Chapter 14

The Relationship Between Citizen and Government: The Citizen as Taxpayer

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, 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.

In June 1976, the Commission recommended the enactment of a

[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 jurisdiction.

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, 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 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

[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.*

[4] See, for example, *Federal Tax Return Privacy,* Hearings before the Subcommittee on

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 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 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

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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.

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—
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> (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 law.

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—
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> (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 this 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 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.