investigation of that violation. Unless the probable cause standard can be met, the Commission believes it must be presumed that there is insufficient evidence to indicate that the societal interest in disclosure outweighs the individual's interest in preventing disclosure.

Further, in answer to the second question, the Commission has concluded that the taxpayer must have actual notice that information about him is being sought and an opportunity to contest its disclosure. Otherwise, there will be no guarantee that the taxpayer's interests will be adequately represented. The Internal Revenue Service should not be expected to serve as the taxpayer's surrogate when it is the entity that may be ordered to produce the tax information by the court, and when to represent the taxpayer's interest it may have to oppose the forcefully articulated arguments of another Federal agency.

Thus, **the Commission recommends that the Congress prohibit the Commissioner of Internal Revenue from disclosing individually identifiable information about a taxpayer to another Federal agency for non-tax law enforcement purposes unless the Commissioner is in receipt of a court order issued pursuant to the following six-part procedure:**

(1) **A Federal agency with civil or criminal law enforcement authority shall file an application through the United States Department of Justice, or directly if it is authorized to do so, with an appropriate United States District Court for an order granting access to information the Internal Revenue Service maintains on an individual. In its application, the agency shall have reasonably described the information it seeks.**

(2) **The applicant agency shall serve the taxpayer to whom the requested information pertains in the same manner as it would serve an adversary party in initiating litigation. The taxpayer shall have 20 days following service of process to respond.**

(3) **The U.S. District Court shall have jurisdiction to order the IRS Commissioner to disclose the information sought where the applicant agency has maintained its burden to prove:**

(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) there would be no legal impediment to the applicant agency acquiring the information sought directly from the taxpayer.

(4) The taxpayer shall be permitted to participate fully in all proceedings pursuant to the application to the court. The District Court judge may require that the information sought be submitted by the Internal Revenue Service for his review *in camera*. If service of the taxpayer cannot be reasonably effected, the application may proceed at the discretion of the court without participation by the taxpayer.

(5) If the court determines that the applicant agency is not entitled to obtain an order substantially requiring the Commissioner of Internal Revenue to produce the requested information, the court may order that the applicant agency reimburse the taxpayer for litigation costs, including reasonable attorneys' fees incurred in connection with the application proceedings.

(6) The order issued by the District Court, directing the Commissioner of Internal Revenue to deliver the information sought, shall be considered a final order of the District Court and subject to appropriate review.

In offering this recommendation, the Commission recognizes that an additional burden would be placed upon a judiciary that already bears a heavy load. Moreover, access by law enforcement agencies to IRS information on taxpayers would be reduced, perhaps substantially, from that currently enjoyed. In addition, the applicant agency will have to bear a further burden of deciding whether the importance of the tax information it seeks outweighs the liabilities that may be created by the requirement to involve the individual to whom the information pertains in the process. Nevertheless, the Commission believes that its recommendation constitutes an appropriate balancing of the competing societal and individual interests.

Finally, the Commission addressed separately the question of whether tax information about jurors in non-tax proceedings should be made available to the Department of Justice. Treasury Department regulations currently provide that

> Returns shall not be made available to the Department of Justice for purposes of examining prospective jurors except that this shall not prohibit the answering of inquiry, from the Department of Justice, as to whether a prospective juror has, or has not, been investigated by the Internal Revenue Service.

The Commission strongly believes that this regulation should be abandoned, because it sees no compelling societal interest in disclosure that

justifies this use of tax information for a purpose that has no relevance whatsoever to tax administration. Accordingly, **the Commission recommends that the Congress not permit the disclosure of any tax information about a prospective juror for use in jury selection.**

Safeguard Requirements for Recipient Federal Agencies

To assure compliance with the Commission's general recommendation that recipients of individually identifiable tax information from the Service be prohibited from re-disclosing such information without the consent of the individual to whom it pertains, the Service should be empowered to require Federal agency recipients of IRS information to establish reasonable administrative, technical, and physical safeguards to prevent the unauthorized disclosure of such information. This is consistent with the Commission's recommendation that State agencies establish safeguards satisfactory to the IRS as a condition of receiving Federal tax information.

Accordingly, **the Commission recommends that the Congress provide that the Internal Revenue Service may require Federal agencies that obtain individually identifiable data from the IRS to institute reasonable administrative, technical, and physical safeguards satisfactory to the Service to avoid the unauthorized use or disclosure of such information.**

The Commission recommends further that if the President and committees of Congress obtain individually identifiable data from the IRS they, too, be required to institute reasonable administrative, technical, and physical safeguards satisfactory to the IRS to avoid the unauthorized use or disclosure of that informaton.

The Commission is aware that this recommendation may conflict with existing arrangements for determining the adequacy of safeguards a Federal agency establishes to protect the personal information it maintains. The Commission believes, however, that the special character of Federal tax records warrants a departure from normal procedure.

Penalties For Unauthorized Disclosure

Section 7213 of the Internal Revenue Code provides that a Federal or State employee who discloses tax records in an unauthorized manner may be guilty of a misdemeanor, and fined $1,000 and/or imprisoned for up to one year. The Commission has been urged to recommend an increase in the penalties for unlawful disclosure.

The Commission resists the arguments of those who urge that unauthorized disclosure be made a felony. The Commission developed no evidence to support the proposition that unlawful disclosures are occurring because of the limited nature of the potential punishment. Moreover, the Commission is concerned that the creation of overly stringent sanctions could lead to a situation in which juries will be reluctant to convict alleged wrongdoers because of the severity of the offense and potential punishment.

On the other hand, the Commission recognizes that the deterrent effect of the financial penalty currently available in the statute is less now than it

was when Congress first imposed it because of the reduced value of the dollar. Accordingly, to assure effective deterrence without jeopardizing enforcement, **the Commission recommends that the Congress amend Section 7213 to increase the maximum fine from $1,000 to $5,000.** The Commission does not recommend that the violation be deemed a felony or that incarceration for more than a year be authorized.

The Commission also recommends that Section 7213 be amended to make it apply to former employees of Federal, State, and local government agencies, private contractors, and any other individual authorized to obtain Federal tax information.

Use of the Social Security Number by State Taxing Authorities

Section 7 of the Privacy Act of 1974 makes it unlawful for any Federal, State, or local government agency to deny an individual any right, benefit or privilege provided by law because of such individual's refusal to disclose his Social Security number unless such disclosure is specifically required by Federal statute, or was required by an agency maintaining a system of records in existence before January 1, 1975, if such disclosure was required under statute or regulation adopted prior to such date.

The overwhelming majority of State taxing authorities did not have the requisite statute or regulation in effect before January 1, 1975, and there is no Federal statute authorizing State taxing authorities to demand the disclosure of the Social Security number of State taxpayers. The Commission intends to view the SSN as a "cross-cutting issue," and to examine its use in each set of hearings it undertakes. The Commission has, however, made the following determination. If the SSN is viewed only as a means to an end, where society has deemed to be legitimate the end sought to be achieved, there should be no bar to using the SSN to achieve it. The Commission has concluded that the disclosure of Federal tax returns to State taxing authorities is not inconsistent with the individual's right to control the use of information about him because of the compatibility of the purpose for which it is used with the purpose for which it was collected. Therefore, it has concluded that the use of the SSN to facilitate the matching of Federal tax records with State tax records should also be permissible.

Accordingly, **the Commission recommends that the Congress provide by statute that a State taxing authority may require a State taxpayer to disclose his SSN to the State taxing authority, provided, however, that the statute prohibits the use or disclosure of the SSN for purposes other than State tax administration, and that penalties comparable to those in Section 7213 of the Internal Revenue Code be applied to the unauthorized disclosure of the SSN by an officer or employee of the State taxing authority.**

The Commission would emphasize, however, than an authorization for the use of the SSN, such as that recommended above, should be permitted only when the merits of the information exchange which the SSN is used to facilitate have been carefully examined.

* * * * * * *

Section 5 of the Privacy Act of 1974 directs the Privacy Protection Study Commission to report to the President and the Congress on

> such . . . legislative recommendations as it may determine to be necessary to protect the privacy of individuals while meeting the legitimate needs of government and society for information.

The Commission is persuaded that the foregoing recommendations on Federal tax return confidentiality respond to that general charge.

Part II

The Relationship Between Citizen and Government: The Citizen as Taxpayer[1]

In 1974, the Congress made all Federal agencies subject to a broad set of restrictions regarding the uses and disclosures that can be made of records they maintain about individuals. Section 3(b) of the Privacy Act of 1974 permits a Federal agency to disclose information about an individual without his consent only if one of eleven conditions is met.[2] As the Commission has pointed out in Chapter 13 [of its final report], however, it believes that no one set of rules applicable to all Federal agencies can suffice in all instances. Effective disclosure policy must make special provision for the confidentiality of the records of particular Federal agencies through enactment of statutes that set disclosure policy for a single agency, or for the records generated in a particular type of relationship an individual may have with one or more agencies. Records that contain a great amount of detail about individuals or that must be held in strict confidence if individuals are to be induced to participate in a government undertaking deserve special attention in this regard.

The Internal Revenue Service and the records it maintains about taxpayers represent such a special case. Although the taxpayer volunteers most of the information the IRS needs, his disclosures to it cannot 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 on 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.

---

[1]Part II originally appeared as Chapter 14 of the Commission's final report, *Personal Privacy in an Information Society*, released on July 12, 1977.

