[JOINT COMMITTEE PRINT]

STUDY OF PRESENT-LAW TAXPAYER CONFIDENTIALITY AND DISCLOSURE PROVISIONS AS REQUIRED BY SECTION 3802 OF THE INTERNAL REVENUE SERVICE RESTRUCTURING AND REFORM ACT OF 1998

VOLUME III: PUBLIC COMMENTS AND GENERAL ACCOUNTING OFFICE REPORTS

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

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JOINT COMMITTEE ON TAXATION

106th CONGRESS, 2nd SESSION

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[1] The table of contents for all three volumes of the study is contained in Volume I.

INTRODUCTION

Section 3802 of the Internal Revenue Service Restructuring and Reform Act of 1998 (the "IRS Reform Act")[2] directs the Joint Committee on Taxation and the Department of the Treasury to undertake separate studies of the present-law disclosure provisions of the Internal Revenue Code, including provisions relating to tax-exempt organizations, and make any legislative and administrative recommendations they deem appropriate. The studies are due by January 22, 2000.

The staff of the Joint Committee on Taxation (the "Joint Committee staff") is publishing its study in three volumes. As set forth in more detail below, Volume I[3] contains the Joint Committee staff study relating to general disclosure provisions, Volume II[4] contains the Joint Committee staff study of disclosure rules relating to tax-exempt organizations, and Volume III,[5] contains reproductions of public comments received by the Joint Committee staff and reports prepared by the General Accounting Office ("GAO") for the Joint Committee staff in connection with the study.

Volume I contains the following: (1) an executive summary and a discussion of the methodology employed by the Joint Committee staff in conducting the study (Part One); (2) a description of the present-law rules relating to general disclosure provisions, including a discussion of sections 6103 and 6110 of the Internal Revenue Code (the "Code"), the Freedom of Information Act, and the Privacy Act (Part Two); (3) a discussion of the policies underlying confidentiality and disclosure of tax returns and return information (Part Three); (4) data and

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

[3] Volume I may be cited as follows: Joint Committee on Taxation, *Study of Present-Law Taxpayer Confidentiality and Disclosure Provisions as Required by Section 3802 of the Internal Revenue Service Restructuring And Reform Act of 1998, Volume I: Study of General Disclosure Provisions* (JCS-1-00), January 28, 2000.

[4] Volume II may be cited as follows: Joint Committee on Taxation, *Study of Present-Law Taxpayer Confidentiality and Disclosure Provisions as Required by Section 3802 of the Internal Revenue Service Restructuring And Reform Act of 1998, Volume II: Study of Disclosure Provisions Relating to Tax-Exempt Organizations* (JCS-1-00), January 28, 2000.

[5] Volume III may be cited as follows: Joint Committee on Taxation, *Study of Present-Law Taxpayer Confidentiality and Disclosure Provisions as Required by Section 3802 of the Internal Revenue Service Restructuring And Reform Act of 1998, Volume III: Public Comments and General Accounting Office Reports* (JCS-1-00), January 28, 2000.

background information regarding the use of tax returns and return information obtained under present-law rules (Part Four); and (5) Joint Committee staff recommendations relating to general disclosure provisions (Part Five). Volume I also contains the following appendices: (1) a description of the legislative history of section 6103 (Appendix A); (2) information provided by the taxpayer in an advanced pricing agreement request (Appendix B); (3) Congressional resolutions authorizing disclosures to nontax writing committees (Appendix C); (4) a summary of public comments received by the Joint Committee staff relating to general disclosure provisions (Appendix D); and (5) a copy of the most recent annual disclosure report provided to the Joint Committee pursuant to section 6103(p)(3)(C) (Appendix E).

Volume II of the study (relating to tax-exempt organizations) contains the following: (1) an executive summary (Part I); (2) a discussion of the methodology employed by the Joint Committee staff in conducting the study (Part II); (3) a description of present law and background information relating to disclosure rules applicable to tax-exempt organizations (Part III); (4) an economic analysis of the benefits of tax-exempt status (Part IV); (5) analysis of issues relating to the disclosure of information regarding tax-exempt organizations (Part V); and (6) Joint Committee staff recommendations to increase disclosure of information relating to tax-exempt organizations (Part IV). Volume II also contains the following appendices: (1) a description of the legislative history for the disclosure provisions applicable to tax-exempt organizations under section 6104 of the Code (Appendix A); (2) copies of IRS Annual Returns for Tax Exempt Organizations (Appendix B); and (3) a summary of public comments received by the Joint Committee staff relating to disclosure provisions regarding tax-exempt organizations (Appendix C).

Volume III contains reproductions of the public comments received by the Joint Committee staff in connection with the study and reproductions of two GAO reports prepared for the study at the request of the Joint Committee staff.

I. REPRINT OF COMMENTS RECEIVED BY THE JOINT COMMITTEE STAFF RELATING TO GENERAL DISCLOSURE PROVISIONS

The following documents are reproductions of the comments received by the Joint Committee staff in connection with its study of the general disclosure provisions.

Defending Liberty
Pursuing Justice

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October 8, 1999

Ms. Lindy L. Paull
Chief of Staff
Joint Committee on Taxation
1015 Longworth
Washington, DC 20515

Re: Comments on Taxpayer Confidentiality and Tax Return Information Confidentiality in General

Dear Ms. Paull:

On behalf of the Section of Taxation the enclosed comments on Taxpayer Confidentiality are submitted as requested in the Joint Committee on Taxation's press release 99-03.

These comments are presented on behalf of the Section of Taxation. They have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, accordingly, should not be construed as representing the position of the Association.

If we can be of any assistance please do not hesitate to let us know.

Sincerely,

Paul J. Sax
Paul J. Sax
Chair, Section of Taxation

cc: James D. Clark, Chief Tax Counsel, Ways and Means Committee
Janice Mays, Democratic Chief Counsel, Ways and Means Committee
Mark Prater, Chief Tax Counsel, Senate Finance Committee
Russell Sullivan, Minority Chief Tax Counsel, Senate Finance Committee
Jonathan Talisman, Acting Assistant Secretary Tax Policy, Department of Treasury

These comments have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, accordingly, should not be construed as representing the position of the Association.

1. The adequacy of present law protections governing taxpayer privacy.

Issue: *Should a revenue agent be permitted to disclose return information to another revenue agent in the investigation of another taxpayer?*

A. Currently revenue agents and District Counsels are free to use taxpayer return information in the preparation of litigation or against another taxpayer.[1] Such information is used to prepare for litigation, develop legal analysis, lines of inquiry, and to shape the course of further fact gathering.

1. Section 6103's mandate of return non-disclosure puts the taxpayer, for whom litigation is directed ("taxpayer A"), at a significant unfair disadvantage because the Internal Revenue Service (the "Service") personnel, including District Counsel, have access to other's ("taxpayer B") return files (some of which might be exculpatory) to which the taxpayer A is not privy.

B. Recommendations.

1. Because section 6103 prohibits taxpayer A from examining taxpayer B's return information, the likelihood of abuse of such information could be high. There is no regulatory framework to guarantee that taxpayer B's return information will not be used unfairly against taxpayer A. The Service should be prohibited from using such information in the litigation of taxpayer A.

2. The use of third party return information in an audit or litigation with another taxpayer substantially increases the likelihood that such information will be intentionally or inadvertently disclosed. Section 6103 is designed to prevent just such an eventuality. The use of third party taxpayer information should be prohibited.

3. Whether greater levels or voluntary compliance can be achieved by allowing the public to know who is legally required to file tax returns but does not do so.

[1] John A. Townsend, Section 6103 and the use of Third Party Tax Return Information in Tax Litigation, 46 Tax Lawyer 923 (1993). Townsend suggests that the perils of intra-Service use of taxpayer information must be carefully balanced with Service interest in efficiency and administration of the Tax Code.

A. Regulatory Inefficiency.

An attempt to publish the names of those who do not file tax returns but are required to do so will likely be inefficient and require the commitment of a disproportionate amount of agency resources. Those who are likely to have their names published as non-filers fall into two categories:

(1) those who have never filed.

(2) those who have filed in the past but no longer do so.

B. Implications.

An attempt to ascertain non-filers out of category (1) will require an inquiry into taxable income without the aid of any past tax return information. Many taxpayers would go without detection, decreasing the efficacy of the program. The expense and effort associated with this endeavor would far exceed any benefit of publication. The publication of names from category (2) would necessarily rely on past tax return information which has little bearing on current tax liability. Any publication that endeavors to list non-filers who should file will necessarily divulge important tax return information from previous years for which there *is* a return but will say little about a taxpayer's current need to file.

C. Recommendations.

Publication of the names of those who do not file a tax return but are required to do so should be limited to those who have been convicted for a failure to file. Only the procedural safeguards afforded by a formal proceeding protect the privacy interests of taxpayers and guarantee a high percentage of compliance.

5. The impact on taxpayer privacy of sharing tax information for the purposes of enforcing State and Local tax laws (other than income tax laws), including the impact on taxpayer privacy intended to be protected at the Federal, State, and Local levels under the Taxpayer Browsing Protection Act of 1997.

Several inquiries have been made with respect to the cooperation of the Internal Revenue Service and State tax and other regulatory bodies. This issue has, in particular, received some attention in California. Comments with regards to this issue will be forthcoming.

6. The extent to which the current disclosure provisions provide taxpayers, exempt organizations, and tax practitioners with sufficient guidance.

A. Regulatory Complexity.

Regulatory complexity with respect to sections 6103 and 6110 have decreased the amount and quality of guidance from the Service. In particular, efforts at categorizing disclosable guidance has created confusion among tax practitioners, legal publishers, and taxpayers. This confusion has spurred multiple lawsuits designed to force the disclosure of agency documents, while at the same time providing the Service a propensity to release some of these forms of guidance as a result of Tax Analysts' FOIA litigation, much of these guidance documents are redacted to the point that their usefulness is called into question.

C. Recommendations

Congress should broaden the scope of section 6110 to include the disclosure of all internal memoranda as long as it is consistent with the mandates of section 6103. We see this as a two step process.

1. The standard for the publication of internal guidance should be descriptive rather than demonstrative. Guidance which purports to offer agency interpretations, positions, and intentions with respect to agency law in function rather than mere form should be subject to a presumption of disclosability. That presumption is rebutted only under provisions in accordance with 2, below.

2. Clear and concise guidelines should be developed to evaluate all new forms of guidance for disclosability. Only when such guidance (1) is taxpayer specific, and (2) does not disclose agency interpretations or positions with respect to agency law, will it be subject to non-disclosure.

Taxpayer Confidentiality in Transfer Pricing

Under section 482 of the Internal Revenue Code, the pricing of transactions between controlled taxpayers must be at arm's length. An Advance Pricing Agreement (APA) is an agreement between a multinational taxpayer and the Internal Revenue Service (IRS) to apply a transfer pricing methodology (TPM) to determine an arm's length price for sales of tangible property, services, royalties, and other intercompany transactions for a specified period of time. An APA offers the IRS and the taxpayer an alternative process to resolve difficult and complex factual transfer pricing issues in a manner that avoids the uncertainty and the lengthy and costly process involved with the normal audit, Appeals, and litigation cycle. By the time an agreement is finalized, APAs often cover one to three past years, as well as specified future years. In "bilateral" APAs, the IRS also enters an agreement under a tax treaty provision with the competent authority of another country to use the TPM in the APA to resolve and/or avoid any double tax issue.

In submitting a request for an APA, a taxpayer must provide detailed information describing its business operations and products, including proprietary and sensitive pricing information. See Revenue Procedure 96-53, sections 5.03 and 5.04. For example, an APA request often includes pricing or licensing agreements, marketing and financial studies, business plans, budgets, and projections, and product line reports.

(APAs) are agreements between the Service and a particular taxpayer regarding the allocation of income, deductions, profits, and allowances between related taxpayers. They are confidential now, and, because they contain sensitive information, taxpayers are eager that they not be disclosed.

In recent litigation to force disclosure of APAs, the IRS eventually took the position that APAs were written determinations under section 6110 of the Code, and as such the IRS would release the APAs, after redacting any confidential and proprietary information. In light of proposed legislation addressing the disclosure of APAs, the Service has modified its position, and proposed that the court delay its ruling pending the possible enactment of a legislative solution.

The possible disclosure of APAs as written determinations under section 6110 of the Code raises serious questions. As written determinations, the background files for an APA would also be subject to disclosure.

First, APAs are not rulings by the IRS that apply the law to a given set of facts. APAs are customized, negotiated contracts between the taxpayer and the IRS based on a fact intensive determination of the arm's length price for specified intercompany transactions.

Second, APA information is "return information" under section 6103. When section 6103(l)(14) was added to the Code in 1993 to allow disclosure of certain return information to the Customs Service, the legislative history indicates that Congress considered APAs to be return information. Moreover, the legislative history states that "information submitted or generated in the APA negotiating process should remain confidential." See H.R. Report No. 103-361, Vol. 1 at 104 (1993).