[2]These conditions are met when a disclosure is: (1) to officers and employees of the agency [maintaining the record] on a "need to know" basis; (2) required under the Freedom of Information Act; (3) for a "routine use" [a "use of the record for a purpose compatible with the purpose for which it was collected"]; (4) to the Bureau of the Census, for activities related to censuses and surveys; (5) to recipients who have provided assurance that the record will be used solely as a statistical research or reporting record, and the record is transferred in other than individually identifiable form; (6) to the National Archives; (7) to a Federal, State, or local agency for use in an authorized law enforcement activity; (8) to a person pursuant to a showing of compelling circumstances affecting the health or safety of an individual; (9) to a committee of Congress in connection with matters within its jurisdiction; (10) to the Comptroller General; and (11) pursuant to the order of a court of competent jursidiction.

In June 1976, the Commission recommended the enactment of a Federal statute more stringent with respect to disclosures of records made by the IRS than either the Privacy Act of 1974 or the confidentiality provisions of the Internal Revenue Code (IRC) then in force. The recommended statute would constitute the Service's sole authority to disclose its records about individuals to other Federal agencies and to agencies of State government. The Congress enacted a statute similar in many respects to the one recommended by the Commission as Section 1202 of the Tax Reform Act of 1976 *[P.L. 94-455]*.

The Commission believes that its 1976 recommendations for IRS disclosure policy can serve as an example of the kind of particularized disclosure statutes the Congress should enact for certain types of government records that deserve or require special confidentiality protections. The Commission also believes that the rationale for its 1976 IRS recommendations which is articulated here and in an appendix volume on Federal tax return confidentiality, [see Part I of this volume] exemplifies the kind of considerations that should be taken into account in enacting any Federal confidentiality statute. Although the Congress, in enacting Section 1202 of the Tax Reform Act, did not reach the same conclusions as the Commission in every detail, the Commission approves without reservation the process by which the disclosure was formulated—enactment of a statute by the Congress with opportunities for public comment and participation in its deliberations.

The Privacy Commission Mandate

The Privacy Act of 1974 required the Privacy Protection Study Commission to report to the President and the Congress on

> whether the Internal Revenue Service should be prohibited from transferring individually identifiable data to other [Federal] agencies and to agencies of State governments. *[Subsection 5(c)(2)(B)(ii) of P.L. 93-579]*

After conducting public hearings and a review of policies and practices regarding Federal tax return confidentiality, the Commission, as noted above, made an interim report to the President and to the Congress in June 1976 in which it recommended special constraints on IRS disclosure of individually identifiable data to other Federal agencies and to State and local government agencies.

The Commission believes that to satisfy its statutory obligation to reflect and report on questions of Federal tax return confidentiality it must take account of the 1976 changes in the law governing disclosure of tax returns and related information and consider the need for further recommendations. Accordingly, this chapter compares the Commission's earlier recommendations with the modifications contained in the Tax Reform Act of 1976.

In addition, the Commission has reconsidered two interim recommendations that were not intended to be final. One concerned the Department

of Health, Education, and Welfare's Parent Locator Service (PLS), which had begun to operate only a short time before the Commission's interim report was released. The Commission reserved judgment on IRS disclosures to the PLS until it could see how the PLS would perform. The other concerned information about a taxpayer provided to the IRS by "third-party sources" (i.e., persons other than the taxpayer himself). The issue demanding resolution was whether the same disclosure standards should apply to third-party source information as to information provided by a taxpayer about himself. To help answer that question, the IRS agreed to monitor disclosures of both taxpayer-supplied and third-party source data for a three-month period beginning April 1, 1976. The Commission's interim report was completed before the Commission had the results of this monitoring, so a final judgment on the third-party source issue was deferred.

In considering its recommendations for further legislative change, this chapter also takes note of criticisms made by Federal agencies of the 1976 restrictions on the disclosure of taxpayer data for non-tax purposes.

The IRS Disclosure Problem

The reasons for congressional and public concern about the widespread use of Federal tax information by government agencies other than the IRS, and for purposes unrelated to tax administration, have been well documented.[3] While the Congress long ago recognized the sensitivity of information obtained and retained for purposes of Federal tax administration, it had nonetheless, in 1910, designated tax returns as "public records" and given to the President and the Secretary of the Treasury broad discretion in making them available to other agencies and persons.

The disclosure to other government agencies of information about individual taxpayers has increased steadily since 1910. In most instances, new uses of such information were authorized administratively and without any real opportunity for public debate. Federal and State agency recipients of the information met criticisms of their uses of it by asserting that the information was essential to the performance of their particular government functions. In the face of such pleas, it was difficult for IRS administrators to deny them access, and in a substantial number of cases they did not.

The abuses that inevitably resulted were from time to time brought to the attention of the Congress and the public, sometimes dramatically. The Nixon Administration allegedly used tax returns to harass its political adversaries, and an announcement early in the 1970's that information about individual taxpayers would be made available to the Department of Agriculture to aid in statistical analysis aroused intense controversy. Allegations that special powers of the Internal Revenue Service were being misused to collect information for purposes well beyond tax administration

[3]See, e.g., Administrative Conference of the United States, *Report on Administrative Procedures of the Internal Revenue Service,* Senate Document 94-266 (October 1975) at pages 821 *et seq.*

but related to other law enforcement activities eventually led to a series of Congressional hearings on the propriety of various uses of tax information.[4] They led in turn to the mandate in the Privacy Act of 1974 given the Commission and, two years later, to the restrictions embodied in the Tax Reform Act of 1976.

The Rationale for the Commission's Recommendations

Federal tax administration depends in large measure on the power of government to compel its citizens to disclose information about themselves, and the existence of special investigative authority. The Commission's mandate did not require it to study the administrative structure of tax administration in detail, although in sections of Chapter 9 [of the Commission's final report] the Commission has in a general way examined issues of fairness arising in that context.

Some argue that because the IRS uses government resources to collect tax information, such information should be treated as a generalized governmental asset, and that such generalized use does not constitute a material violation of any interest of the taxpayer because the information belongs to the Federal government. The only disclosure constraint needed, say the proponents of this view, is to assure that the information is used only in pursuit of legitimate government objectives.

The Commission emphatically rejects these arguments for two reasons. First, the individual taxpayer is inherently at a disadvantage vis-a-vis a government agency that has access to IRS information about him because the IRS has the threat of serious punishment to compel the disclosure of information the individual would otherwise not divulge. That fact alone, in the Commission's view, argues in general for carefully controlled dissemination of IRS data on individual taxpayers and in most cases for no dissemination. 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's authority to compel such information from the taxpayer.

Second, the Commission believes that the effectiveness of this country's tax system depends on the confidentiality of tax returns and related information. While no one has tried to measure how the knowledge that other Federal and State agencies can inspect tax returns affects an individual taxpayer, the Commission believes 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. This is not to say that the taxpayer will decline to cooperate, but that his incentive to do so may be weakened. Such

[4]See, for example, *Federal Tax Return Privacy,* Hearings before the Subcommittee on Administration of the Internal Revenue Code of the Committee on Finance, U.S. Senate, 94th Congress, 1st Session; *Proposals for Change in the Administration of the Internal Revenue Laws,* Hearings before the Oversight Subcommittee of the Ways and Means Committee, U. S. House of Representatives, 94th Congress, 1st Session; *IRS Disclosure,* Hearings before the Subcommittee on Administrative Practice and Procedure of the Committee on the Judiciary, U. S. Senate, 93d Congress, 1st Session.

a tendency in itself creates a potentially serious threat to the effectiveness of the Federal tax system.

The Commission believes that authorizing the IRS to disclose individually identifiable tax information to another agency for a purpose unrelated to the administration of a Federal tax law is seldom defensible unless the Congress would be willing in principle to compel individuals to disclose the same information directly to the agency requesting it from the IRS. Even then, however, the agency seeking the information should still have to demonstrate a compelling societal need that disclosure of tax information to it by the IRS would fulfill.

Scope of the Commission's Recommendations

The Commission restricted the scope of its study to individually identifiable information about individuals. The decision is consistent with the scope of the Privacy Act and its mandate to the Commission. The Commission did not inquire into issues regarding disclosure of IRS information about corporations and other business entities. While the recommendations in this chapter do not apply to disclosure of these other kinds of information, they do apply to the *individually identifiable* data about individuals in the tax returns of business entities.

As prescribed by the Privacy Act, the Commission further restricted its study of IRS disclosure to disclosures to agencies of Federal and State government. It did not inquire into the propriety of IRS disclosures to the President and to the Congress, nor has it formulated standards for determining how much access to tax information the public should have. Nonetheless, the Commission notes with approval that the Tax Reform Act of 1976 creates statutory limitations on the disclosure of individually identifiable tax information to members of the public *[Section 6103(e) of the I.R.C.]*, to Committees of Congress *[Section 6103(f) of the I.R.C.]*, and to the President and White House staff *[Section 6103(g) of the I.R.C.]*.

GENERAL RECOMMENDATIONS

The Commission's interim report proposed general recommendations regarding the manner in which disclosures of tax information without individual consent should be authorized. The general recommendations and the rationale for them are set forth in the Commission's June 1976 interim report. In brief, the Commission recommended:

(1) that no disclosure of individually identifiable data by the Internal Revenue Service be permitted unless the individual to whom the information pertains has consented to such disclosure in writing or unless the disclosure is specifically authorized by Federal statute;

(2) that the Congress itself specify by statute the categories of tax information the IRS can disclose and the purposes for which the information can be used, rather than delegate general discretionary authority in this matter to the Commissioner of

Internal Revenue or any other representative of the Executive Branch;

(3) that the IRS be prohibited from disclosing any more individually identifiable taxpayer information than is necessary to accomplish the purpose for which the disclosure has been authorized, and that the IRS adopt administrative procedures to facilitate public scrutiny of its compliance with this requirement; and

(4) that recipients of tax information from the Internal Revenue Service be prohibited from redisclosing it without the written consent of the taxpayer, unless the redisclosure is specifically authorized by Federal statute.

The Tax Reform Act of 1976 is consistent in the main with the Commission's general recommendations. Although tax returns were designated as public records prior to the 1976 legislation, Section 6103(a)(1) of the Internal Revenue Code (IRC) provided for inspection of them " . . . only upon order of the President and under rules and regulations prescribed by the Secretary [of the Treasury] or his delegate and approved by the President." While this language suggested that disclosure should be narrowly restricted, in practice tax return data were disseminated widely throughout the Federal government and to State and local government officials.

The Tax Reform Act of 1976 substantially modified this section of the Internal Revenue Code. The general rule, now established by Section 6103(a) of the Code, is that "Returns and return information shall be *confidential.*" (emphasis added) While the Internal Revenue Code, as modified by the Tax Reform Act, authorizes certain disclosures that are not consistent with the Commission's specific recommendations, the Commission regards the substitution of the basic rule of confidentiality for the prior assumption that tax records are public records as a major step forward in controlling the disclosure of tax information.

In enacting the 1976 law, Congress also undertook direct responsibility for determining which disclosures should be permissible. Under prior law, authority to determine the propriety of intragovernmental disclosures was delegated to the Executive branch. In practice, IRS officials had found it hard to deny other agencies and departments access to tax information if it was argued forcefully that such information was essential to the fulfillment of statutory responsibilities. The revised Section 6103 makes confidential treatment mandatory unless disclosure is specifically authorized by Federal statute.

Having established the principle of confidentiality, the Congress, in the Tax Reform Act, listed categories of permissible disclosures of tax information. While the Commissioner of Internal Revenue and the Secretary of the Treasury bear major responsibilites for assuring compliance with the law, and for organizing the administration of permissible disclosures, the Executive branch now has no discretion to permit disclosures of individually identifiable tax information in ways not specifically authorized by the Congress in the Internal Revenue Code. The fact that future

disclosures must be specifically authorized by statutory directive provides, in the Commission's view, a valuable check on access to tax information for purposes unrelated to the collection of revenue undertakings.

The revised Section 6103 also limits redisclosure, as the Commission had recommended. It now provides that, except as authorized by statute:

> (1) no officer or employee of the United States;
> (2) no officer or employee of any State or of any local child support enforcement agency who has or had access to returns or return information under this section; and
> (3) no other person (or officer or employee thereof) who has or had access to returns or return information . . . shall disclose any returns or return information obtained by him in any manner . . . *[Section 6103(a) of the I.R.C., as amended by the Tax Reform Act of 1976.]*

For the first time, the other government agencies that obtain tax information from the IRS are in all cases expressly prohibited by statute from redisclosing it for purposes unrelated to the purpose for which the information was acquired.

The 1976 legislation also took heed of the Commission's recommendation that the IRS be prohibited from ever disclosing any more individually identifiable tax information than is necessary to advance the government objective for which disclosure has been authorized. Nonetheless, there are instances in which the statutory authorizations for disclosure contained in the Tax Reform Act are overly broad in describing the types of information that may be disclosed and the purposes for which the information may be used. These will be discussed below. The Commission strongly reaffirms its commitment to the principle of "limited disclosure" and urges the Internal Revenue Service to respect that principle in implementing the 1976 law.

SPECIFIC RECOMMENDATIONS

Disclosure for Purposes Related to Federal Tax Administration

The Commission recognizes that almost every use of tax data in any aspect of tax administration is clearly compatible with the purpose for which the information was collected and with the legitimate expectations of the taxpayer. Accordingly, it recommended in 1976 that the IRS be authorized by statute to disclose tax data " . . . to the Department of Justice for use in investigations and prosecutions of violations of tax laws, provided that the information pertains to a party to the actual or anticipated litigation."

On this point, the Tax Reform Act of 1976 provides that:

> A return or return information shall be open to inspection by or disclosure to attorneys of the Department of Justice (including United States attorneys) personally and directly engaged in, and solely for their use in, preparation for any proceeding (or investigation which may result in such a proceeding) before a Federal grand

jury or any Federal or State court in a matter involving tax administration, but only if—

(a) the taxpayer is or may be a party to such proceeding . . . . *[Section 6103(h)(2)(A) of the I.R.C., as amended by the Tax Reform Act of 1976]*

Section 6103(h)(4) of the Internal Revenue Code, as amended by the Tax Reform Act, also specifically authorizes the disclosure of a return "in a Federal or State judicial or administrative proceeding pertaining to tax administration . . . if the taxpayer is a party to such proceeding . . . . "

The Commission finds the disclosures authorized in these provisions consistent with its recommendations.

The Commission recommended that some limited disclosure of tax information to the Department of Justice about an individual who is not the object of a tax investigation or prosecution, be authorized but only if " . . . the information disclosed is relevant to issues in an actual or anticipated tax litigation." Moreover, the Commission concluded that "information . . . should be considered relevant only if the treatment of an item on the return of a party to an actual or anticipated tax litigation, or the liability of such a party for

The Tax Reform Act of 1976 authorizes the disclosure to the Justice Department of tax information about individuals not under investigation or prosecution in two situations:

— if . . . the treatment of an item reflected on such return is or may be related to the resolution of an issue in the proceeding or investigation; or
— such return or return information relates or may relate to a transactional relationship between a person who is or may be a party to the proceeding and the taxpayer which affects, or may affect, the resolution of an issue in such proceeding or investigation. *[Section 6103(h)(2)(B) and (C) of the I.R.C., as amended by the Tax Reform Act of 1976]*

Section 6103(h)(4)(B) and (C) authorizes the disclosure of such information in Federal and State judicial or administrative proceedings pertaining to tax administration. The Commission finds the disclosures authorized by these provisions consistent with its recommendations.

The Commission specifically recommended in 1976 that the Congress prohibit access to tax information in two situations involving tax administration. In the past, tax information could be used against witnesses in tax litigation solely for the purpose of impeaching their testimony. The Commission found no justification for this use of tax data unless, of course, the testimony impeached is relevant to the issues in litigation in the ways contemplated by the new Section 6103(h)(4)(B) or (C) of the Internal Revenue Code. While the language of those two sections has not yet been interpreted by the judiciary, both of them authorize disclosure only if the data are "directly related" to an issue or a transaction in the lawsuit. The Commission assumes that these two sections will not be construed as

authorizing disclosure solely for purposes of impeachment in ways unrelated to the issues in litigation, and thus finds them consistent with its recommendations.

The Commission, in its interim report, also recommended against the continued use of tax information by government attorneys in connection with the selection of jurors. Tax information has been used to determine whether prospective jurors may be biased against the government because of a previous action against them by the IRS. The Commission found this practice highly inappropriate even with respect to litigation involving the tax laws, especially because counsel almost always has substantial opportunities to discover possible prejudice against the government in a prospective juror directly through *voir dire* procedures.

The Tax Reform Act of 1976 authorizes the use of tax data for jury selection. It provides that:

> In connection with any judicial proceeding [involving tax administration] . . . to which the United States is a party, the Secretary [of the Treasury] shall respond to a written inquiry from an attorney of the Department of Justice (including a United States attorney) involved in such proceeding or any person (or his legal representative) who is a party to such proceeding as to whether an individual who is a prospective juror in such proceeding has or has not been the subject of any audit or other tax investigation by the Internal Revenue Service. The Secretary shall limit such response to an affirmative or negative reply to such inquiry. *[Section 6103(h)(5) of the I.R.C., as amended by the Tax Reform Act of 1976]*

By making limited information regarding jurors available to all parties to the litigation, this provision removes one element of unfairness that obtained under prior laws, which permitted only government counsel to have access to tax data. Nevertheless, the Commission still finds no justification for the use of confidential tax data from IRS files in jury selection, particularly because it is so clearly incompatible with the purpose for which the IRS acquires the information. Whatever value tax information may have in jury selection appears to be marginal, and in any case, the same information can be obtained directly from the prospective juror. Therefore, the Commission reiterates the recommendation in its interim report:

Recommendation (1):

That the Congress prohibit the disclosure of any tax information about a prospective juror for use in jury selection.

Disclosure for Use in Administering Certain Federal Programs

The Commission recommended in 1976 that the IRS be authorized to disclose certain individually identifiable tax data to the Social Security Administration for its use in administering the Social Security Act and the Employee Retirement Income Security Act (ERISA). The Tax Reform Act

of 1976 authorizes such disclosures *[Section 6103(l)(1) and (5) of the I.R.C., as amended by the Tax Reform Act of 1976]* and limits the type of information that may be disclosed and the purpose for which it may be used, as recommended by the Commission. The Tax Reform Act of 1976 also authorizes the IRS to disclose information to the Department of Labor and Pension Benefit Guaranty Corporation ". . . for the purpose of, but only to the extent necessary in, the administration of titles I and IV" of ERISA *[Section 6103(l)(2) of the I.R.C., as amended by the Tax Reform Act of 1976]*. The Commission believes that all of these disclosures are justified by the statutory and administrative relationship between the income tax laws and, respectively, the Social Security Act and the pension laws.