Third, bilateral APAs also involve negotiations with the competent authorities of other countries pursuant to tax treaty provisions to use the TPM in the APA to resolve any related double tax controversy. If the disclosure of bilateral APAs extends to the competent authority agreements on which the bilateral APAs are based, it could jeopardize the relationships of the United States with the tax authorities of these countries.

Fourth, as noted, APAs typically will cover taxable years for which returns have already been filed as of the completion of the agreement. Also, the IRS and taxpayers in some instances use, or "rollback," the TPM in the APA to resolve identical transfer pricing issues in open taxable years not covered by the APA. The use of APAs in this manner has the same effect as closing agreements, which are not disclosed by the IRS because of the negotiated nature of the agreements.

Fifth, the disclosure process for APAs would place an enormous burden on the IRS and the taxpayer to review and redact the APA documents. All documents must be reviewed for information that directly or indirectly identifies the taxpayer, as well as for confidential trade and financial information. The amount and type of information submitted with an APA request does not compare with the relatively summary factual information submitted to obtain other "written determinations," such as a private letter ruling. The burden would be especially great for the background files, which are not in electronic format.

Sixth, because of the sensitive nature of the information, disputes may arise concerning the information that is redacted, requiring resources from both the IRS and taxpayers to resolve the dispute.

Finally, disclosure of APAs could jeopardize the vitality of the APA program. The APA program has generally been well received by taxpayers and offers tremendous benefits to both taxpayers and the government. In the APA process, taxpayers have voluntarily submitted sensitive pricing and other trade information with the understanding that the IRS would keep this information confidential. For some companies the advantages of resolving this complex tax issue through the APA process would be greatly diminished or eliminated by the disclosure of APAs and the background information.

As a final matter, legislation has been proposed that would require the IRS to publish an annual report on APAs. The proposed report would include for each calendar year the number of applications for APAs, the number of APAs completed, pending, and withdrawn, and a summary of the transfer pricing methodology for each completed APA, without the disclosure of the taxpayer's identity or confidential and proprietary information. In addition, the proposed report would for the completed APAs describe in general terms the TPMs, the relationships of the parties, the trades or businesses, and the prices or results used to determine compliance with the TPM. The proposed report would also describe in general terms the critical assumptions, covered transactions, functions performed, risks assumed, sources of comparables, comparable selection criteria, the nature of adjustments to comparables or tested parties, and the term lengths. This provision was in the tax bill just vetoed by the President.

While there may be issues with some of the specific items in the proposed disclosure legislation, the public will likely know more about APAs from the issuance of a summary report than it would know from a release of individual redacted APAs. In addition, a requirement for the IRS to issue the report, if enacted, would provide a balance between protecting the confidential taxpayer information provided to and needed by the IRS to fully evaluate the transfer pricing issues and at the same time provide information to the public about the approach agreed to by the IRS in certain factual patterns covered by the APAs.

Disclosure of Information with Respect to Tax-Exempt Organizations

1. Whether the public interest would be served by greater disclosure of information with respect to tax-exempt organizations described in Code section 501.

a. <u>Public Inspection of Written Determinations on Exempt Status.</u> Over the past several years there has been an increased focus on the so-called "guidance deficit" -- the decline in precedential guidance issued by the Internal Revenue Service in the form of Revenue Rulings and other similar guidelines. One consequence of the guidance deficit is that tax practitioners place greater weight on the redacted form of private letter rulings and technical advice memoranda released to the public under section 6110. Although section 6110(k)(3) provides that such documents have no precedential status, they are widely regarded by practitioners as an important source of information about how the IRS National Office interprets tax laws and regulations in particular factual situations. There is, however, an anomaly in the application of section 6110 to tax-exempt organizations.

Section 6110 requires the IRS to make available for public inspection redacted versions of "written determinations," including private letter rulings and technical advice memoranda. However, section 6110 (l)(1) excepts from the application of that section "any matter to which section 6104 applies." The latter section is considerably broader than section 6110, and requires exempt organizations to make available for public inspection nonredacted copies of their IRS applications for exemption, determination letters, and Forms 990 for the past three years. Section 6104 does not, however, require exempt organizations to make available copies of private letter rulings or technical advice memoranda issued to such organizations by the IRS.

Because rulings and technical advice memoranda relating solely to exempt status issues arguably fall within the ambit of section 6104 (although that section does not require disclosure of such determinations), the IRS takes the position that their disclosure is not authorized by section 6110 and does not release them, even in redacted form. See, e.g., Treas. Reg. §301.6110-1(a). The IRS does, however, release written determinations issued to exempt organizations that include issues not within the ambit of section 6104, such as the application of the unrelated business income tax to particular proposed transactions.

The failure of the IRS to release private letter rulings and technical advice memoranda dealing only with exempt organization issues deprives practitioners of important sources of information about IRS National Office interpretations of the tax laws applicable to such organizations. Exemption issues are, of course, of critical importance. Given the limited issuance of precedential guidance, access to redacted versions of private letter rulings and technical advice memoranda on exemption issues would be of tremendous value to tax practitioners and their clients. Since the current IRS decision not to release these determinations is due not to any policy of tax administration, but only to an apparent gap in the legal authority for such release, we suggest that the Joint Committee on Taxation investigate this matter to determine whether the problem can be addressed by regulations or whether a statutory change is required, and we recommend that appropriate corrective action be taken.

b. There are many issues regarding disclosure as to which the Tax Section does not have a formal recommendation. The Tax Section encourages the staff of the Joint Committee on Taxation to review and study the following issues before any action is taken. Members of the Tax Section would be willing to participate to assist the Committee staff in the review and study.

(1) Closing Agreements.

There is an issue as to whether closing agreements should be disclosed, which is of significant controversy. One side argues for complete and full public disclosure, and the other side opposes disclosure on the basis that the willingness to compromise an issue is achieved precisely because the closing agreement will not be disclosed. If disclosure is required, both parties will be reluctant to compromise issues because of subsequent public scrutiny.

(2) Lobbying Activities.

Most section 501(c)(3) organizations are permitted to engage in lobbying to a limited extent. In addition, a narrow range of activities are considered exceptions to the definition of lobbying, and therefore are not counted as lobbying. The exceptions to the definition of lobbying are: (a) non-partisan analysis, study or research, Treas. Reg. §56.4911-2(c)(1); (b) examination and discussion of broad social, economic and similar problems, Treas. Reg. §56.4911-2(c)(2); (c) technical advice or assistance to a governmental body, Treas. Reg. §56.4911-2(c)(3); and (d) certain "self defense" communications, Treas. Reg. §56.4911-2(c)(4). The issue is whether a tax-exempt organization should be required to disclose its activity and related information whenever it engages in activity which is within the definition of one or more of the exceptions to lobbying. Such disclosure is not required at this time. The argument in favor of disclosure is that the IRS and the public should know whenever an exception is being relied upon so that they can judge for themselves whether it is appropriate and understand the full scope of lobbying by charitable organizations. One argument against such a requirement is that many educational activities arguably could be subject to disclosure, because the exact definition of lobbying is not entirely clear, and therefore when an organization is relying on an exception is not also clear. This is particularly true for organizations that have not made the election to be governed by a percentage test under Code section 501(h). In addition, burdensome reporting requirements will further chill the valuable, free contribution of ideas to the public debate by the very entities representing the public interest that most need to be encouraged to participate

(3) <u>Political Action Committee.</u>

An additional issue is the reporting requirement applicable to Political Action Committees (PACs), described in section 527 of the Code. The only reporting requirement occurs when the PAC receives net investment income in excess of $100. One issue is whether the name and address of the donor and amount of the contribution should be disclosed, as well as the activities of the PAC. In addition, there is an issue whether name, address and persons sponsoring the PAC should be provided in the form of an information return (Form 990) or an expanded SS-4 form.

2. The extent to which the present law tax-exempt disclosure provisions assure accountability of exempt organizations to the public, the Internal Revenue Service and other agencies that provide oversight.

a. <u>Disclosure to State Attorney General or Other State Official Charged With Regulation of Tax-Exempt Organizations.</u>

Section 6104(c) was enacted as part of the Tax Reform Act of 1969 in order to permit the Internal Revenue Service to provide confidential information relating to tax-exempt organizations described in section 501(c)(3) to a state attorney general or other state official charged with regulation of these organizations. The legislative history indicates that such section was adopted in recognition of the desirability of coordinating federal enforcement of organizations described in section 501(c)(3) with parallel state regulatory programs. Prior to its passage, the Internal Revenue Service could exchange confidential information only with a state department of revenue or similar tax service. However in almost every state, it is the attorney general who has the exclusive power to regulate tax-exempt organizations. Section 6104(c) was passed in recognition of the desirability of coordinating enforcement efforts.

Unfortunately, the hoped for result has never been achieved. This is due in large part to the fact that regulations under this section issued in June of 1971 severely curtailed its impact, rendering it in most instances ineffectual. Notification to state officers is required under section 6104(c) after the Internal Revenue Service has made a "final determination" refusing recognition of exempt status or denying it on the basis of the organization's operations; or upon the mailing of a notice of deficiency of tax under section 507 or chapters 41 or 42. The phrase "final determination" was defined in the regulations for purposes of the paragraph to mean after all administrative review with respect to such determination has been completed. The practical effect of this interpretation has been that, by the time a state officer is notified, the exempt organization will in most cases long since have dispersed its funds, disbanded, and disappeared. Although the state might then be able to bring court action to remove fiduciaries and compel accountings, its effectiveness is so severely limited that it is unlikely to act. There is no parallel limitation on the ability of the Internal Revenue Service to provide information to state tax authorities and it is difficult to understand why state attorneys general, who possess broad enforcement powers and deal at all times with sensitive matters in many areas of the law, cannot be treated on the same basis as their colleagues working directly in tax enforcement. Consideration should be given to an amendment of section 6104(c) to permit early exchange of information between state and federal officials which may improve enforcement at both levels of government.

b. Present Disclosure Requirements.

Under Code section 6104, tax-exempt organizations described in section 501(c) or (d) must make available for public inspection copies of their applications for tax-exempt status (Form 1023 or Form 1024), IRS determination letters and information returns (Form 990 or 990-PF) for the past three years. We are of the view that the disclosure requirement is adequate to inform the public, the Internal Revenue Service, and other agencies that provide oversight. There is a question as to whether the information requested on the information return is adequate to assure the desired accountability, especially with respect to the general public. The Internal Revenue Service should be encouraged by the Treasury or directed by Congress to initiate a study to determine whether the present information returns include sufficient relevant and consistent information with respect to the accountability oversight issue. There are many instances of inconsistencies in reporting; for example, the question of the economic benefit of fringe benefits, which in some cases are accounted for on a cash basis and in other cases on an accrual basis. The amount of compensation in any form is an important issue of disclosure, and there should be definitive criteria for consistent reporting to avoid misleading presentation or exclusion of information. Perhaps individuals requesting the information return could be surveyed regarding the information they would find most helpful and what information currently reported is not useful to them.

Further, some consideration should be given to providing information in addition to that in the form of an information return or in lieu of information returns. Many tax-exempt organizations complete their information returns late in the year. In some cases, they are not filed until November 15 of the year following the calendar year of activity. In such instance, the information on the information return is somewhat dated. Consideration should be given to providing the information prior to the due date of the information return in the form of an annual report or audited financial statements, if available, in lieu of the information return. Another alternative is to encourage voluntary disclosure of information to the public by the tax-exempt organization and to educate the public, in particular donors, about how to read an information return, where to find information of interest to the reader, and factors which may be useful to the reader in considering how well the organization is carrying out its programs.

Steven Bankler, CPA

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CERTIFIED PUBLIC ACCOUNTANT

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April 20, 1999

Mr. Mel E. Schwartz, Accountant
Joint Committee On Taxation
204 Dirksen
Washington, D.C. 20515

Re: Proposed changes to IRS Disclosures (IRC §6103)

Dear Mel,

As per our telephone conversation last month, I would like to suggest a modification to the disclosure rules of the Internal Revenue Code §6103.

As you may be aware, the IRS invokes IRC §6103 and will not discuss ANY taxpayer information except with the taxpayer or his authorized representative. Section 6103 impedes open communication, discussion of the code, and compliance EVEN where the taxpayer has voluntarily released the tax returns to the public (such as elected officials and candidates). Therefore, I believe that there should be a provision in IRC §6103 which makes this section inapplicable when the taxpayer has voluntarily released his tax return to the public. This provision should be effective upon enactment for all open tax years.

I would appreciate your assistance and any comments you have on this matter.

Very truly yours,

Steven Bankler, CPA

SB/slf

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WE SOLVE PROBLEMS®

September 21, 1999

SEP 27 1999

Hon. Lindy L. Paull, Chief of Staff
Joint Committee on Taxation
Room 1015
Longworth House Office Building
Washington, DC 20515

Dear Mr. Paull:

As a private citizen, and a voter, I wish to share with you my feelings and comments regarding your committee's study concerning the subject of taxpayer confidentiality.

1. The adequacy of current protections governing privacy.
   I am uncomfortable with the present laws, and do not particularly trust the IRS despite all the so-called reforms. There should be stricter limits on the use of taxpayer information, and greater penalties for violations of the confidentiality rules. And, NO taxpayer information should EVER be put on the Internet.

2. The need, if any, for third parties to use tax return information.
   The ONLY time anyone should be able to see confidential taxpayer information is if that taxpayer has given explicit permission, in writing, for their records and information to be accessed.

3. The impact on *taxpayer privacy* of sharing tax information for the purposes of enforcing state and/or local tax laws.
   I am opposed to the federal government sharing information with state and/or local authorities. Not that I have anything to hide, nor am I trying to conceal any wrongdoing. But, when I file my federal tax return, I expect only a limited number of federal employees to have access to my tax information. I am concerned that the more people who have access to my information, the greater the chance that the information could be misused.

At voting time, I will hold my legislators personally responsible, at the polls, if any of my private tax information has been misused or abused.

Sincerely,

Oliver Bennett
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November 10, 1999

HAND DELIVERED

NOV 10 1999

Ms. Lindy L. Paull
Chief of Staff
Joint Committee on Taxation
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Independence Avenue & New Jersey Avenue, S.E.
Washington, DC 20515

Re: Congressional Study Regarding Internal Revenue Code Section 6103

Dear Ms. Paull:

On behalf of The Bureau of National Affairs, Inc., I write to respond to the Joint Committee on Taxation's request for public comments for the report to Congress on taxpayer confidentiality required by the Internal Revenue Service Restructuring and Reform Act of 1998. In particular, the JCT has requested comments regarding the interrelationship between Section 6103, which makes confidential tax returns and tax return information, and Section 6110, which mandates public access to tax rulings and other Internal Revenue Service written interpretations of the tax law.

Public access to IRS's position on the meaning of the tax laws is of vital importance to all taxpayers. Section 6110 protects public access to IRS tax rulings, while shielding taxpayer identity, trade secrets and confidential financial and commercial information. Section 6110 has a proven track record of success.

The proper balance set by Congress in Section 6110 between taxpayer privacy and the public's right to know the law is threatened now by those who seek to make IRS tax rules secret. Certain accounting firms and specialty tax firms are actively lobbying Congress to change the balance struck between Section 6103 and Section 6110 to bar public access to the tax rules adopted by the IRS in tax rulings known as Advance Pricing Agreements ("APAs"). An APA, like a private letter ruling, states the IRS's interpretation of how the law should work under certain circumstances. The tax rulings adopted by the IRS in APAs are not otherwise publicly available. The IRS acknowledges that it applies tax rules contained in APAs to taxpayers other than the taxpayers to which they were issued. The firms objecting to public disclosure of APAs have private libraries of APAs issued by the IRS to their clients and former clients, which they advertise worldwide on the Internet to attract new clients who seek to understand and apply the IRS' interpretation of the tax laws. In January 1999, the IRS announced that it would make

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APAs available for public inspection pursuant to Section 6110. BNA sought this result in litigation brought against the IRS under Section 6110 to enable all taxpayers to have access to the tax rules contained in APAs and to permit Congressional and public oversight of the IRS's interpretation and application of the tax laws.

Representatives of BNA have met with members of Congress, your staff and others on the Hill to oppose an amendment to Section 6110 that would make APAs and the IRS tax rules that they contain exempt from public access. Enclosed is prior correspondence from BNA to Congress opposing such an amendment and BNA incorporates those letters into these comments.

BNA urges the JCT to report to Congress that Section 6110 should not be amended to deny public access to IRS tax rules adopted in APAs. Should you want to discuss this matter further with us, we would be pleased to do so.

Sincerely,

Eunice Lin Bumgardner

Enclosures

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October 20, 1999.

BY HAND

The Honorable William V. Roth, Jr.
Chairman, Committee on Finance
United States Senate
SD-219 Dirksen Senate Office Building
Washington, D.C. 20510

Re: Public Access to Tax Rulings in Advance Pricing Agreements

Dear Chairman Roth:

On behalf of the Bureau of National Affairs, and other proponents of public access to interpretations of the tax law adopted by the Internal Revenue Service (IRS), I urge the Senate Finance Committee not to include in the "Extenders" legislation a provision that would bar public access to the IRS-approved tax rules contained in Advance Pricing Agreements (APAs). This letter responds to assertions presented to you and your committee members in the letter you received recently from Charles Shewbridge on behalf of the Tax Executives Institute.

We support IRS issuance of APAs and are of the view that the APA program and tax administration overall is best served by preserving public access to the rule of law while at the same time protecting taxpayer privacy. No one disputes that APAs contain tax rules adopted by the IRS. The IRS does not publish these rules anywhere but in APAs. The IRS is applying these rules not only to the APA holder but also to other taxpayers that do not have APAs. Taxpayers should know about these rules before the rules are applied to their situations in audits that may occur years from now. In addition, preserving public access to the tax rules in APAs should foster growth in the APA program by permitting taxpayers to seek APAs that would apply new or already approved rules to their situations.

Disclosure of the tax rules in APAs would not violate taxpayer privacy. Congress enacted Section 6110 of the Internal Revenue Code to ensure public access to tax rules while shielding taxpayer specific information from disclosure. Section 6110 specifically requires the IRS to withhold information that would identify a taxpayer or the taxpayer's trade secrets or confidential commercial or financial information. Section 6110 requires taxpayer participation in the redaction process and affords the taxpayer with rights of action against the IRS to protect against disclosure of exempt information. The redaction process under Section 6110 has resulted in no litigation in the over 25 years that Section 6110 has been law. As the Associate Chief Counsel (International) for the Department of the Treasury, Michael Danilack stated in March 1999 -- "Section 6110 of the Internal Revenue Code was written by Congress precisely to provide a mechanism for ensuring that this balancing [of taxpayer privacy and public access to tax rules] is carried out properly."

From the beginning of the APA program, taxpayers and the IRS have planned for disclosure under Section 6110. The first APA issued by the IRS to a taxpayer provided for public disclosure of the APA after redaction of information exempt from disclosure under Section 6110. The IRS model APA provided to taxpayers interested in obtaining an APA does the same.

Contrary to TEI's assertion, the APA program has not been adversely affected by the IRS' decision to disclose redacted APAs under Section 6110. Since the IRS announcement in January 1999 that it would disclose redacted APAs under Section 6110, the numbers of APAs requested and issued has increased over the same time period last year.

Disclosure will help the APA program and enforcement of the transfer pricing laws more generally. As Associate Chief Counsel Danilack has represented: "disclosure of APAs under Section 6110 will end up helping many taxpayers, including those seeking an APA, to better understand their transfer pricing responsibilities." This senior Treasury official elaborated that "there is a strong interest in ensuring that general information about the substantive results being reached in the [APA] program is widely available . . . As the [APA] program has developed over the past several years, the larger body of completed APAs increasingly reflects the Service's tried and proven approach to transfer pricing in a variety of circumstances."

The APA provision in the House "Extenders" Bill, Section 201 of H.R. 2923, would deny the public access to the tax rules adopted by the IRS in APAs. APAs would be completely exempt from public disclosure. The "report" that H.R. 2923 would mandate (in lieu of disclosure of redacted APAs under Section 6110) would not provide the public with the tax rules adopted by the IRS in APAs. To the contrary, H.R. 2923 would require the IRS to separate the transfer pricing methods approved by the IRS from the circumstances under which the IRS approved them. Moreover, the IRS would be permitted to omit from the report any method or other piece of information that it deems exempt from disclosure and to do so without any acknowledgment that the report is incomplete or why. Under H.R. 2923, only those tax practitioners with private libraries of APAs obtained for their clients could have any sense of the tax rules that the IRS is following.

There is no balance between the public's right to know the IRS's interpretation of the tax law and taxpayer privacy in H.R. 2923. By secreting the tax rules in APAs from the public, H.R. 2923 would make the IRS less user-friendly and more vulnerable to charges that the tax laws are not being administered fairly.

WINSTON & STRAWN

October 20, 1999
Page 3

Section 6110 is a tax rule disclosure regime with a demonstrated track record of success in protecting taxpayer privacy. No exception to Section 6110 should be made for the tax rules in APAs.

Sincerely,

Beryl Anthony Jr.

Beryl F. Anthony, Jr.

cc: Mark Prater, Chief Tax Counsel.
Tom Roesser, Tax Counsel
Members, Committee on Finance
The Honorable Bill Archer
The Honorable Charles Rangel

WINSTON & STRAWN

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Fax Cover Sheet

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FROM:	CHARLES L. KINNEY
DATE:	Monday, October 25, 1999 10:58:16 AM

CLIENT/MATTER: 103835.1

Please Deliver as Soon as Possible To:

RECIPIENT:	Eunice Lin Bumgardner, VP & GC
COMPANY:	Bureau of National Affairs, Inc.
FAX NO.:	973-3707
PHONE NO.:	

Total number of pages including this page: 05

COMMENTS:

Eunice and Eleanor: I do not believe I sent the attached list with copies of the letters to Senate Finance Committee members and respective staffs. With an addition this morning (Charles Lardner - Senate Judiciary), 60 letters have been forwarded by messenger. Letters to Senators were individually addressed. Four were signed by both John Napier and Beryl Anthony.

Linda, for Charles Kinney

IF YOU DO NOT RECEIVE ALL THE PAGES, PLEASE CALL OUR FAX OPERATOR AS SOON AS POSSIBLE.
THANK YOU.
202-216-8669

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and
The Honorable Charles Rangel
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Roth + Moynihan letters + cc's

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messengered 10/25 per request of E Smith

-23-

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THE BUREAU OF NATIONAL AFFAIRS, INC.

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May 12, 1999

Lindy Paull
Chief of Staff
Joint Committee on Taxation
1015 Longworth House Office Building
Washington, DC 20515

Re: Public Access to Tax Laws/Advance Pricing Agreements
Oppose Secret Law Amendment to Budget Reconciliation Bill

Dear Mr.Paull:

The Bureau of National Affairs, Inc. is involved in pending litigation against the Internal Revenue Service to obtain access to IRS tax rulings known as Advance Pricing Agreements. BNA v. IRS et al., C.A. Nos. 96-376, 96-2820 and 98-1473 (D.D.C.)(HHK)(JMF). BNA is writing you because we understand that certain tax practitioners have approached you seeking an amendment to the Internal Revenue Code to exempt APAs entirely from public disclosure. Their proposal to legislate secret tax law is unprecedented and unfounded, raises concerns of constitutional dimensions, and should be rejected.

The IRS has conceded that APAs are written determinations subject to public disclosure under Section 6110 of the Internal Revenue Code and is well into the process of redacting the APAs to ready them for public disclosure later this year. Congress enacted Section 6110 in response to court decisions ordering the disclosure of private letter rulings under the Freedom of Information Act. Congress specifically designed Section 6110 to protect individual taxpayer privacy while providing other taxpayers access to IRS tax rulings. Section 6110 is good tax policy, good government and should not be rendered meaningless by an amendment to the Internal Revenue Code that would allow a tax ruling signed by a taxpayer to be kept secret from other taxpayers.

BNA seeks redacted APAs only. BNA does not seek the identity of any taxpayer with an APA or the taxpayer's confidential business information. Section 6110 specifically protects such information from disclosure. APA background material is not at issue in the APA litigation. **BNA has not requested background material about any APA and does not intend**

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to do so. BNA seeks to make public the IRS rulings set forth in the APAs themselves, which information Section 6110 mandates the IRS to make available for public inspection.

Background

BNA is a leading publisher of print and electronic news and information. BNA reports on developments in business, labor relations, law, health care, economics, taxation, environmental protection, health and safety and other public and regulatory issues. Today, BNA produces more than 200 news and information services including five highly respected daily publications, one of which is Daily Tax Report. BNA is the parent company of Tax Management Inc., which publishes Transfer Pricing Report.

In 1996, BNA filed suit to require the IRS to make APAs available for public inspection. An APA is a prospective determination by the IRS approving a particular transfer pricing methodology for future transactions between a taxpayer's related companies. The methodologies in APAs apply to sales and purchases of goods and services for years for which no tax return has been filed with the IRS. The methodologies adopted by the IRS in APAs include methodologies that are not set forth in Treasury regulations.

APAs are the working law of the IRS on transfer pricing. This law should be publicly available and not the province of the elite tax bar. As discussed below, the IRS now acknowledges that the release of APAs will assist many taxpayers. Indeed, disclosure of redacted APA will avoid taxpayers learning for the first time of IRS-approved methodologies during IRS audits and examinations. In particular, the IRS has admitted that it uses methodologies and other key features of APAs in audits and examinations of taxpayers who are not parties to APAs, who lacked access to the APA methodologies, but who are in situations similar to taxpayers who are parties to APAs.

In January 1999, in response to BNA's Motion for Summary Judgment, the IRS conceded that APAs are written determinations subject to public disclosure pursuant to Section 6110. The IRS already has reviewed all existing APAs for information subject to exemption under Section 6110 and has provided proposed redacted APAs to the taxpayers for their review and input. The taxpayers are due to respond to the IRS by June 8, 1999. With respect to bilateral or multilateral APAs, the IRS intends to consult with the foreign countries involved with those APAs prior to their public disclosure, which the IRS has scheduled for October 1999. If Congress does not intervene, Section 6110's orderly process for redaction and release of rulings will continue to take place.