The Commission also recommended in 1976 that the IRS be authorized to disclose certain tax information to the Railroad Retirement Board in furtherance of the latter's responsibility for administering the Railroad Retirement Act, again because of the interrelationship between tax administration and the administration of railroad retirement benefits. The 1976 legislation provides such authorization *[Section 6103(l)(1)(C) of the I.R.C., as amended by the Tax Reform Act of 1976]*. The Commission finds this provision consistent with its recommendation.

Disclosure to States and Localities for Purposes of Tax Administration

The Commission, in its interim report, concluded that IRS disclosure of individually identifiable tax information to State tax administrators for use in connection with the administration of the general revenue laws of the States is compatible with the purposes for which information from and about a taxpayer is collected. Such use is also consistent with the need for cooperation between the different levels of government in a federal system, and serves the interest of effective and fair tax administration. Thus, the Commission recommended that the IRS be authorized to disclose individually identifiable tax data to State tax officials, but with certain limitations.

In particular, the Commission recommended against the disclosure of Federal tax information to help a State administer its regulatory or licensing laws even though a license fee—sometimes called a "tax"—may be required as part of the regulatory scheme. The Commission believes that to justify disclosure of tax information to a State, there should be at least a general correspondence between the State tax law for the administration of which the Federal tax information is sought, and the Federal tax law for the administration of which the information was originally collected. In accord with its general recommendation regarding the principle of limited disclosure, the Commission also recommended that disclosures to the States be limited to specified tax returns, the schedules accompanying them, and summary information regarding adjustments thereto, and that such disclosure be permitted only to the extent necessary to determine a taxpayer's liability under a State's general revenue law.

The Tax Reform Act of 1976 specifically authorizes the IRS to continue its disclosures of Federal tax information to State tax collectors in

Section 6103(d) of the Internal Revenue Code, as amended by the Tax Reform Act of 1976. This section provides that

> returns and return information . . . shall be open to inspection by or disclosure to any State agency, body, or commission, or its legal representative, which is charged under the laws of such State with responsibility for the administration of State tax laws for the purpose of, and only to the extent necessary in, the administration of such laws, including any procedures with respect to locating any person who may be entitled to a refund.

The Commission is not satisfied that the new law defines the purposes for which it authorizes disclosure to the States carefully enough and regrets that the statute does not specify the particular types of tax information that may be disclosed. The Commission urges the IRS to take care that its disclosures of tax information to the States conform to the principle of limited disclosure.

Although it approves IRS disclosure of Federal tax information to State taxing authorities, the Commission notes that this practice increases the risk of subsequent unauthorized redisclosure of such information. Accordingly, the Commission recommended in 1976 specific statutory requirements calculated to reduce that risk. In particular, it recommended:

(1) that requests for disclosure be submitted in writing by the principal tax official of the State rather than by the governor;
(2) that a State receiving tax data have in effect a statute prohibiting the disclosure of information acquired from the IRS *and* information supplied by the State taxpayer that is a copy of or copied from his Federal return, for purposes other than State tax administration, but that a two year grace period be allowed for enacting such legislation;
(3) that States receiving Federal tax data institute reasonable physical, technical and administrative safeguards satisfactory to the IRS to reduce the likelihood of unauthorized use or disclosure; and
(4) that the IRS be specifically empowered to suspend a State's access to Federal tax information, despite the existence of State legislation, if unauthorized disclosures are made or if adequate safeguards have not been established.

Section 6103(a)(2) of the Internal Revenue Code, as amended by the Tax Reform Act of 1976, requires that officers and employees of a State treat IRS tax information as confidential. The 1976 legislation also provides for disclosure of tax information to State taxing officials

> only upon written request by the head of such [taxing] agency, body, or commission, and only to the representatives of such agency, body, or commission designated in such written request as the individuals who are to inspect or to receive the return or return

information. *[Section 6103(d) of the I.R.C., as amended by the Tax Reform Act of 1976]*

Another provision contained in Section 6103(d) of the Internal Revenue Code, as amended by the Tax Reform Act of 1976, deters the use of Federal tax data for political purposes by denying access to the chief executive officer of a State.

The Tax Reform Act also requires States to establish safeguards against unauthorized redisclosures that are satisfactory to the IRS and subject to monitoring by Federal tax officials. Section 6103(p)(4) of the Internal Revenue Code, as amended by the Tax Reform Act of 1976, now conditions continued access to Federal tax information on the maintenance of such safeguards. The Commission finds that these provisions of the Code mitigate the risk of unauthorized redisclosure of Federal tax information once it is in the hands of State officials.

The Tax Reform Act of 1976 does not require States to enact statutes prohibiting disclosure of information acquired from the IRS as well as information supplied to the State by a taxpayer that is a copy of information on his Federal return for purposes other than State tax administration. It does, however, require as a condition of receiving IRS tax information that a State law make statutory provision for confidentiality if its own tax law requires its taxpayers to file copies of their Federal tax returns with their State tax returns. The reason for this requirement is that when the State's file on a taxpayer includes a copy of his Federal tax return or information from it, and also information about him that the State received from the IRS, it would be hard to determine if disclosure of information from the file was or was not an unauthorized disclosure of IRS information. The existence of a State penalty for the unauthorized disclosure of copies of Federal returns acquired by the State from its taxpayers would assure that unauthorized disclosures do not go unpunished because of the difficulty in determining the source of the Federal tax information. The Tax Reform Act's provision in this regard differs from that recommended by the Commission in that it does not require an absolute ban on disclosure of such information for purposes unrelated to State tax administration. Instead, it permits disclosure of copies of Federal tax returns "to another officer or employee" of the State for purposes other than State tax administration. *[Section 6103(p)(8)(B) of the I.R.C., as amended by the Tax Reform Act of 1976]*

The Commission concluded in its interim report that the use of tax information by local revenue authorities is also compatible with the government purpose that justifies the collection of tax information by the Federal government. Accordingly, the Commission recommended in 1976 that State taxing authorities be given authority to use Federal tax information in administering local tax laws, and that the IRS be authorized to disclose certain taxpayer identification and location information directly to local taxing authorities. The Tax Reform Act of 1976 does not authorize any disclosure to local taxing officials, nor does it authorize the use of Federal tax data by State officials in administering local tax laws.

The main reason for not authorizing the disclosure for the purposes of local tax administration seems to be the risk of unauthorized redisclosure.

The Commission believes, however, that requiring IRS approval of local safeguards and the threat of denying access if safeguards are not adequate mitigate this risk. The Commission notes, moreover, that the Congress in the Tax Reform Act gave local government officials authority to obtain certain Federal tax information for their use in locating absent parents, despite doubts about the ability of a local government to safeguard Federal tax information.

Disclosure for Statistical Purposes

When the Commission issued its interim report, it knew of only one Federal agency that had clearly demonstrated its need for individually identifiable tax information about individuals for statistical purposes—the Bureau of the Census. Noting the crucial role administrative records play in statistical analysis, and the stringent statutory restrictions on the disclosure of information by the Census Bureau, the Commission recommended that the IRS be authorized to continue to disclose tax information to the Census Bureau.

The Tax Reform Act is consistent with the Commission's recommendation in that it authorizes the IRS to provide tax data to the Bureau of the Census ". . . for the purpose of, but only to the extent necessary in, the structuring of censuses and national activities authorized by law." *[Section 6103(j)(1) of the I.R.C., as amended by the Tax Reform Act of 1976]*

The Commission's interim report did not include a recommendation with respect to the Treasury Department's use of individually identifiable data for statistical studies connected with tax policy analysis. The interim report noted, however, that the Commission would approve such disclosure if the Treasury Department can demonstrate its need for *individually identifiable* data for statistical purposes. Section 6103(j)(3) of the I.R.C., as amended by the Tax Reform Act of 1976 authorizes disclosure:

> to officers and employees of the Department of the Treasury whose official duties require such inspection or disclosure for the purpose of, but only to the extent necessary in, preparing economic or financial forecasts, projections, analyses, and statistical studies and conducting related activities.

The Commission recognizes that the purposes described in this section can be interpreted broadly, but finds the disclosures it generally authorizes to be consistent with the Commission's reasons for recommending continued disclosure to the Bureau of the Census. The Commission also notes with approval that, according to the applicable Internal Revenue Code provisions, such disclosures

> . . . shall be permitted only upon written request which sets forth the specific reason or reasons why such inspection or disclosure is necessary and which is signed by the head of the bureau or office of the Department of the Treasury requesting the inspection or disclosure. *[Section 6103(j)(3) of the I.R.C., as amended by the Tax Reform Act of 1976]*

Dependence upon written requests with articulated objectives should deter unjustified disclosures.