Reasons to oppose an amendment to exempt APAs from public inspection are as follows:

(1) **Congress should not interfere with pending litigation.** In Section 6110, Congress enacted a carefully balanced mini-FOIA specifically designed to protect taxpayer privacy

while making tax rules available to all taxpayers. The IRS is employing Section 6110 procedures to APAs in the BNA litigation to ensure that taxpayer privacy interests are fully protected. BNA has been litigating over access to APAs for three years and Congress should not intervene to change the law now that the IRS is redacting APAs for public disclosure.

(2) **The IRS has represented that disclosure of redacted APAs would benefit the taxpaying public.** The IRS, through Associate Chief Counsel (International), Michael Danilack, made clear in March of this year that it expects "that disclosure of APAs under section 6110 will end up helping many taxpayers, including those seeking an APA, to better understand their transfer pricing responsibilities . . . . As the [APA] program has developed over the past several years, the larger body of completed APAs increasingly reflects the Service's tried and proven approached to transfer pricing in a variety of circumstances. The release of redacted APAs will make this information generally available and should increase the public's confidence that the tax system operates fairly with respect to all taxpayers . . . Section 6110 of the Internal Revenue Code was written by Congress precisely to provide a mechanism for ensuring that this balancing is carried out properly . . . . "

(3) **Secret tax laws are inimical to our democracy**. As the IRS has conceded in Court, APAs contain IRS written determinations on U.S. tax law. APAs exist precisely because individual taxpayers want pre-approval from the IRS of particular transfer pricing methodologies. The methodologies approved by the IRS in APAs may differ from those published by the IRS in Treasury regulations. Unless redacted APAs are disclosed publicly, the unpublished methodologies in APAs are secret law -- private regulations for those who can buy them. The concerns about secret law extend beyond transfer pricing because the IRS has made public its intention to expand the APA program to domestic tax issues as well as other international tax issues

The secrecy surrounding the APA program has generated concern that certain taxpayers have obtained unduly favorable deals from the IRS and that the transfer pricing laws are otherwise not being applied in an evenhanded manner. There also is concern that the APA program unfairly favors a few tax practitioners who have private libraries of APAs unavailable to other tax practitioners and the tax paying public. These exact same concerns about due process and other constitutional rights led Congress to enact Section 6110 to require the IRS to make its rulings on tax laws available to the public.

(4) **The IRS' decision to disclose redacted APAs under Section 6110 has not undermined the APA program.** On January 11, 1999, the IRS announced its decision to disclose redacted APAs pursuant to Section 6110 and **the IRS itself reports that its decision to disclose APAs has had little impact on the APA program.** New applications for APAs are up slightly in the first quarter of 1999 over the first quarter of 1998 (11 new requests this quarter versus 10 new requests for the first quarter of last

year). The inventory of pending APA requests stands at 197 in March 1999 as compared with 154 at the end of March 1998. The IRS completed six agreements in the first quarter of 1999, which is four less than the first quarter of 1998, but that difference the IRS attributed to the now largely completed one-time task of redacting all 176 completed APAs for release under Section 6110. The APA program completes an average of 10 APAs per quarter.

Treasury Assistant Secretary for Tax Policy Donald C. Lubick testified before the Tax Executives Institute in March that "those who may be thinking [about] legislation to prohibit any disclosure of any contents even of the APA itself, may not be acting in the best long-term interests of the [APA] program . . . ." As underscored by the IRS in Mr. Danilack's statement, the APA program likely will be bolstered by making redacted APAs available to a wide range of taxpayers and tax practitioners.

(5) **Exemption of APAs from public access would render Section 6110 meaningless.** Section 6110 mandates public access to tax rulings and other written determinations. As with private letter rulings, the taxpayer negotiates an APA with the IRS. Like letter rulings, APAs issue only if the taxpayer agrees with the determination proposed by the IRS. APAs differ from letter rulings in that they are signed by the taxpayer. The select tax practitioners argue that this distinction in form, not substance, warrants exemption of APAs from public inspection. Section 6110's disclosure mandate, however, would be utterly meaningless if having the taxpayer sign the ruling could avoid Section 6110 disclosure.

(6) **The IRS has no express or implied agreement with taxpayers to keep APAs secret.** Taxpayers have always been on notice that APAs are written determinations. APAs were first called Advance Determination Rulings and the first one resulted from an "Advance Determination Request." The IRS published its guidance on APAs, Revenue Procedures 91-22 and 96-53, pursuant to regulations governing written determinations. These revenue procedures refer to information in APAs being exempt from disclosure as confidential business information, which would not have been necessary if APAs were entirely exempt under Section 6103. Moreover, the first model APA prepared by the IRS specifically provided for disclosure of the APA under Section 6110. In addition, we now know that actual APAs represent that disclosure of them may occur under Section 6110.

(7) **APAs are not binding contracts.** An APA is neither a closing agreement, nor a compromise settlement pursuant to 26 U.S.C. §§ 7121-22, as the IRS has admitted. An APA does not finally resolve a taxpayer's tax liability for any period of time. Instead, an APA is a non-final, revocable ruling, which is issued by the IRS in advance of planned transactions by a taxpayer, and which the IRS will not follow if the transactions that in fact occur differ meaningfully from those predicted.

In light of the above, BNA respectfully requests you to oppose an amendment to the Internal Revenue Code that would deny the taxpaying public access to IRS tax rulings contained in APAs. All taxpayers should have access to IRS tax rulings in APAs and the IRS has so agreed in its pending litigation with BNA. The IRS is redacting APAs for public disclosure pursuant to Section 6110 of the Internal Revenue Code and Congress should allow the judicial process to run its course.

We would be pleased to meet with you or your staff to discuss this matter. To arrange a meeting or to otherwise speak with us, please call me directly or contact BNA counsel, Eleanor Smith of Zuckerman, Spaeder, Goldstein Taylor & Kolker at 202-778-1800.

Cordially,

Paul N. Wojcik

cc: Eleanor H. Smith, Esq.

COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF REVENUE
STRAWBERRY SQUARE
HARRISBURG, PA. 17128-1100

THE SECRETARY

(717) 783-3680

September 30, 1999

OCT 08 1999

Ms Lindy Paull
Chief of Staff
Joint Committee on Taxation
Room 1015 LHOB
Washington, D C 20505

Dear Ms. Paull:

The Pennsylvania Department of Revenue has actively participated in the sharing of tax information with the Internal Revenue Service for many years. The information we receive from the IRS is a valuable tool for us to use to enhance taxpayer compliance and assist with our collection and enforcement efforts. We receive both individual and business tax data from the Service. We use the data to create statistical overviews, assist in audit selection, develop business tax models, generate income tax underpayment notices, determine PA tax non-filers, determine if proper taxes are being remitted, estimate revenues, identify correct addresses and reduce the number of state income tax notices we must issue.

Revenues generated from our matching programs with Internal Revenue Service tax information for both individuals and businesses are significant. The most profitable program is the CP-2000 matching effort, which produced collections of over $1,742,000 in 1999 using tax year 1995 information. During 1999 the individual Revenue Agent Reports resulted in collections of nearly $725,000 while the corporate RAR effort created tax assessments in excess of $1.5 million between March of 1998 and May of 1999. We also run a gain from the sale of home match, which produced collections in excess of $757,000 in 1999. These four programs brought in over $4.7 million, which could have only been generated from IRS tax information.

The Department treats the securing and safeguarding of Federal tax data to prevent unauthorized access or disclosure very seriously. All tax information is requested by our IRS liaison or obtained through our Implementation Agreement with the IRS. All information, whether in paper or magnetic media format, is tracked on a control log and secured from the time it is received until it is destroyed. Access is limited to those having a need for the data. Federal information on our computer system is protected and access is granted only to those having an authorized user-id and password. Also, the floors in our building where federal data is maintained are secured and access is obtained only by magnetic card.

Ms. Lindy Paull
Page Two
September 30, 1999

Additional steps have been taken to enhance employee awareness to secure confidential tax information. A copy of the Security Policy and Procedures for Employees of the Department of Revenue is distributed to all employees. In addition, an Agreement to Adhere to the Confidentiality Provisions of the Tax Laws of Pennsylvania and the United States is provided to each employee to sign annually. Periodic visits are made to those bureaus using IRS data to make sure it is being secured and being used for tax administration purposes. Periodic training is given to both current and newly hired employees emphasizing security and the penalties for unauthorized access or disclosure. Since the passing of the Taxpayer Browsing Protection Act over 350 employees have received UNAX training.

As part of our Implementation Agreement we also provide Pennsylvania Tax Information to the IRS. Types of information we provide include copies of audit reports and investigator reports, listings of fuel distributors and retailers, an annual list of federal non-filers, a listing of all estates over a certain parameter, criminal tax information, and individual requests for tax returns or tax information.

As can be seen, the current exchange of information program we have with the Internal Revenue Service is quite beneficial to both agencies. The continued receipt of Federal tax data will to provide us with this valuable tax compliance and collection tool.

If you have any questions or need additional information you may contact our IRS liaison Harry H. Wildasin at 717-705-0596.

Sincerely,

Robert A. Judge Sr.
Robert A. Judge Sr.
Secretary of Revenue

Cc: Harley Duncan, Federation of Tax Administrators

OCT 0 7 1999

COMMONWEALTH *of* VIRGINIA

Department of Taxation
September 29, 1999

Ms. Lindy Paull
Chief of Staff
Joint Committee on Taxation
Room 1015 LHOB
Washington, D. C. 20515

Dear Ms. Paull:

I am pleased to have the opportunity to offer to the Joint Committee on Taxation (JCT) information concerning the use of federal tax data by the Virginia Department of Taxation. As the JCT deliberates policy concerns surrounding the dissemination of federal tax information to state tax authorities, I hope and believe that the legitimate regard for taxpayer privacy can be satisfied without compromising the ability of state tax agencies to identify and collect the lawful revenue due the respective states.

Our use of federal tax information is extensive in scope and significant both in terms of revenue and in the general advancement of taxpayer compliance. In the immediate past two fiscal years alone, Virginia tax assessments **directly** attributable to the availability of federal tax information exceeded **$270 million** and involved more than 200,000 Virginia taxpayers. As I am certain the JCT recognizes, many of these assessments mark the beginning point for state tax compliance by the affected taxpayers, multiplying the potential revenue impact over many years.

We use federal data to administer a variety of state tax compliance programs. All of these programs, however, fall into one of four basic categories:

- Identification of any Virginia resident who files a federal tax return, but neglects to file a Virginia return for the same tax period.
- Identification of Virginia taxpayers who have omitted income reported by third parties from their federal and state returns.
- Assessment for state purposes of any Internal Revenue Service audit or examination changes which flow through to a state tax liability. (Virginia is a federal tax conformity state.)
- Correction of taxpayer reporting discrepancies revealed by comparisons of federal returns with state returns.

We constantly strive to achieve the highest performance possible with respect to the safeguarding of taxpayer confidentiality. We do this in part because of legal requirements, but more importantly we do it because we recognize that confidentiality is an indispensable component of any voluntary tax system. Most of our federally based programs operate in a highly automated, extremely secure environment. Access to federal data is rigidly controlled through the use of password protected and auditable computer systems, adherence to strict procedures governing the handling, storage, and transmittal of confidential tax data, and regular reviews for employee compliance with our standards concerning confidentiality. Periodic audits by the Internal Revenue Service consistently have verified our success in this area.

With passage of the Taxpayer Browsing Protection Act, we have taken additional steps to prevent and detect unauthorized access to both federal and state taxpayer information. The 1999 Virginia General Assembly provided resources for this specific purpose. We are in the process now of hiring additional personnel who will be tasked with developing the capability to detect or block employee access to our computer systems for nonbusiness reasons, training employees in how to improve the protection of confidential information, and increasing employee awareness of the consequences of violating taxpayer confidentiality.

I hope the foregoing makes clear the importance we place on having access to federal tax information and the seriousness with which we approach our responsibilities regarding the use of it. These programs are key components of our effort to provide the most level playing field we can for Virginia taxpayers, and alternative sources for the same information simply do not exist for the most part. I believe that any legislative or regulatory attempt by Virginia to acquire this information independently would inevitably prove to be more costly, more intrusive and burdensome for taxpayers, and far less effective than is the case with the present system.

Thank you for the opportunity to share my thoughts and concerns on this important subject. If any of the areas I have touched on need clarification, please contact me at your convenience.

Sincerely,

Danny M. Payne
Tax Commissioner

c: Mr. Harley T. Duncan
Executive Director
Federation of Tax Administrators

SEP 0 8 1999

September 2, 1999

Mr. Lindy Paull
Chief of Staff
Joint Committee on Taxation
Room 1015, LHOB
Washington, D.C. 20515

Dear Mr. Paull,

SUBJECT: TAXPAYER CONFIDENTIALITY STUDY

Having seen your request for input on the taxpayer confidentiality study, I am offering brief input (enclosed) from the context of my 27 years experience at the IRS. If there is a need to discuss this material, I may be reached at 516-249-5041 (home) or 212-298-2011 (work).

Sincerely,

George Deller
Regional Taxpayer Advocate
Internal Revenue Service

gld

cc: National Taxpayer Advocate

-34-

COMMENTS FOR JOINT COMMITTEE ON TAXATION
TAXPAYER CONFIDENTIALITY STUDY
SECTION 3802/RRA98

SECTION 6103(k), Disclosure of Certain Returns and Return Information for Tax Administration Purposes

(3) **Disclosure of Return Information to correct Misstatements of Fact.** The Secretary may, **but only following approval by the Joint Committee on Taxation**, disclose such return information or any other information with respect to any specific taxpayer to the extent necessary for tax administration purposes to correct a misstatement of fact published or disclosed with respect to such taxpayer's return....

I have worked at the IRS for over 27 years and have seen several instances where "misstatements of fact" were published regarding taxpayer returns. I have never seen an instance where the Secretary of the Treasury or the Commissioner of Internal Revenue actually obtained the authority to "correct the misstatement of fact" and exercised this authority.

A few months ago I asked a usually reliable source in IRS National Office whether the Treasury/IRS had ever actually sought this authority. The response received was that the authority had only been sought twice ever. Further, the response indicated that in neither case had a response been received from the Joint Committee on Taxation. **If this indeed true,** it is a sad commentary regarding the Treasury/IRS efforts at "setting the record straight". It is also a sad commentary regarding the responsiveness of the Joint Committee on Taxation.

Proposals

1) If the above information is incorrect, please advise me and educate other Service employees regarding any instances where the authority to disclose was sought and approved.
2) If the above information is substantially correct, please modify IRC 6103(k)(3) to eliminate the need for the Secretary to obtain the approval of the Joint Committee (this provision is unworkable). Instead, replace this text with a requirement that the Commissioner of Internal Revenue Service obtain the approval of the independent National Taxpayer Advocate to make such disclosure.

ISSUE- CAN A GREATER LEVEL OF VOLUNTARY COMPLIANCE BE ACHIEVED BY ALLOWING THE PUBLIC TO KNOW WHO IS LEGALLY REQUIRED TO FILE TAX RETURNS BUT DOES NOT DO SO?

Answer: **OF COURSE!** The complicating factors, however, are that the above proposal does not go nearly far enough and that the effective administration of such a provision would be a nightmare.

DISCUSSION

1) **The Proposal Does Not Go Nearly Far Enough.** There are three major aspects to voluntary compliance with the Tax Code. First, as you have identified are those people and businesses that **REPEATEDLY** do not file tax returns. Second, there are those people and businesses that **REPEATEDLY** file tax returns showing **ZERO** tax. Third, there are those people and businesses that file tax returns but **REPEATEDLY** ignore any responsibility to actually pay tax.

Any credible proposal to increase compliance through disclosure of non-compliance must address all three aspects of non-compliance.

2) **Effective Administration of Disclosures Would be a Nightmare.** Since one-time non-compliance is often the result of a special event, such as illness, the focus of a disclosure provision should be limited to **REPEATED** non-compliance. Since *GOOD FAITH* errors on the part of the government would

undoubtedly occur, individual recourse for such errors should be limited to a public acknowledgement of the error by the government and any legitimate costs encountered by a taxpayer to set their record straight. Any legislation should require the Treasury to issue regulations governing the parameters of disclosure for repeated failure to file, repeated, self-proclaimed ZERO tax liability and repeated failure to pay bona fide taxes.

OCT 0 1 1999

September 30, 1999

Gentleman/Ladies:

I am writing to you in support of legislation to protect taxpayers who disclose confidential information to the Internal Revenue Service. I am a Board Certified Specialist in Taxation, and am admitted to practice in Louisiana and Texas.

I recently was involved in a situation in which my client provided certain information to the Internal Revenue Service on a highly confidential basis. The information was supplied because of a concern on the part of my client that a possible misappropriation of funds had occurred. My client sought to have the Internal Revenue Service examine books and records with the purpose of determining whether or not revenues had been misappropriated. I wish to emphasize that the contact with the Internal Revenue Service by my client was not undertaken to retaliate against the individual involved. (It also should be noted that eventually it was determined, through other means, that no such diversion of funds had occurred).

My client eventually was contacted by a representative of the Criminal Division of the Internal Revenue Service. My client responded, in writing, to requests from the Criminal Division for detailed responses to certain information requests. Ultimately, there were a number of written and telephone communications from my client to the Internal Revenue Service and its Criminal Division.

My client, at the time, also was involved in civil litigation with the spouse of the person whose activity was being questioned by my client in the course of his contacts with the Internal Revenue Service. Sometime prior to trial, someone within the Internal Revenue Service voluntarily disclosed the existence of these communications to both the individual whose activity was being questioned and to her spouse. The individual who made this disclosure also went to be exceptional length of providing a photo copy of a letter written by my client to the Criminal Division of the Internal Revenue Service. The individual within the Internal Revenue Service who did this went to the further exceptional step of providing the original post mark from the envelope in which my client's confidential letter had been mailed to the Internal Revenue Service. This was done with the singular purpose of providing assistance to the other party in the civil litigation. The materials were mailed (anonymously) in a plain brown envelope.

The effect of this disclosure was to prompt opposing counsel, and the trial judge, to brand my client as a "snitch" in the course of the trial proceedings. Furthermore, this disclosure led to a separate lawsuit against my client, which cost my client many thousands of dollars to defend and resolve.

We did consider filing a lawsuit against the Internal Revenue Service. However, in filing a lawsuit, my client would have been required to disclose, in a public proceeding, a number of other confidential communications with the Internal Revenue Service. In essence, my client was left with the disclosure of other confidential communications with the Internal Revenue Service as a condition to pursuing his lawsuit. The very real fear on the part my client was that these additional disclosures, and the pursuit of this claim in a public forum, would invite further litigation against him from the parties involved. It also would expose him to possible ridicule and loss of employment. Accordingly, despite having a very good case, with an outrageous course of conduct by the Internal Revenue Service, my client chose not to pursue any lawsuit.

In order to remedy this circumstance, and protect others who may encounter similar circumstances, I would propose legislation which would incorporate the following provisions:

1. Individuals who disclose confidential information to the Internal Revenue Service in the course of aiding or assisting the Internal Revenue Service in the course of an investigation statutorily would be guranteed absolute confidentiality. Any violation with subject the offending employee of the Internal Revenue Service to felony prosecution and punishment.

2. Individuals whose confidential communications were disclosed by the Internal Revenue Service in violation of the statute, would have a private right of action against the Internal Revenue Service and the offending employee. If successful, the individual would be entitled to actual damages, attorney fees, and punitive damages.

3. The individual would be permitted to have the proceedings kept under seal, so that no public disclosure of the proceeding would be made. (Under present law, an individual who attempts to redress wrongful disclosures is placed in the position of having to make a public disclosure of the confidential information and his actions if he is to pursue his claim. This establishes a severe disincentive to the pursuit of any such action. Ultimately, it protects the wrongdoer because it deters individuals from pursuing legitimate claims against an offending party or the Internal Revenue Service.)

4. The statute of limitations for pursuing such claims should be five years. Moreover, in our case, I would ask that any remedial legislation allow the filing of a lawsuit if the wrongful disclosure occurred within five years of the date on which the House Ways and Means Committee first begins consideration of this proposed legislation.

As a tax attorney, I have dealt with representatives of the Internal Revenue Service on many occasions. These representatives typically are professional and courteous. However, in this one particular instance, the conduct of one individual (whose identity never was determined) was truly outrageous. Moreover, that individual sought to use his or her access to confidential government files to directly and illegally assist a private litigant in civil proceedings before a state trial court. This conduct needs to be firmly deterred. Individuals who are injured by such conduct should be to be given the opportunity to recover damages from the Internal Revenue Service in a fair and confidential proceeding. Only through such a proceeding can future illegal disclosures and conduct be deterred.

Your consideration of these issues, and of necessary remedial legislation is both timely and necessary. I thank you, in advance, for your attention and efforts in this area.

Sincerely,

William W. Edelman

WWE/jwm

FEDERATION OF TAX ADMINISTRATORS

444 North Capitol St., NW, Washington, D.C. 20001 • (202) 624-5890

September 24, 1999

SEP 24 1999

Ms. Lindy Paull
Chief of Staff
Joint Committee on Taxation
Room 1015 LHOB
Washington, D.C. 20515

Dear Ms. Paull:

This letter responds to your request for comments on third-party use of federal tax return information protected under § 6103 of the Internal Revenue Code. The Federation represents the tax administration agencies in the 50 states, Washington D. C. and New York City.

We are writing specifically about the return information used by these agencies for tax administration purposes. We will address need for "third parties" such as state tax agencies to use tax return information and the adequacy of present-law protections governing taxpayer privacy. You are also likely to receive comments from individual state tax administration agencies that will share more detailed explanations of how they use the federal tax return information.

The need for state tax agencies to use federal tax return information
In addressing the need for use of federal return information, we will discuss several issues: (1) current uses of information; (2) use of return information by non-income tax states and for non-income tax purposes; (3) reciprocal sharing of otherwise confidential information with the Internal Revenue Service for federal tax administration purposes; and (4) alternatives to the use of federal return information.

General comments. To varying but substantial degrees, states base their individual tax systems on the federal system.[1] Even those states that have chosen to not piggyback their tax bases on the federal model do, nonetheless, conform various components of the tax closely to the federal model. States have chosen this approach on the basis of efficiency, good public policy and simplification of the tax administration process for individual taxpayers, employers, payers, and tax administration agencies themselves.

[1] At the present time, 37 of the 42 states with a broad-based income tax conform to a "federal starting point," i.e., they begin the calculation of state income tax liability with a federal figure. Twenty-six states begin with Adjusted Gross Income, 8 states with federal taxable income, and 3 states base state tax liability on federal tax liability.

One consequence of this federal-state conformity is that states can and do rely on substantial parts of the federal tax administration and enforcement process, including the information obtained in that process, in the administration of their own tax. The use of federal tax return information is the cornerstone of state income tax compliance and administration efforts. The use of federal return information and the results of federal compliance activities allow states to avoid inefficient and duplicative examination and enforcement activities.[2] Moreover, conforming to federal provisions and the use of federal return information enables states to avoid imposing duplicative, and likely differing, information reporting and tax filing obligations on taxpayers, employers and other paying agents. It also enables states and the federal government to cooperate in providing many services to taxpayers.

Specific data used. I.R.C. 6103(d) provides that the Internal Revenue Service (IRS) may exchange any federal return information with a state tax administration agency for "tax administration purposes" provided that certain safeguards are met (see later discussion). Under the requirements of §6103, IRS provides an annual spreadsheet that shows exactly which extracts[3] are provided to which agencies each year, so we have not repeated that information in this letter.

Of the various extracts, four are of primary importance from a compliance or enforcement standpoint: (1) federal data from individual returns, primarily shared through the Individual Master File (IMF) (data reported on returns), and the Individual Return Transaction File (IRTF), schedules and attachments that are filed with returns; (2) the Individual Return Master File (IRMF) (data reported by certain third parties – 1099 filers), (3) federal adjustments made by matching return amounts to amounts reported by third party payers (known as the "CP 2000" data extract); and (4) Revenue Agent Reports (RARs) that transmit the results of IRS field exams.

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[2] State tax rates, on average, are about 1/4 the level of federal rates. Thus, deploying a force of field examiners to deal only with state individual income tax issues is not an efficient deployment of resources. Using federal return information enables states to achieve certain compliance levels in an efficient manner.

[3] Including the Individual Master File (IMF), which contains basic personal income tax return information; the Individual Returns Transaction File (IRTF), which contains detailed line-by-line personal income tax information; the Business Return Master File (BRMF), and the Business Return Transaction File (BRTF), the same as the IMF only for corporations, partnerships, sole proprietors with employees; the CP 2000 (IRS Underreporter Program), a comparison of information reported by the taxpayer on Form 1040 and the Information Returns provided by payers – changes made by IRS on the federal return based on the third-party report are provided to the states; the Information Returns Master File (IRMF), a database of IRS third-party information returns (e.g. 1099's, W-2s, K-1s), Revenue Agent Reports, known as the RARs, which transmit the results of IRS field exams; the Audit Information Management System (AIMS), federal audit adjustment results, and LAND (Appeals Information Management System), which is the appellate level results of federal audit adjustments; the Taxpayer Address Request (TAR), the most current mailing address of taxpayers who have filed returns with IRS; the Levy Extract, both payer and payee information taken from W-2s, K-1s, the 1099 INT, DIV and MISC, and Form 5498, supplying potential sources of levies; the State Tax Model, a weighted model of the taxpayer population of a given state using live tax data; the Exempt Organization Master File (EOMF), listing organizations that have IRS tax exempt status; and Non-Itemizer, listing taxpayers who did not itemize on their federal returns.