DISCLOSURE OF INFORMATION ABOUT PROSPECTIVE FEDERAL APPOINTEES

In 1976, the Commission recommended termination of the IRS practice of disclosing tax information about prospective Federal appointees to the White House and to heads of Federal agencies without the consent of the individual to whom the information pertains. The Tax Reform Act, however, endorses current practice by authorizing the disclosure of tax information to:

> a duly authorized representative of the Executive Office of the President or to the head of any Federal agency, upon written request by the . . . head of such agency, or to the Federal Bureau of Investigation on behalf of and upon written request by . . . such head, [of] return information with respect to an individual who is designated as being under consideration for appointment to a position in the executive or judicial branch of the Federal Government. *[Section 6103(g)(2) of the I.R.C., as amended by the Tax Reform Act of 1976]*

The Tax Reform Act does, however, limit the information that may be disclosed as follows:

> Such return information [about prospective appointees] shall be limited to whether such individual—
>
> (A) has filed returns . . . for not more than the immediately preceding 3 years;
> (B) has failed to pay any tax within 10 days after notice and demand, or has been assessed any penalty . . . for negligence, in the current year or immediately preceding 3 years;
> (C) has been or is under investigation for possible criminal offenses under the internal revenue laws and the results of any such investigation; or
> (D) has been assessed any civil penalty . . . for fraud. *[Section 6103(g)(2)(A) - (D) of the I.R.C., as amended by the Tax Reform Act of 1976]*

The Commission's reasons for recommending against this practice include: such use is not compatible with the purpose for which the information was originally obtained by the IRS; the same information can be obtained directly from the prospective appointee; an office seeker would be eager to authorize such disclosure if he considered it to be in his interest; and the prospective appointee might have no opportunity to rebut adverse information about himself thus revealed. The 1976 legislation has partially obviated the last of these concerns by requiring that "within 3 days of the receipt of any request . . ., the Secretary [of the Treasury] shall notify such individual in writing that such information has been requested." *[Section 6103(g)(2) of the I.R.C., as amended by the Tax Reform Act of 1976]* While

this notification reduces the potential for unfairness somewhat, the Commission still finds the disclosure of tax information without the consent of the prospective appointee neither necessary nor justified.

Accordingly, the Commission reiterates its earlier recommendation:

Recommendation (2):

That the Congress not permit tax information about prospective Federal appointees to be disclosed to the White House and heads of Federal agencies without the consent of the individual to whom the information pertains.

Disclosure to the Parent Locator Service

The Federal Parent Locator Service (PLS) of the Department of Health, Education, and Welfare provides address and place of employment information obtained from Federal agencies to State and local authorities which use this information in locating "absent parents" in order to enforce child-support obligations. The Commission addresses the general issue of the propriety of the policies governing access to various types of information by the Federal and State Parent Locator Services as a separate issue in Chapter 11 of [the Commission's final] report.

In its 1976 interim report, the Commission pointed out that despite the obvious propriety of the PLS program, the use of individually identifiable tax information for locating absent parents is obviously not compatible with the purposes for which the IRS was empowered to collect such information. The PLS was then too new for its performance to be assessed, however, and thus the Commission refrained from recommending that tax information be withheld from it. Rather, the Commission recommended:

(1) that if tax information is to be disclosed for parent location, such disclosure be specifically authorized by Congress;
(2) that any disclosures so authorized be limited to situations in which residence and employment information may serve to locate individuals against whom outstanding court orders for child support were unsatisfied;
(3) that there be strict prohibitions against redisclosure of such information by either Federal or State officials; and
(4) that statutory penalties for unauthorized disclosure be applied in such cases.

The Tax Reform Act of 1976 specifically authorizes the disclosure of tax information in aid of child-support enforcement by providing that:

> The Secretary [of the Treasury] may, upon written request, disclose to the appropriate Federal, State, or local child-support enforcement agency—
>
> (i) available return information from the master files of the Internal Revenue Service relating to the address, filing

status, amounts and nature of income, and the number of dependents reported on any return filed by, or with respect to, any individual with respect to whom child-support obligations are sought to be established or enforced pursuant to the provisions of part D of Title IV of the Social Security Act and with respect to any individual to whom such support obligations are owing; and

(ii) available return information reflected on any return filed by, or with respect to, any individual described in clause (i) relating to the amount of such individual's gross income . . . or consisting of the names and addresses of payors of such income and the names of any dependents reported on such return, but only if such return information is not reasonably available from any other source. *[Section 6103(l)(6)(A) of the I.R.C., as amended by the Tax Reform Act of 1976]*

The Internal Revenue Code also provides, however, that such disclosures are permissible " . . . only for purposes of, and to the extent necessary in, establishing and collecting child-support obligations from, and locating, individuals owing such obligations."

The Commission appreciates that the Tax Reform Act of 1976 fulfills one of its recommendations in that the Congress, after considering the question, specifically approved disclosure of IRS records to the PLS. The disclosures authorized by the Tax Reform Act, however, exceed substantially those contemplated by the Commission. Implicit in its 1976 recommendation was the belief that the IRS should be authorized to disclose to the PLS only residence and place of employment information and only for the purpose of locating an individual. The Tax Reform Act authorizes the IRS to disclose to the PLS much more information than necessary to help locate an absent parent, and the Act permits the PLS to use IRS information in calculating the individual's support obligation. Moreover, the Tax Reform Act, in contrast to the Commission's recommendations, authorizes the IRS to disclose to the PLS information regarding the individual to whom support is owed by the absent parent, in addition to information about the absent parent.

The Commission finds a marked qualitative difference between the use of tax information to locate someone and the use of tax information to prove the extent of the individual's liability for child support. Moreover, there are alternative sources of information to prove the extent of liability, including the individual himself, which do not raise the specter of unfettered and unwarranted trespass on the confidentiality of information the absent parent is compelled to give the IRS. In addition, the disclosure of information about the individual to whom support is owed is, in the Commission's view, a totally unjustified incursion into IRS files, given that the individual can be requested to disclose, or authorize the disclosure of, information about himself or herself to State or local child-support enforcement officials. Thus, the Commission recommends:

Recommendation (3):

That Federal tax information authorized to be disclosed to the Parent Locator Service be limited to the minimum necessary to locate an alleged absent parent; that such information be used only in aid of location efforts; and that no disclosures of IRS information about an individual to whom support is owed be permitted without the individual's authorization.

The Commission is further concerned that State and local child-support enforcement officials not make unauthorized redisclosure of information received from the IRS. While the penalties for unauthorized disclosure established by the Tax Reform Act would apply to such officials, and while safeguards to avoid unauthorized disclosure would have to be maintained as mandated by the Act, the Commission urges that special care be devoted by the Federal officials responsible for monitoring child-support enforcement activities to assure that the risk of unauthorized disclosure has been effectively diminished by the penalty and safeguard provisions.

Disclosure to Federal Law Enforcement Agencies for Non-tax Investigations and Prosecutions

The Commission pointed out in its interim report that the use of tax information in non-tax civil and criminal investigations is wholly incompatible with the public finance purposes for which the information was collected, and objectionable on intrusiveness grounds in that it takes advantage of the fact that such information is often provided to the IRS under threat of criminal penalties. The Commission also noted, however, that under applicable statutory and constitutional standards, Federal law enforcement authorities can usually get a copy of a taxpayer's return directly from him. The Commission therefore recommended in 1976 that the IRS be forbidden to disclose tax information for non-tax criminal or civil investigations and prosecutions, except in situations in which the Federal investigator or prosecutor could legally obtain a copy of the return directly from the taxpayer. In sum, *the Commission believes that Federal law enforcement officials should not have easier access to information about a taxpayer when it is maintained by the IRS than they would have if the same information were maintained by the taxpayer himself.*

Consistent with this general position, the Commission recommended in its interim report that a taxpayer be notified of a request for tax information for law enforcement purposes unrelated to tax administration and given an opportunity to oppose the disclosure before a United States District Court. Disclosure would then be authorized by the District 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 the information sought directly from the taxpayer exists.

The Commission also recommended that where appropriate, the District Court considering the disclosure request inspect the data *in camera*, and that the District Court be empowered to award litigation costs, including reasonable attorneys fees, to taxpayers who successfully oppose disclosure requests.

The Tax Reform Act of 1976 authorizes disclosures for non-tax criminal (but not civil) investigations. In the case of information provided directly to the IRS by or on behalf of the taxpayer, the Tax Reform Act conditions disclosure upon the issuance of a United States District Court order. Nevertheless, the circumstances outlined in the Tax Reform Act under which the court may order disclosure differ markedly from those the Commission recommended.

The Tax Reform Act provides that:

> A return or taxpayer return information shall, pursuant to, and upon the grant of, an *ex parte* order by a Federal district court judge as provided by this paragraph, be open, but only to the extent necessary as provided in such order, to officers and employees of a Federal 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) pertaining to the enforcement of a specifically designated Federal criminal statute (not involving tax administration) to which the United States or such agency is or may be a party. *[Section 6103(i)(1)(A) of the I.R.C., as amended by the Tax Reform Act of 1976]*

The order can only be sought upon the authorization of the Attorney General, Deputy Attorney General, or an Assistant Attorney General, or if the requesting agency is other than the Department of Justice, by the head of the agency. Tax information acquired by a Federal agency pursuant to a court order may be entered into evidence in any administrative or judicial proceeding pertaining to the enforcement of a Federal criminal statute to which the United States or the agency is a party, but only if the court finds that such return or return information is probative of a matter in issue relevant in establishing the commission of a crime or the guilt of a party. *[Section 6103(i)(4) of the I.R.C., as amended by the Tax Reform Act of 1976]*

The Tax Reform Act of 1976 does not require that the taxpayer be notified of the request; it does not require that the taxpayer be given an opportunity to oppose the disclosure; and all of the proceedings are *ex parte*. The Tax Reform Act further provides for the issuance of the *ex parte* disclosure order by a District Court judge

> . . . if he determines on the basis of the facts submitted by the applicant that—

(i) there is reasonable cause to believe, based upon 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 it is determined that, notwithstanding the reasonable availability of the information from another source, the return or return information sought constitutes the most probative evidence of a matter in issue relating to the commission of such criminal act. *[Section 6103 (i)(1)(B) of the I.R.C., as amended by the Tax Reform Act of 1976]*

To find that the first two conditions exist, the judge apparently needs to conclude only that there is some basis to believe that a crime has been committed and that the information sought may be relevant to the investigation of a crime. Any law enforcement authority conducting any legitimate investigation should be able to satisfy both conditions easily. The third subsection might be read to suggest that law enforcement officers must try to get a copy of the tax return from other sources—probably the taxpayer himself—before they can seek a court order for it. It seems unlikely, in most instances, that a determination of nonavailability from alternative sources could reasonably be made without an attempt to secure the information directly from the taxpayer, the person who is most likely to have a copy of it. Nonetheless, the legislative history of this provision offers no basis for inferring that a Federal law enforcement official would be required to try to obtain a copy of a tax return directly from the taxpayer (or another source) before seeking an *ex parte* disclosure order. Federal law enforcement officers have consistently asserted to the relevant Committees of the Congress and to the Commission itself that notification to the taxpayer of a pending investigation might seriously impair the investigation. The Commission must conclude, therefore, that the third condition required to be found by the court does not require a prior direct approach to the taxpayer.