From these extracts, state tax administration agencies operate two types of enforcement programs. First, through using the RARs and the CP 2000 reports, states can make direct adjustments to a state tax return. That is, if a federal adjustment affects an item of income or expense that will also have state tax consequences, the state tax administration agency can proceed (after verifying the information to the state return) directly to a corresponding state adjustment, presuming the taxpayer voluntarily filed an amended state return. Second, states use the data contained in the IRMF and IRTF (and similar business taxpayer extracts) to match to their own income tax files and to develop independent programs to identify non-filers and persons under-reporting items of income or overstating items of expense.

It is not possible to provide a state-by-state listing of the state revenue consequences of using federal tax return information for enforcement purposes. Over time, we have found that state agencies do not always separately capture data about the portion of compliance programs that directly relates only to the use of federal data, even where that can be identified, which is not always possible.

However, we have attached (Attachment A) data collected in 1996 that gives values from specific state compliance programs that can be considered illustrative of the value of the federal tax data to state tax agencies. Not reflected on the attached chart are revenues that would result from a voluntary amendment of a state tax return by taxpayers subject to a federal adjustment, which likely amounts to hundreds of millions of dollars annually. Additionally, we asked states to share with us the ways in which they receive indirect benefits (less easily measured) from the IRS data. An illustrative sampling of responses also is attached (Attachment B).

There are three components to calculating the revenue value of a compliance program that is based on federal data. First, there is the obvious – though sometimes difficult to calculate – value of the revenue that is captured because of the program. Second, and perhaps more significant, is the value of resources that the state is *not* expending on its own compliance program. Finally, there is the incalculable value of the data to *voluntary compliance*, which is the ultimate goal of any enforced compliance program. Even if a compliance program brings in zero new revenues, it serves a critical purpose by providing requisite compliance or audit "coverage." Coverage is the foundation for voluntary compliance – taxpayers voluntarily comply best when they recognize the high risk of noncompliance.

Non-enforcement uses. Federal return information is also used by states to reduce the burden imposed on the taxpayer in dealing with federal and state tax administration agencies and to provider better taxpayer service.

One of the most commonly used extracts is the Taxpayer Address Request (TAR) file used for numerous purposes by most states, always with the intention of getting necessary information to the taxpayer at his or her most recently reported and most accurate address. For example, Michigan recently checked compliance with a new state tax deduction and initially identified 70,000 returns as potentially ineligible. After asking

IRS to verify those taxpayers' federal income tax filing addresses, the state narrowed its list of ineligible filers to only 11,000 – sparing 59,000 taxpayers from having to receive a verification request from the state.

Most states are able to greatly reduce the number of 1099G information returns it sends taxpayers by using the Non-Itemizer extract (because non-itemizers have not deducted state tax payments and thus don't need a report of the amount of those payments). States that receive federal data in many cases no longer require taxpayers to file separate or equivalent Schedule A or Schedule B forms.

Federal return information is also an important element in the development of tax models used for revenue estimating and legislative and tax policy research, for both income-tax and non-income-tax states alike. Because of the conformity to federal tax provisions, states do not generally capture information about specific types of income and expense (i.e., they use a federal starting point). Thus, federal data on such elements for returns filed in a particular state is critical to the development of state-level analytic models. A number of states use the data for compliance-related research such as performing market segmentation analysis, Tax Gap analysis, and other studies.

Cooperative programs. The ability to exchange information under §6103 is also critical if state tax agencies and the Internal Revenue Service are to be able to undertake any joint administrative activities such as examination, collection or specific taxpayer service. Under current interpretations of §6103, it is considered a disclosure (and thus subject to exchange provisions) if a state tax agency employee reviews federal return information in the performance of any joint administration activity (even if it is in the taxpayer's presence with the taxpayer's permission).

For example, if a taxpayer is trying to set up an installment agreement with both the federal and a state government, the taxpayer clearly benefits if the two collection agents are able to work cooperatively together rather than requiring the taxpayer to negotiate separately with each agent. Under §6103, this requires a state official to review federal taxpayer data. It may not be commonly considered a "use" of federal data in everyday terms, but anytime a state official sees or is privy to any taxpayer data after it has been accepted by the IRS, it falls under the protection of §6103. We have no quarrel with this definition, but merely wish to illustrate that state tax agencies "use" data in ways that go beyond ordinary boundaries.

Oklahoma most recently used IRS transcript data in joint outreach programs helping victims of the May tornadoes prepare amended, as well as complicated original, returns reflecting the casualty loss provisions available in Presidential Disaster Areas.

Use of federal income data by non-income-tax states. Nine states do not have a broad-based individual income tax that is similar to the federal individual income tax: Florida, Texas, Alaska, Nevada, South Dakota, Washington, Wyoming, Tennessee, and New Hampshire. Most of these states do, however, carry on active exchange of information programs with the Internal Revenue Service. The types of exchange programs include:

- Exchange of information for enforcement of a non-income tax, e.g., exchange of motor fuel tax information to enforce motor fuel taxes and business income taxes in Florida, New Hampshire and South Dakota;
- Exchange of income tax information to enforce a related state tax, e.g., the intangible profits tax in Florida, the interest and dividends taxes in Tennessee and New Hampshire;
- Exchange of general information for enforcement and administration purposes, e.g., taxpayer address verification, levy source extracts, etc.; and
- Exchanges of information to compare similar items of income and expense that a taxpayer might report for two different taxes, e.g., gross receipts for income and sales tax purposes. [Note that the most common request is by IRS to compare gross receipts reported to the states for sales tax purposes to the same amounts reported on federal income tax returns.]

Importantly, exchanges with non-income tax states (or with any state for non-income tax purposes) must be for tax administration purposes and are governed by the same safeguard and disclosure requirements imposed on third-party uses of income tax return information. This serves to substantially and adequately protect taxpayer privacy in our estimation.

Reciprocity. The exchange of tax return information between state and federal tax administration agencies is not a one-way street. States also provide a wide range of confidential tax return information to the Internal Revenue Service for tax administration and enforcement purposes. The exchanges are of two types: (1) continuous, e.g., all state audit adjustments that meet certain criteria and lists of all licensed or registered taxpayers for motor fuel or sales tax purposes; or (2) ad hoc in response to individual requests for information about particular taxpayers or types of taxpayers. In the "ad hoc" area, the IRS makes extensive use of state sales tax information about particular taxpayers (to compare to income tax reported amounts) and about types of businesses as part of their compliance research and analysis function. Again, all such exchanges are undertaken pursuant to state law and an exchange agreement between the state and the Service.

Alternatives to using federal data. If states were not able to use federal return information, they could (and probably would) attempt to obtain as much of the data as possible directly from taxpayers and third party payers. It would be possible for state tax agencies to require many taxpayers and third-party payers (e.g., employers and others) to file the wage, tax and income reports now required by the IRS directly with the state tax administration agency under requirements imposed by the state tax administration agency. This alternative, however, would undoubtedly impose considerable additional costs on employers and other payers who would be required to file a larger number of reports, probably with differing formats and data requirements than is the case at the present time. In addition, states would be faced with greater costs than at present because they would be required to transcribe, process, and verify all the information to make it useable.

Moreover, it is likely that states could not require all payers to report information on amounts paid to all taxpayers to the state tax administration agency. Current law standards for the jurisdictional reach of states may well prevent them from requiring a payer whose only contact with the state was making payments to a resident of the state to report such payments to the state. Likewise, the ability (practical and legal) of a state to require payers and employers to report payments to nonresidents of a state who may have an income tax obligation to it is questionable.

Adequacy of present-law protections

The exchange of information between state tax administration agencies and the IRS is governed by I.R.C. §6103 (d) and related sections. Those laws provide for substantial safeguards and security of the taxpayer information to prevent unauthorized disclosures or re-disclosures. Those safeguards are spelled out in detail in IRS Publication 1075, Tax Information Security Guidelines for State, Local and Federal Agencies. Generally speaking, those safeguards include the following types of measures:

- The exchange of information may be only for tax administration purposes.
- All exchanges must be pursuant to a written exchange of information agreement.
- Each exchange is subject to an "need and use" review to assure that the information is actually needed, that it is for tax administration purposes and that it will actually be used (and not just warehoused for possible future use).
- Standards for the physical security and safeguarding of the federal return information as well as the segregation of such information from non-federal information are established. State tax agencies must develop and maintain plans outlining their approach to meeting the guidelines. IRS personnel make periodic site visits and evaluation of the security arrangements.
- Similar standards are established for the safeguarding of information stored on or used in computer systems and facilities.
- Improper security and safeguard procedures can lead to sanctions by the IRS, including loss of the ability to exchange information.
- Civil and criminal penalties are provided for improper disclosure of federal return information.
- Federal return information obtained by a state tax administration may not be re-disclosed to another entity, including another state tax administration entity with whom IRS may have an exchange agreement.
- States have their own confidentiality and privacy laws concerning taxpayer information that are very similar in intent and scope to the federal laws.

Protection from "browsing"
While the general points made regarding the safeguarding of federal tax return information also apply to compliance with the Taxpayer Browsing Protection Act of 1997, it deserves a brief separate discussion. It is a new law, and it represents a heightened federal sensitivity to the meaning of taxpayer privacy. Now it is clear that Congress intends taxpayers' private data to not only remain confined within the walls of an agency, but that no individual employees without a defensible, neutral business reason should ever view the data.

FTA has worked closely with the IRS beginning prior to enactment of this law to communicate its intent and its requirements to the state tax agencies. Volunteer states worked with IRS representatives to identify the practical, day-to-day implications of the law and share the results of their thinking with all states. (Among other things, FTA provided states with a copy of the IRS employee statement that is signed annually, to serve as a model for state versions.) IRS disclosure officers work with their assigned states to assure understanding of the law. Finally, FTA wrote, and IRS produced, a training video that has been distributed to all states.

Conclusion
We would summarize our comments simply by saying that state tax agencies currently make extensive use of federal tax return information for a wide variety of tax administration purposes, including taxpayer service, enforcement and compliance and research and analysis. The current system of information exchange provides benefits not only to state tax agencies but also to taxpayers and to the federal government. The attached material from the states amply demonstrates these points.

Most importantly, for the purposes at hand, this vital exchange program operates in a fashion that does not unduly compromise taxpayer privacy or confidentiality. The safeguards and procedures currently in place insure that information is exchanged only for authorized uses and that it is properly secured and safeguarded when it is exchanged.

We hope you find this information helpful. Please feel free to contact me if you have questions or comments.

Sincerely,

Harley T. Duncan
Executive Director

Attachment A
Illustrative Examples of Amounts Assessed Using Federal Tax Return Information

Dollars were assumed to be assessments unless otherwise specified. Because dollars assessed in one year may be collected in a following year, dollars collected may exceed dollars assessed in any one-year period.

	1993		1994		1995		Comments and clarifications
	Assessed	Collected	Assessed	Collected	Assessed	Collected	
Arkansas							
Nonfilers	11,702,304		13,462,500		18,524,283		
CA FTB							
Underreport	121,158,098		157,495,230		125,402,525		
Colorado							
Underreport	2,935,519	1,570,739	3,138,727	2,505,687	1,337,516	1,226,225	
CP2000	1,984,505	994,314	1,203,399	2,127,227	7,735,541	2,592,087	
Georgia							
Nonfilers	12,006,556		13,710,187		20,448,441		Income tax division;
					10,297,880	417,117	Central Audit Division
Underreport	375,412		7,866,550		4,181,782		Income Tax Division;
	11,318,664	1,768,561	6,101,235	1,546,394	5,029,960	2,834,062	Central Audit Division
Indiana							
Underreport	2,309,582		1,652,314		786,731		Assessments; Average 85% to 90% of dollars assessed
Delinquent collections (discrepancy assessments)	--		1,638,954		2,293,592		Average 85/90% of dollars assessed
Individ. federal audits	2,288,014		1,934,181		1,691,242		
Iowa							
Nonfilers	943,238	953,223	1,374,751	960,318	473,843	774,743	Assessments for 96 jumped to $2.5 million, with $859,000 already collected
Underreport	2,834,042	1,529,447	1,307,759	1,270,722	3,206,434	1,677,032	$2,818,521 already collected in

							1996
Louisiana							
Nonfilers	7,023,700		8,046,200		10,644,600		Years are 94, 95, 96
Underreport	3,253,900		2,850,500		3,060,700		
Maryland[1]							
Underreport	5,857,645		6,838,802		8,971,079		
Michigan							
Nonfilers	7,100,310		36,988,174		47,462,809		
Underreport	13,760,413		11,944,730		8,000,578		
Minnesota							
Office exams	6,500,000		4,900,000		9,100,000		
Nonfiler	7,300,000		7,500,000		9,500,000		
Montana							
Nonfiler	3,829,337		3,659,088		6,257,150		
Underreport	638,820		384,544		660,846		
New Jersey							
Nonfilers	3,161,730	1,522,174	609,091	517,199	344,473	363,574[2]	.
Underreport	3,142,222	1,584,667	5,776,482	2,185,191	9,052,463	5,387,909	Federal Audit Project
Other					5,100,000		
N. H.							
Nonfiler	1,000,000		1,250,000		1,000,000		
Underreport	3,291,000		2,048,000		2,079,000		

[1] Maryland's 1993 installation of new consolidated tax processing system delayed implementation of certain matching programs; most of revenues collected from CP 2000 occurred in 1995 and 1996 though amounts shown here are representative. A shortage of data from other activities should not be assumed to reflect a lack of activity in those areas.

[2] This Delinquency Project was phased out from an Income Tax Audit Branch activity and is now administered by Compliance

FTA survey
September 1996

New York							
Extracts					119,330,000		
Accounts Receivable Collections [3]					24,040,000		75 percent of dollars assessed are collected in the first two years (from the extract program)
New Mexico							
Non & under	2,035,453		1,706,979		2,265,779		
ND							
Nonfilers	226,971		195,975		180,765		
Underreport	677,039		418,667		589,934		
PA							
Nonfiler IMF	708,004	458,312	688,181	375,453	1,892,684	1,129,603	
SC							
IMF	2,092,232		1,875,392		758,137		
IRTF	203,328		1,222,158		3,196,535		
Utah							
Nonfilers	7,375,827[4]		3,996,819		8,040,601		
Underreporter	4,623,170		4,266,926		6,070,624		
Wisconsin							
Individual[5]	7,579,112		5,312,391		3,701,343		
Corporate [6]	2,255,536		2,280,704		5,899,512		

Data supplied to Federation of Tax Administrators by state tax administration agencies.

[3] The revenue collected from individuals and businesses who file amended returns as a result of federal changes/audit activity

[4] 93 reflects an average to modify the effects of a unique non-filer audit program

[5] Numbers represent totals from all individual income tax projects, both initial and delinquent collections

[6] Corporate franchise/income tax projects

FTA survey
September 1996

Attachment B
Indirect Benefits Related to the Extract Program

Alabama	In the process of developing new compliance programs based upon the IRMF, and hope to generate significant revenues. TAR extract: Very valuable in that it enables us to locate taxpayers to secure delinquent returns, etc.
CA FTB	Indirect benefits from the nonfiler program include the correction of 20,000 addresses by using the TAR extract as an address source. We also have obtained SSN verification from the extracts, allowing for better decision-making by staff working on filling enforcement accounts. Also, the Compliance Development Bureau realizes many indirect benefits by making extensive use of the extracts to conduct broad and extensive market segmentation analyses. They also use the extracts to perform Tax Gap analyses, and for studies relating to taxpayer characteristics and for determining the proper universe to analyze.
Florida	(While Florida has no individual income tax), Florida has benefited from the Tape Exchange Program for many years, particularly in the administration of the annual Intangible Personal Property Tax and our Corporate Income Tax. The value of the federal tape data to Florida is apparent from the data matching abilities demonstrated by them (see attached detail). Florida routinely accesses federal tape data for a number of important tasks, ranging from identification of new accounts for mailing tax returns to audit case selection. The federal data is a unique and valuable source that we think is critical for Florida to succeed in our search for ways to leverage our resources.
Hawaii	Statistical data is used in revenue estimating and projections as to tax yields, tax impacts, and economic conditions affecting the State. Also, Hawaii has instituted a single page individual income tax return as of the 1995 tax year that begins with the federal adjusted gross income. The IRS extracts will be relied on heavily to provide all tax return information that is lacking on the Hawaii return.
Iowa	The IMF tape is used to select specific data fields to assist with the gathering of information for various selective and/or nonfiler audit programs. For example, we often use the IMF tape to identify address information and select AGI amounts in the administration of nonfiler audit programs. Data extracted from the IMF tape is also used to supplement state data in the process of verification of names and addresses in selective audit programs. In addition, IMF

information is used to assist in the completion of analysis of impact of federal/state tax policy issues.

Iowa also has developed an automated billing system using the CP 2000 federal tape. This automation has saved staff time throughout the agency, including support staff, examination, records, and account receivable personnel. It has reduced the billing cycle turnaround time, which also indirectly decreases follow-up telephone calls and correspondence that affects examination and taxpayer service staff. Decreased turnaround time for issuing billings is also considered a customer service improvement.

Missouri The Taxpayer Address Request tapes are used to locate delinquent taxpayers.

Michigan We recognize that compliance improves overall when a quarter of a million people are contacted in three years, through the tax preparation community that serves these people. Tax preparers learn from our projects and are more likely to better serve and advise their entire client population on tax issues.

We also use the non-public use file for identifying the effects of proposed state or federal legislation on Michigan revenues. Loss of this information would affect our ability to accurately forecast revenue changes.

There is one additional revenue-saving program which is not included in the table. In December 1993, the Michigan legislature passed a school reform package. Part of the package included an education tax of 24 mills on residential and commercial property. Homeowners were given an 18 mill exemption on their homestead provided they owned and occupied the homestead as their legal principal residence. The exemption was declared by filling a T-1056 Affidavit for Homestead Exemption with the city where the property was located; the Department of Treasury then processed the affidavits. We matched them against our current year income tax file to verify that the individuals claiming an exemption were Michigan residents. We identified a discrepancy of 70,000 affidavit filers. The discrepancy may have been due to processing errors or to tax evasion by nonresidents. We asked the IRS to verify those taxpayers' federal income tax filing address, and identified 11,000 as filing from other than a Michigan address. Approximately 50 percent of those ultimately had their exemption affidavits denied. Intangible Personal Property Tax and our Corporate Income Tax.

Minnesota	**Collections Division** - Federal information is used for many purposes to resolve accounts. It is used for direct enforcement, evaluating ability to pay, location of debtors, and negotiation of pay plans. All of these result in collections, both voluntary and enforcement. The information is valuable and it contributes to the resolutions of many cases. **Information systems** - Six years of Form 1040 and related schedule information is loaded into an information retrieval system known as TRIPOD (Tax /Return Information Put On Display) in addition to state return information. **Research** - A database was created which includes property tax information by county and federal IMF-IRTF income data matching to property tax data by county. This database is used as a statistical reference for various legislative studies. Federal income information is used for the state's Tax Incidence Study, which measures the tax burden for various tax types. **Business extracts**: BMF/BRTF tape extracts are entered into a desktop database which summarizes 1065 and 1120S data fields. Information is also entered from paper Form K-1s into a separate desktop system which includes 1065, 1120S and 1041 K-1 schedules. These systems are used for audit selection and nonfiler discovery. Employees verify income and expense items from the federal corporate income tax return and would utilize the BMF/BRTF as part of that initiative program. The **Withholding Division** uses data items to identify nonfilers. Exempt organization information is extracted from the BMF to identify nonfilers with unrelated business income (IRC sections 511 to 515). An annual EIN database extracted from the BMF is created for the Processing Division to support the identification of filing entities. Finally, the IMF/IRTF is used to identify nonfiling health service providers for the Licensed Health Care Provider Gross Receipts Tax.
New Jersey	A new individual income tax delinquency program looking at 1992 tax year has identified 5,100 nonfilers whose accounts average $1,000 each in collections One of the most invaluable resources that this Division has access to is the Mag Tape Exchange Program. The tapes we receive from IRS are primarily used in the areas of compliance and audit. Measuring the indirect benefits is difficult to assess in monetary terms. However, we do know that without this source of information, data bases would have to be created for mailing of Form 1040 (more than 4 million returns filed annually), for Form 1065 (partnership returns) and Form 1099G. Also, other sources would have to be developed to identify nonfilers since we now can identify individuals who file with the IRS and not with this Division. More importantly, resources

which we are now allocating to other areas do not have to be utilized to develop tape programs that are available at a very little cost to this Division.

One example of the indirect benefits derived is the use of these tapes by our Office of Tax Analysis, which conducts research on a broad range of tax policy and tax administration issues and is responsible for providing revenue projections for use in the State Budget. The IMF/IRTF tapes are used as a data source to supplement our sample of individual NJ Gross Income Tax files, and it provides key data fields that we do not have or do not currently enter from the NJ 1040 form. We recently completed one project to examine the feasibility of piggybacking the NJ Gross Income Tax onto various alternative federal bases. We are in the middle of another project to input housing tenure and property tax deductions to our sample that will use data on property tax deductions by high income filers from the federal form 1040.

New Hampshire — We also use IRS information to calculate per capita income for individual cities and towns. This information has many planning on resource allocation functions, most notably it helps distribute education aid. Additionally, IRS data is used extensively to model proposed legislation and predict the resulting fiscal impact. Finally, IRS tape data has been used to provide statistical data to support state tax litigation.

New York — We estimate that the revenue impact of individuals and businesses filing amended returns as the result of federal changes is hundreds of millions of dollars annually. While it is difficult to estimate the indirect revenue impact on the use of federal tax information, it is significant. Federal tax information is used extensively in practically all functional areas in this Department. The impact of the loss of this data would be great.

North Carolina — The Department uses IMF/IRTF information in collection efforts, especially in attempts to locate taxpayers. In many instances the address information included in the extracts is more current than information available from other sources. In addition, our revenue officers have a better indicator of taxpayers' income by accessing the IMF/IRTF as compared to considering the information found on the individual income tax return filed with the department. With the implementation of the integrated tax administration system, the IMF/IRTF information will serve as one of the cornerstones of the department's audit strategy. The department believes that with the use of the IMF/IRTF and the BMF/BRTF, additional revenues exceeding $25 million will be generated.

Since federal taxable information is the starting point for determining North Carolina state taxable income and since the department does not require taxpayers with North Carolina addresses to include a copy of the federal return, it is crucial to the department to continue to have access to the information included on the federal extracts. The decision to not require a copy of the federal return was based substantially on the fact that the department would have access to federal extract information. The continued receipt of this information lessens the burden on taxpayers because they are not required to send a copy of their return to the department, foregoing the expense of duplication and mailing of the federal return. In addition, the department's space requirement for the storage of individual income tax returns is reduced because of not storing copies of federal returns.

Pennsylvania

For the CP 2000, there is a non-direct-revenue-producing result of increasing compliance. Approximately 13,860 taxpayers were filled for the nonfilers, and 22,589 were billed for underreporting. Those taxpayers have been educated to their additional Pennsylvania tax responsibilities. Also, for the Sale of Real Estate, approximately 8,617 taxpayers now know that Pennsylvania does not follow the federal rule allowing the gain on the sale of real estate to be rolled over.

Importantly, the audit bureau has begun matching our sales tax files with the 1994 BMF, BRTF, IMF and IRTF. While we don't have any concrete results, the preliminary findings are interesting. The matches showed an initial difference of $11,228,990,202.52 ($11.2 billion). Further investigation will be necessary. Also, of 63,892 matches of the BRTF with the sales tax file, an initial difference of $70 billion was discovered. Additional investigation will be needed to see if there is a logical reason for the differences, such as restaurant chains. The examination of these tapes will produce audit assignments, and we will use the results to determine the cost/benefit of this effort. Another possible course of action will be to examine those IRS accounts which did not match any of our sales tax accounts, thus uncovering nonfilers.

Utah

Indirect benefits are difficult to put into numbers. WE benefit from the tapes in various divisions of the Tax Commission. We utilize this information to verify fact of filing, levy source, verifying Social Security numbers, verifying addresses, etc. Please note that, once an account is assessed and progresses on to collections, the dollar value is no longer separated as to the source of assessment. We are not able to determine how many of the dollars we collect result from an audit derived from the federal tapes. However, all income tax collections would essentially be from federal information as the Utah tax return is tied directly to the IRS adjusted gross income.

Wisconsin	Wisconsin uses IRS tapes of non-itemizers to determine which taxpayers should not be sent 1099s for their state income tax refunds.
West Virginia	Information is also used for statistical analyses of the impact that legislative or administrative actions would have on revenue and/or resources.

MILLER & CHEVALIER
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August 27, 1999

SEP 01 1999

Ms. Lindy Paull
Chief of Staff
Joint Committee on Taxation
Room 1015, Longworth House Office Bldg.
Washington, DC 20515

Subject: Response to Request for Input on Taxpayer Confidentiality Study

Dear Lindy:

In response to your request, I have had several experiences recently with lenders that, as a condition to making loans to private borrowers, routinely request that each borrower sign a blanket waiver of confidentiality and authorization to permit the lender at any time in the future to obtain copies of the borrowers federal income tax returns. I do not believe that this is an appropriate use of the waiver because I do not believe that taxpayers should routinely be required to relinquish the confidentiality protections that federal law presently affords with respect to future tax information simply because the financial industry has the economic clout to compel the waiver as a condition to enable a taxpayer to finance a home, an automobile, or otherwise borrow money.

On the other hand, I sympathize with those in the lending community that at the present time are requesting the Internal Revenue Service to make available taxpayers' tax information online in order to be able to respond to appropriate requests for lenders for present (rather than future) tax information when properly authorized by taxpayers to do so. Therefore, I would distinguish between requests by lenders who wish to verify the present financial condition of borrowers and those who routinely request open-ended waivers for future use by the lenders or persons to whom the lenders may advertently or inadvertently transfer such waivers.