The 1976 legislation also authorizes disclosure of information that has not been provided to the IRS by or on behalf of the taxpayer for non-tax criminal investigations *without* resort to court order. The IRS may disclose such information on receipt of a written request from the Attorney General, Deputy Attorney General, Assistant Attorney General, or head of an investigating agency other than the Department of Justice setting forth:

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

(D) the specific reason or reasons why such disclosure is or may be material to the proceeding or investigation. *[Section 6103(i)(2) of the I.R.C., as amended by the Tax Reform Act of 1976]*

Tax information obtained by a Federal agency pursuant to such a written request may be entered into evidence in any administrative or judicial proceeding pertaining to the enforcement of a Federal criminal statute to which the United States or the agency is a party. *[Section 6103(i)(4) of the I.R.C., as amended by the Tax Reform Act of 1976]*

The legislative history of the Tax Reform Act does not reveal the rationale for distinguishing between a disclosure of information that was provided by or on behalf of the taxpayer and a disclosure of information about the taxpayer provided by another source. The Congress appears to have concluded that Fifth Amendment concerns only arise when information submitted by the taxpayer is used against him in a non-tax criminal investigation. When information is supplied to the IRS by another source, use of it in a non-tax investigation apparently poses no problem. Congress, like the Supreme Court, seems to assume that information in the possession of someone besides the taxpayer cannot be the confidential and protectable information of the taxpayer. As the Commission discovered in its broad inquiry into government access to records about individuals held by third-parties, however, the assumption is incorrect.

Information obtained by the IRS from sources other than the taxpayer is often derived from records which the taxpayer has no choice but to have that other party maintain, such as bank and credit-card records. In essence, such third-party source information is not obtained from an independent source, but from a surrogate without whom the taxpayer could not participate in contemporary society. Frequently, the information maintained by such an agent of the taxpayer illuminates those "intimate areas of personal affairs" that the Fourth and Fifth Amendments are intended to protect from unsupervised inquiry by the executive branch of government. It is exactly such revealing record information that other agencies of government are often anxious to acquire.

Since much of the third-party source information held by the IRS is information supplied from the confidential records of the taxpayer, though the records are in the possession of another party, the Commission believes that such information should be protected by the same standards as information obtained directly from the taxpayer. Two further considerations strengthen this conclusion. First, a good deal of third-party source information is available only because the source is required to keep records about the taxpayer open to inspection by the IRS, or to routinely report information to the IRS for purposes of tax administration. Second, even where there is no compelled reporting or record keeping, the expansive reach of the IRS's administrative summons power permits it to acquire information that other agencies cannot acquire through their ordinary investigative processes. Powers to collect information about an individual and intrude on his privacy were granted for the specific purpose of enforcing the tax law, not as a general device by which any government agency can acquire intimate and revealing details of a taxpayer's activities. For all of

these reasons, the Commission finds no justification for applying less stringent disclosure standards to third-party information than to information supplied by the taxpayer. Therefore it disagrees with the distinction the Tax Reform Act makes in its provisions governing disclosure of information for use in non-tax criminal investigations, and recommends:

Recommendation (4):

That the Congress subject all information about a taxpayer to the same restrictions on disclosure for non-tax investigations and prosecutions that the Commission recommended in its interim report.

While disagreeing with certain aspects of the 1976 law, as indicated above, the Commission believes that the actions taken by the Congress to limit disclosures for non-tax criminal law enforcement are salutary. The Commission is, however, concerned that information disclosed properly for purposes of tax investigation and litigation will be used by the recipient agencies for non-tax criminal law enforcement in ways not consistent with the new restraints in the Tax Reform Act of 1976.

In January, 1977, the IRS promulgated Temporary Regulations[5] implementing the disclosure provisions of the Tax Reform Act that at best seem ambiguous as to the non-tax uses to which the Justice Department may put tax information they have received from the IRS for purposes relating to tax administration. Section 404.6103(h)(2)-1(a)(1) of the Temporary Regulations provides for the use of tax information originally disclosed to the Department of Justice in connection with "a matter involving tax administration" in " . . . any . . . proceeding . . . also involving the enforcement of a related Federal criminal statute which has been referred by the Secretary [of the Treasury] to the Department of Justice." There is no mention of a court order for such supplementary uses of the tax data, as specified in the Tax Reform Act's amendment to section 6103(i) of the Internal Revenue Code. Other portions of the Temporary Regulations *[Section 404.6103(h)(2)-1(a)(2)]* open the door wider by authorizing the Justice Department to use information conveyed under the provisions of the Tax Reform Act permitting disclosures for tax administration in a non-tax proceeding or investigation that " . . . involves or arises out of the particular facts and circumstances giving rise to the proceeding (or investigation)" relating to tax administration or to a matter involving the enforcement of a Federal criminal statute referred to the Justice Department by the Secretary of the Treasury.

These regulations seem to permit the use of tax information in joint investigations and prosecutions of non-tax as well as tax violations. The language of the regulations is, however, sufficiently vague to allow for the use of tax information for non-tax criminal law enforcement even where there is not a joint investigation or prosecution. It would seem, therefore, that the Temporary Regulations provide an easy way to avoid the Tax Reform Act's restrictions on the disclosure of tax data for non-tax criminal

[5]42 *Federal Register* 16 (January 25, 1977), pp. 4437-40.

law enforcement. The Commission believes that the Temporary Regulations may be inconsistent with the spirit and substance of the 1976 restrictions contained in the Tax Reform Act, and with the Commission's recommendations. Accordingly, the Commission urges that the Temporary Regulations be reevaluated to consider whether these regulations do indeed violate the restrictions imposed by the Tax Reform Act on the use of tax data for non-tax investigations and prosecutions.

Safeguard Requirements for Recipient Federal Agencies

The Commission is concerned that Federal agencies receiving tax information from the IRS are not always fully cognizant of the importance of guarding against unauthorized disclosures of such information. The Commission therefore recommended in 1976 that the IRS, experienced in protection of its records, be empowered to require recipient Federal agencies to institute reasonable administrative, technical, and physical safeguards satisfactory to the IRS to avoid the unauthorized use or disclosure of tax information.

The Tax Reform Act of 1976 prescribes a series of safeguards and vests substantial powers to enforce them in the Federal tax officials. It provides that recipient Federal and State agencies " . . . shall, as a condition of receiving returns or return information [from the IRS]—

(A) establish and maintain, to the satisfaction of the Secretary [of the Treasury], a permanent system of standardized records with respect to any request, the reason for such request, and the data of such request made by or of it and any disclosure of return or return information made by or to it;
(B) establish and maintain, to the satisfaction of the Secretary, a secure area or place in which such returns or return information shall be stored;
(C) restrict, to the satisfaction of the Secretary, access to the returns or return information only to persons whose duties or responsibilities require access and to whom disclosure may be made under the provisions of this title;
(D) provide such other safeguards which the Secretary determines (and which he prescribes in regulations) to be necessary or appropriate to protect the confidentiality of the returns or return information;
(E) furnish a report to the Secretary, at such time and containing such information as the Secretary may prescribe, which describes the procedures established and utilized by such agency, body, or commission or the General Accounting Office for ensuring the confidentiality of returns and return information required [hereunder]." *[Section 6103(p)(4) of the I.R.C., as amended by the Tax Reform Act of 1976]*

The 1976 law also requires that after using IRS data the recipient agency

must either return it to the IRS or render it completely undisclosable and so report to the Service.

The 1976 law requires the Secretary of the Treasury to file quarterly reports with the House Committees on Ways and Means, the Senate Committee on Finance, and the Joint Committee on Taxation describing

> . . . the procedures and safeguards established and utilized by [recipient agencies] . . . for ensuring the confidentiality of returns and return information . . . [as well as] deficiencies in, and failure to establish or utilize, such procedures. *[Section 6103 (p)(5) of the I.R.C., as amended by the Tax Reform Act of 1976]*

The 1976 law also authorizes the Comptroller General to audit the implementation of safeguard requirements.

The Commission is satisfied that the confidentiality of IRS information disclosed to other Federal agencies is now well protected by the statutory safeguard requirements, IRS review authority, periodic reporting on safeguards to Congress, and the Comptroller General's audits.

Penalties for Unauthorized Disclosure

The Commission recommended in 1976 that the ceiling on the fine for unauthorized disclosure of tax information specified in Section 7213 of the Internal Revenue Code be raised from $1,000 to $5,000, and that penalties be made applicable to former employees of Federal, State, and local governments as well as to present employees and to government agency contractors that have access to Federal tax information. The Commission refrained from recommending that the offense be treated as a felony, rather than a misdemeanor, but only because the change might present practical problems in obtaining convictions.

The Tax Reform Act of 1976 amended Section 7213 to raise the potential fine to $5,000, to provide for possible imprisonment of up to five years, and to make unauthorized disclosure a felony. It applies its penalties specifically to offending present *and* former Federal and State employees who have or have had access to Federal tax information, to agents (including contractors) of Federal and State agencies, and to local child-support officials who receive tax information in connection with their enforcement activities. Offenders who are Federal employees may also be dismissed.

A new section of the Internal Revenue Code, added by the Tax Reform Act of 1976, provides additional deterrence to unauthorized disclosure by permitting taxpayers to bring civil actions to recover actual damages against officials who knowingly or negligently make such an unauthorized disclosure of tax data. *[Section 7217 of the I.R.C.]* Where willful or grossly negligent violations have occurred, it specifies that the taxpayer may be awarded punitive damages as well.

While the Commission did not recommend the enactment of statutory authorization for civil actions in its interim report, it recognizes that the availability of civil remedies for taxpayers is likely to deter departures from

the rules of confidentiality prescribed by the Tax Reform Act of 1976. Moreover, the Commission has considered as a general matter the desirability of civil remedies for Federal agency violations of the Privacy Act of 1974, and has recommended that citizens aggrieved by intentional or willful agency violations be able to pursue civil remedies to recover actual and general damages and attorneys' fees.[6] The details of the Tax Reform Act creating civil remedies are not congruent with the Commission's general recommendations, however, in that they make individuals, rather than an agency, liable for wrongful disclosure. The Department of Justice has expressed concern about this aspect of the Tax Reform Act of 1976.

Third-Party Source Information

The Problem

Much of the discussion, analysis, and debate regarding IRS disclosure of tax information to other government agencies has focused on the dissemination of an individual's tax return. In fact, these issues are often characterized collectively as "tax return confidentiality."

In undertaking its examination of IRS policies and practices regarding disclosure, the Commission has also focused primarily on the dissemination of tax returns and information from tax returns for uses other than Federal tax administration. In developing the recommendations, both in its interim report and in this chapter, the Commission has not questioned the basic violation of privacy resulting from the decision by Congress to require extensive disclosure of personal information by individual taxpayers to the IRS. Accepting the congressional determination that such compulsory disclosure is justified by the need to finance government operations, the Commission directed its attention to the propriety of using such data for purposes for which, and in circumstances where, the Congress has never established such extraordinary disclosure requirements.

In examining IRS disclosure policies, however, the Commission realized that a substantial portion of the information maintained and disclosed by the IRS has not been provided to it by the taxpayer. In addition to disclosing tax returns, the IRS discloses many types of individually identifiable information that it has acquired from third-party sources during the course of administering the tax laws. The Commission considered as a separate issue whether the standards of disclosure that apply to such third-party source information should differ materially from those recommended for tax returns.

The Commission recognizes that there are reasons for concluding that lesser standards of confidentiality should be applied to third-party source information; however, the Commission also recognized that there are reasons for applying more stringent safeguards. Accordingly, the Commission solicited the views of witnesses at its hearings and of other interested persons and organizations regarding the treatment of third-party source information. In addition, the Commission requested the IRS to undertake a

[6]See Chapter 13 [of the Commission's final report] for a discussion of this issue.

special three-month monitoring of its disclosures to identify precisely what types of third-party source information are disclosed regularly by the Service to other government agencies for purposes unrelated to Federal tax administration.

The Case for Broader Disclosure

There is an obvious argument for the proposition that information obtained by the IRS about an individual from sources other than the individual himself should be more generally available to other government agencies than the tax return filed by the individual.

A primary concern that permeates the consideration of tax return confidentiality arises from principles and values that are reflected in the Fifth Amendment to the Constitution. When is it appropriate to compel an individual to disclose information that can be used to penalize him? The courts have held that the Fifth Amendment does not prevent prosecutions for violations of the filing requirements of the Internal Revenue Code.[7] While the statutory establishment of appropriate disclosure standards is not limited by Constitutional protections, the fairness of using data disclosed as a result of legal compulsion for purposes unrelated to the purpose for which the information was compelled is an issue of overwhelming importance. When information about an individual has been accumulated by the IRS from sources other than himself, the question of self-incrimination simply does not arise. Accordingly, it can be argued that disclosure of such information need not be limited to the same extent as information acquired by the IRS from the individual under threat of criminal penalties.

This argument can be buttressed by the fact that much of the information acquired by the IRS from third-party sources is a product of the investment of time and other resources by employees of the Federal government. As a result, the conclusion that such data ought properly be characterized as a "generalized governmental asset"—a conclusion specifically rejected by the Commission in this chapter—can more easily be defended with respect to third-party source information than to tax returns, which are largely the product of the taxpayer's efforts and not those of the government.

The Case for Stricter Standards

While the absence of Fifth Amendment considerations and the recognition of the cost of collecting the data suggest that restrictions on disclosure of third-party source information need not be as severe as those applicable to tax returns, there are in fact compelling reasons for the imposition of more severe limits on the disclosure of third-party source data than on the disclosure of tax returns.

Although information disclosed to the IRS by a taxpayer is disclosed under compulsion of law and the threat of severe criminal and civil penalties, the taxpayer knows the substance of information that might be

[7] *United States v. Sullivan*, 274 U.S. 259 (1927).

used against him and, some argue, he should realize that the information he gives to the IRS will be used for purposes well beyond Federal tax administration. During hearings before the Commission, for example, a representative of the Department of Justice asserted, in defending continued access to tax information by the Department of Justice, that taxpayers know full well that information contained on tax returns might be used by other government agencies for purposes unrelated to Federal tax administration.[8]

When information about a taxpayer is acquired from third-party sources, the taxpayer is very unlikely to know its substance and may not even be aware of its existence. In such circumstances, the opportunity for an individual to protect himself against the use by others than the IRS of erroneous, incomplete, or outdated information is effectively negated. Accordingly, the risk to individuals of arbitrary or unfair treatment at the hands of his government are significantly increased.

It is, moreover, apparent that the IRS has not been designated by the Congress as an agency responsible for routinely collecting information on behalf of other agencies. Just as the Congress has given the IRS extraordinary powers to compel the disclosure of information by an individual about himself, the Congress has established broad powers to enable the Service to gather information from other sources as well. The rationale for both forms of power is the same—effective government depends upon revenue collection. The overwhelming importance of that objective justifies the compulsion of information from a citizen about himself as well as the creation and use of broad investigative authority. The Commission believes, however, that the fact that the Congress has not given such broad investigative authority to other government agencies wishing to acquire tax information from the IRS is itself a clear manifestation of the inappropriateness of disclosure by the Internal Revenue Service. Such inappropriateness, compounded by the increased risks to the subject because he may be unaware that data about him has been collected or what the data collected includes, suggests that third-party source information collected by the Service should be used and disclosed solely for purposes of Federal tax administration.

The Internal Revenue Service Special Study

As noted above, the Commission requested the Commissioner of Internal Revenue to maintain a full accounting for one month of the disclosures that were actually made by Internal Revenue Service offices throughout the nation. Former Commissioner Alexander graciously consented to undertake the accounting, and ordered that detailed disclosure logs be maintained in the field for the month of April 1976. The Commissioner directed all Regional Commissioners, District Directors, and Service Center Directors to furnish a report of all disclosures made to Federal agencies. To assure accuracy, the Commissioner further ordered

[8]Testimony of Deputy Attorney General, U. S. Department of Justice, *Federal Tax Return Confidentiality*, Hearings before the Privacy Protection Study Commission, March 11, 1976, pp. 70-71.

that negative reports should be filed if there are no disclosures during this period. In order to diminish the probability of generating results skewed by the pecularities of a single month, the disclosure accounting order was subsequently extended through the end of June 1976 at the Commission's request.

The individual summaries of disclosures prepared in the field were provided by the IRS to the Commission staff. The staff prepared a summary of disclosures recorded for each of the three months, which appears in the appendix volume of this report on tax return confidentiality.

The summaries set forth the number and character of disclosures both of information provided by taxpayers and information provided by third parties. They clearly reflect an interdependence between data accumulated from third parties and data acquired directly from a taxpayer insofar as recipient agencies' needs are concerned. Much third-party information relates to particular tax returns, and in many instances, third-party information has been acquired because of a compulsory reporting requirement on the third party. A taxpayer's own return may, for example, reflect information about other individuals. Information returns, compelled by law, are specifically designed to provide substantial amounts of information about third parties. In other instances, the third-party information disclosures made during this three-month period reflect the value to other agencies of the IRS's special investigative authority. Intelligence files, reports of conversations, and the work product of revenue agents were disclosed on a regular basis.

There are clear indications in the disclosure accounting of the tendency of other agencies to view IRS files as sources of information that could have been easily obtained from other sources. In a number of instances, for example, the IRS disclosed to other agencies information that was clearly taken from generally available public records. Reliance upon the IRS as a source of "newspaper articles" and "auto registrations obtained from State department of motor vehicles" confirms the habitual reliance by other government agencies on the IRS as a rich source of data.

The Commission Recommendation

The results of its analysis of the IRS's disclosure accounting confirm the Commission's belief that disclosures of third-party source data cannot be regarded lightly. The Commission does not believe that the absence of Fifth Amendment considerations constitutes a compelling argument in favor of the untrammelled disclosure of third-party source information. Concerns about invasions of personal privacy are not synonomous with Fifth Amendment protections, nor does the Commission believe that statutory measures to protect personal privacy should be limited to the scope of the Constitution's protections.

The Commission has, therefore, concluded that the same standards of disclosure should be applied to third-party source and to taxpayer-supplied data maintained by the IRS. The Commission believes that there are compelling arguments justifying strict disclosure safeguards for both types

of information. Moreover, if the standards are not the same, an agency whose access to one type of information is restricted may well be able to circumvent the restriction by seeking the same information acquired by the IRS from a different source. Finally, the Commission is fully aware that the establishment of different disclosure restrictions for information obtained by the IRS from different sources may well impose significant administrative burdens on the IRS. In light of the foregoing considerations, the Commission recommends:

Recommendation (5):

That all of the information about taxpayers in the possession of the IRS, regardless of source, be subject to the same disclosure restrictions recommended by the Commission in this chapter and in its interim report.

Desirability of Further Legislative Change

The Commission believes that the Tax Reform Act of 1976 has effected a number of important and highly desirable changes in furtherance of the protection of taxpayers' rights. The Commission's overriding concern at present is that those agencies whose access to tax data for non-tax purposes was partially or wholly frustrated by the 1976 legislation will prevail upon the Congress to weaken its restrictions before the impact of the 1976 changes can be adequately assessed. The Department of Justice has already requested that the new limitations on disclosure be postponed because of its concern about ambiguous language in the statute and the possibility of a proliferation of civil suits by taxpayers aimed at delaying important non-tax criminal investigations.

Attorney General Bell presented this argument in a letter to the Chairman of the House Committee on Ways and Means, and repeated it in testimony before the Oversight Subcommittee of that Committee.[9] He recommended in particular that civil and criminal sanctions be imposed only where "willful" rather than "knowing" or "grossly negligent" unauthorized disclosures of tax information have been made. Such a modification, if adopted, would increase the standard of proof necessary to sustain an action for wrongful disclosure.

The Commission recognizes that the complexity of the 1976 legislation will require judicial interpretation. Moreover, it fully recognizes that the new disclosure limitations may to some extent impede non-tax law enforcement activities that depended in the past on easy access to tax information. The Commission made its recommendations with a full understanding that denial of access to tax information is likely in some instances to prove burdensome to the agency subject to the restrictions. This is a price that the

[9]Letter from Attorney General Griffin Bell to Representative Al Ullman, Chairman of the House Committee on Ways and Means, February 11, 1977; and testimony of Attorney General Griffin Bell, *Administrative Summons and Anti-Disclosure Provisions of the Tax Reform Act of 1976*, Hearings before the Subcommittee on Oversight of the Committee on Ways and Means, U. S. House of Representatives, 95th Congress, 1st Session, pp. 4-47.

Commission would consciously accept in return for the protection of individual rights that will ensue.

The Commission believes that continuous public and congressional scrutiny of IRS disclosures is essential if taxpayers' rights and agencies' needs are to be constantly weighed and balanced. It therefore hopes that disclosure policy will be a matter of continuing concern and public debate. Information regarding the practices and consequences of disclosure should be made available on a regular basis both to the Congress and to the public to assure that the disclosures authorized by law continue to be warranted and to reduce the likelihood that unauthorized disclosures will result from inattention or actions taken in the interest of administrative convenience.

Part III

Disclosures of Tax Information by the Internal Revenue Service

April—June 1976

During the period April 1 to June 30, 1976, the Internal Revenue Service's field offices maintained an accounting of disclosures of tax information made to Federal agencies. This accounting did not include disclosures made by the IRS national office (such as routine disclosures to the Bureau of the Census), nor did it include disclosures made to State taxing authorities.

Because each IRS field office maintained its accounting somewhat differently, there were inconsistencies in the data received by the Commission. The Commission, not the IRS, compiled the summary that appears below and bears responsibility for any errors or misinterpretations that it may contain.

TYPES OF INFORMATION DISCLOSED

I. Taxpayer-submitted information

Type of Information	*Frequency of Disclosure*
Form 1040—individual income tax return[1]	799
Address of taxpayer—usually obtained from 1040	12
Form 1120—corporation income tax return	149
Form 1120-S—small business income tax return	10
Form 1065—partnership return	6
Form SS-4—Application for EI number	1
Corporate charter	1
Minutes of Special Joint Meeting of Board of Directors & stockholders	1
Note payable from taxpayer to third party	2
Minutes of Corporate Directors' Meetings	1
Form 433-AB—statement of financial condition	1
Cororate books and records	1
Forms L-64, 2688, 4868—Requests for extension of filing time	6
Extracts of information from form 1040	2

[1] Includes cases in which irrelevant material, including taxpayer's name, was deleted from the form.

II. Third-party source information and information generated by the Service

Type of Information	*Frequency of Disclosure*
Oral discussions with U.S. Attorneys[2]	26
Oral discussions with Dept. of Justice[2]	13
Oral discussions with FBI	1
Oral discussions with Federal Communications Commission	1
Memoranda of interviews with witnesses or taxpayers[3]	14
W-2—Employer's withholding statement	8
Revenue agents' reports, work papers	19
Special agents' reports, work papers	6
Telephone toll analysis from special agent's investigation	1
Correspondence between taxpayer and IRS	3
Form MAR-1413—Pension Trust Transmittal	1
Form 3858—Examination Planning	1
Form 53—Report of uncollectable taxes	1
Form 4044—Request for Terminal action	1
Form 4251—Return—charge out	1
Form 941—Employer's quarterly tax return	3
Schedule of RAR adjustments	5
Form 2433—Notice of Seizure	1
Form 1902-E—Report of Individual Income Tax Audit Change	1
Form 886-A—Explanation of Items	1
Form 4700—Examination of Planning and Working Statements	1
Form 3050—Certification of Lack of Records	19
Copies of forms & transcripts used by IRS to secure files in response to requests	1
Affidavit—unspecified	6
Copies of checks	4
Discussion of "tax related matters":	
Dept. of Justice	2
U.S. Attorneys	1
Memoranda on amount of Adjusted Gross Income shown on return and employers' name for husband and wife	1
Affidavit of Disclosure Officer as to date and amount of tax assessment and levy	4
Testimony at trial	2
Grand Jury Testimony	3
Inspection of Tax Delinquent Account and Tax Delinquent Investigation History Files	1
Documents tracing contributions from domestic corporation to foreign political parties	1
Memorandum of possible violation of Federal law	3
Memoranda of surveillance	1
Bank records	2
Inquiry as to whether or not prospective juror has been subject of criminal investigation by intelligence division (affirmative or negative response only)	31
Information items & intelligence files (informants' names deleted)	1
Revenue agent's history sheet	1
Revenue agent's memo	1
TDA Assembly	1

[2] Includes discussions when no record of document was found.

[3] Includes memoranda of telephone interviews.

Type of Information	*Frequency of Disclosure*
Notice of Levy	3
Special agent's memoranda of interviews	1
Administrative file	1
Correspondence from taxpayer's representative	1
Correspondence and memoranda of third-party witnesses	1
Question and Answer statements and memoranda of interview	2
Accountant's workpapers	1
Schedule reflecting involvement in various business activities from newpapers	1
Auto registration	3
Analysis of bank records by revenue agents and bank	1
Workpapers—analysis of 1120 figures & corporation's books and records	1
Real estate sales records	1
Files of other law enforcement agencies	1
Social Security records	1
Form RSC-320—form letter (request for more information to help in verification of return)	1
Investigation working papers of special agent and revenue agent	1
Loan applications	1
Documents subpoened for use in non-tax litigation[4]	1
Audit report	1
Transcript of account	1
Memoranda of possible banking violations from special agent	1
Discussion of possible illegal corporate payments	1
Name information—source being public record	1
Memorandum on interview with informant	1
Statistics on corporation's pension plan	1
Letter from taxpayers to overseas bank	2
Foreign bank debit document	2
Newspaper articles	2
Address information from individual account number file	3
Verbal explanation of basis for audit selection of return of defense witness in criminal tax trial	1
Non-filing record of taxpayer	1
Arrest record	1
Miscellaneous—source or information unclear	4

[4] Including sensitive case report, intelligence fact sheet, fraud referral report, and declination memo on fraud referral.

SUMMARY OF DISCLOSURES TO EACH AGENCY

I. Number of Disclosures[5]

Agency	*Number of Disclosures*
Justice Department[6]	237
U.S. Attorneys	806
Securities and Exchange Commission	28
U.S. Customs Service	1
Department of Agriculture	11
Federal Bureau of Investigation	3
Federal Home Loan Bank Board	43
Immigration and Naturalization Service	1
Equal Employment Opportunity Commission	41
Department of Health, Education, and Welfare—SSA	9
Commodity Futures Trading Commission	17
Department of Public Advocate, New Jersey	2

II. Requests for Information with no Disclosure Made[7]

Type of Information	*Agency*	*Frequency of Request*
Form 1040	U.S. Attorneys	75
Form 1040	Justice Dept.	15
Form 1120	U.S. Attorneys	8
Form 1065	U.S. Attorneys	2
Forms L-64, 2688, 4868—requests for extension of filing time	Justice Dept.	3
W-2	U.S. Attorneys	1
Address information	U.S. Attorneys	4

[5] In cases where only part of a request was complied with, for example: 1040-1969 (document furnished); 1972 (no record), the request has been marked twice, once in categories I and II.

[6] Justice Department Strike Force Attorneys are included here.

[7] This does not include "certification of lack of records", or discussions held without disclosure.

☆ U. S. GOVERNMENT PRINTING OFFICE : 1977 O - 244-494