If you have any questions or if I can be of further assistance, please let me know.

Best wishes.

Sincerely yours,

Larry

Lawrence B. Gibbs

LBG/jd

Marilyn Hemery
15 West 55th Street
New York, New York 10019
(212) 757-2220

SEP - 8 1999

September 3, 1999

Joint Committee on Taxation
Longworth House Office Building
Room 1015
Washington, D.C. 20515

Re: Taxpayer Confidentiality Study

Dear Sir/Madam:

I recently read that your Committee is interested in obtaining data for your Taxpayer Confidentiality Study.

I am not sure if the enclosed will be helpful for your Study, nevertheless, I would like the Committee to be aware of what happened to me. In this letter, I will not provide you with in-depth background of my 11-year "romance" with the IRS, but briefly stated:

1. I am a 62-year old widow;

2. My husband was the sole shareholder and only officer of his corporation, a restaurant which he owned and operated for almost 30 years in New York City;

3. In August 1988, the restaurant closed in Chapter 7;

4. In September 1988, the restaurant was auctioned off;

5. In 1990, my husband made an agreement with the IRS as to monies owed (trust fund - which made him personally liable) and we began paying $100 a month for 3 years;

6. On July 13, 1993, the IRS was paid [redacted] by the corporation's bankruptcy trustee;

7. From 1993 to 1997, the IRS did not credit our personal account, along with the restaurant account, for the trustee's payment;

8. In September 1995, my husband died from cancer;

9. In May 1996, I filed for personal relief under bankruptcy Chapter 7;

10. On September 24, 1996, the U.S. Bankruptcy Court released me from all dischargeable debts;

11. In 1997, in desperation I wrote to Senator D'Amato to intervene on my behalf with the IRS and we succeeded in opening a dialogue with the IRS;

12. My accountant, who has power of attorney, also made an offer in compromise;

13. In 1998, my accountant contacted IRS Taxpayer Advocate's office advising that I was the innocent spouse of the corporation's owner, that I was not in the best of health (I am an arthritic having had a total hip replacement in February 1996), and that the continued unresponsiveness by the IRS placed additional undue hardship on me;

14. On April 19, 1999, I received the enclosed notice from the IRS (which check was never received, or even sent for that matter); and

15. Days after receiving the above IRS notice, I received the enclosed notices from law offices and former IRS agents (9 in total)

In addition to the above, the IRS had put a lien on my checking account, closing it, and placed an unbearable lien on my salary (my only source of income) which forced me to leave my job in April 1998 (the lien was finally removed after I left my job). However, this letter refers merely to items 14 and 15 above.

I would like to know how these outside entities obtained my personal data. After I received the April 19th Notice from the IRS was I inundated with these "advertisements." They certainly did not obtain information from me. Not only is there a breakdown in communications within the IRS (Bankruptcy Section v. Public Advocate v. Offer in Compromise Sec. v. Civ. Pen. Sec. v. 1040 Sec. - Yes, they are all involved in my case), there is a breakdown between all of these IRS Sections and the taxpayer (me - and/or my accountant) and obviously there is a breakdown in the security of IRS records.

I hope this information is helpful to your Study. Perhaps you can advise me how these outside interests obtained my name.

Finally, can you recommend a procedure for me to follow with respect to having the IRS mail the refund to me as indicated on the enclosed April 19th notice and to finally close this case? since I do not owe any additional taxes to the IRS?

As an aside, on Friday, August 27th, I received a call from a Ms. Land(?) (I could not completely understand her), ID #1306918, from the Taxpayer Advocate's office, who informed me that (1) she was just assigned my case; (2) that it would take her a few weeks to review the file; and (3) she would be out of the office until September 13th.

Sincerely,

Marilyn Hemery

Marilyn Hemery

Enclosures

9/28/99

OCT 07 1999

Dear Lindy Paull:

I am writing to you as a member of the general public under the public comment period on the issues concerning taxpayer confidentiality as follow:

1) The adequacy of current protections governing privacy - I am still very uncomfortable with the present laws and don't trust the IRS. There should be stricter limits on the use of taxpayer information and greater penalties for violating confidentiality rules. No taxpayer information should ever be put on the Internet. I still don't trust the IRS, despite the tokenism reforms that have been made.

2) The need, if any, for third parties to use taxreturn info - The only time anybody should be able to see my information is if I specifically give permission in writing.

3) The impact on taxpayer privacy of sharing tax info for the purposes of enforcing state and local tax laws -

I am opposed to the federal government sharing info with the state and local authorities. When I file my federal tax return, I expect only a small number of federal employees to have access to it. The more hands that handle my info, the greater the chance there is that it will be misused.

I will hold my legislators responsible at the polls if any of my private tax info ends up in the wrong hands or those that have no business having it.

Sincerely,

Gary Huffman

1123 Cedar Crest Dr.

Lebanon, PA 17046

-62-

1317 Elsinore Avenue
McLean, VA 22102-2702
September 7, 1999

Lindy L. Paull
Chief of Staff
Joint Committee on Taxation
Room 1015
Longworth House Office Building
Washington, DC 20515

SEP 14 1999

Hello,

RE: Tax Law and Privacy Issues

Respectively request you consider the following comments, specifically since voters care about these issues.

1. Adequacy of Current Protections Governing Privacy: I am uncomfortable with the present laws and do not trust the IRS. There should be stricter limits onthe use of taxpayer information and greater penalties for violating confidentiality rules. No taxpayer information should ever be put on the internet. I still do not trust the IRS, despite all the so-called reforms.

2.The Need, if any, for Third Parties to use Tax Return Information: The only time anybody should be able to see my information is if I specifically give permission in writing.

3. The Impact on Taxpayer Privacy of Sharing Tax Information for the Purposes of Enforcing State and Local Tax Laws: I am opposed to the federal government sharing information with the state and local authorities. When I file my federal tax return, I expect only a small number of federal employees to have access to it. The more hands on that information, the more chance there is that it will be misused.

I will hold my legislators personally responsible at the polls if amy of the private tax info ends up in the wrong hands.

Thank you,

S. R. Kettering

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September 27, 1999

SEP 30 1999

Lindy L. Paull, Esq.
Chief of Staff
Joint Committee on Taxation
1015 Longworth House Office Building
Washington, DC 20515

Re: Comments for Joint Committee Study on Confidentiality of Tax Returns

Dear Ms. Paull:

I am writing to you on behalf of a client to express his and my comments for consideration pursuant to the Joint Committee's August 17, 1999 press release seeking written comments on issues relevant to the Committee's IRS Reform and Restructuring Act study on issues regarding taxpayer confidentiality.

During calendar year 1995, my client was seriously disabled. He subsequently attempted to obtain disability payments from his disability insurance company, [redacted] Insurance Company of [redacted], [redacted]. [redacted], during the initial period of full disability and a part of the partial disability period, made payments. However, in order to obtain the remainder of funds due my client under the policy, [redacted] required that he produce his complete income tax return.

Since my client files a joint income tax return with his wife, my client and his wife concluded that [redacted]'s request for the complete income tax return was inappropriate and an invasion of their privacy. They, therefore, refused to provide the income tax return and [redacted] in turn, refused to make any further payments under the disability policy. In response to [redacted]'s requirements for financial information on my client, (his wife is not a party to the insurance contract) my client provided [redacted] with the following:

1. A copy of his Social Security Administration Report of Earnings, which information precisely agreed with that provided previously to [redacted].

2. A sworn statement, under oath and with penalty of perjury, that the information provided was materially correct.

3. A list of several federal laws which mandated the matching of financial information, as to earnings, as between the Internal Revenue Service and the Social Security Administration.

4. Copies of letters obtained from the Internal Revenue Service and Social Security Administration confirming the process for matching of earnings, both that on a W-2 and a Schedule SE (required for a Schedule C or K-1 where self employment occurs).

Despite the production of this information, which included detailed information on receipts, [redacted] refused to make any further payments under his disability policy.

Without going into significant detail, the [redacted] insurance contract provides that:

> "We have the right to require reasonable proof from You of Your:
>
> "(1) Prior Monthly Earnings; and
>
> "(2) Earnings for any month for which Disability is claimed.
>
> "This may include Your income tax returns, income statements, accountant's statements or other proof acceptable to Us."

The contract states that the words "We" and "Us" refer to [redacted] and "You" and "Your" to the insured. We note that the definition *excludes* the spouse, but [redacted] has been heedless of that fact in demanding my client's tax return.

My client and I certainly agree that an insurance company has a right to reasonable documentation to verify a claim. Without such documentation, fraudulent claims would be submitted and the insurance rates would be excessively high. However, [redacted]'s demand for a complete income tax return is excessive and should be curtailed. In our case, if one were to read the above definition carefully, one would realize that the income tax return fails to provide monthly information required under the terms of the policy. Federal tax returns provide only annual results over a consistently used annual period, usually the calendar year. The reasons for curtailment of practices of this kind are as follows:

1. A disability policy, once issued, has only to be concerned with earnings as defined in the insurance policy. Ignoring the ambiguous definition of earnings in this specific policy, [redacted] in this case has defined Earnings to be the total of W-2 Earnings and Self-Employment Earnings which is shown on a Schedule SE. This precise information is accumulated by the Social Security Administration on each taxpayer

2. The federal income tax return has financial information included therein which is highly personal and completely unrelated to the insurance claim, such as investments, private real estate transactions, private agreements with non disclosure requirements, and the like.

3. The federal form 1040 includes financial and personal information (such as social security number, date of birth and earnings) about individuals not a party to the insurance contract. This information could be used by [redacted] to access credit or identity information about individuals or for solicitation purposes. Additionally, to an unscrupulous employee or other individual, this information would enhance their ability, to defraud innocent parties of either their identity or assets. This would include:

    a. Minor children: Being inexperienced, minor children are in no position to protect themselves.

    b. Elderly dependents. Abuse and fraudulent schemes are increasingly plaguing our elderly citizens. This group is extremely vulnerable at a point of time in their lives when they require protection.

c. Innocent spouses: Historically women have filled the role of homemaker and thus had no earnings to report. In today's environment, both genders stand equally (hopefully) in the employment market. Thus, the female spouse is entitled to as much privacy of her financial affairs as is the male partner. There is also a matter of personal physical protection, depending on the information shown on the income tax return.

d. At the time of disability, an insured is very vulnerable and under significant financial pressure and emotional strain. Under these circumstances, when an insurance company withholds disability payments pending receipt of an income tax return, the insured may feel forced to comply. Many times this is done, without the consent of the spouse, who is a person *NOT* a party to the contract. Therefore, in submitting the tax return, the insured, in effect, inadvertently and innocently waives the right of the spouse, as to privacy protection guaranteed by federal law.

When the issue of tax return content and privacy was raised with [redacted], [redacted] responded by stating that:

1. They had the right under the policy to examine the return and determine if items are properly includeable in an income tax return. Thus they usurp the role of the Internal Revenue Service. Additionally, how can individuals, whose training is primarily clerical in nature or specific as to processing claims, have a significant degree of understanding of our complex tax laws.

2. As to the privacy protection issue, they stated that laws exist to protect the privacy of information. However, in this case they have refused to identify the specific statute, or how

the current income tax laws impose upon them an obligation to protect information revealed to them from a taxpayer's income tax return, specifically in a case where the return is "voluntarily" provided to them.

3. By insisting on the providing of an income tax return, if a claim occurs in January, the insurance company could effectively delay payment of that claim for as much as 21 months. A return covering the month of January is finally due on October 15th of the following calendar year, 21 months later, if extensions are requested, as will frequently be done when a taxpayer has several investments and a complex return. Although its disability insurance policies do not so state, [redacted] has stated that they routinely require that an income tax return be provided to prove losses under those policies.

My client has spent large amounts of time and incurred significant expenses on this matter. He is presently bringing suit in state court solely to compel [redacted] to accept alternate information, information other than his and his wife's joint Federal income tax returns, as proof of his claim under this policy. This in itself is a step that the law should not require a person in my client's shoes to take.

The action on the part of [redacted] and other insurance companies in situations such as this is an abuse of power that should be significantly curtailed. My client's predicament illustrates the need for reform of the tax laws either to:

(a) forbid entities other than the Internal Revenue Service and other governmental entities (and private entities serving them) now permitted confidential access to a taxpayer's federal tax return under I.R.C. section 6103 to require the production of Federal income tax returns for any purpose, or

(b) if a private entity either requires or requests someone's federal income tax return in order to perform nongovernmental functions not set forth in section 6103, there should be significant civil penalties of the sort provided in section 7431 and

(and criminal penalties more punitive than those set forth in section 7213(a)(3)), including the right of private legal redress by taxpayers whose information is disclosed or used for any purpose that would include:

(c) if a private entity either requires or requests someone's federal income tax return in order to perform nongovernmental functions not set forth in section 6103, there should be significant civil penalties of the sort provided in section 7431 and (and criminal penalties more punitive than those set forth in section 7213(a)(3)), including the right of private legal redress by taxpayers whose information is disclosed or used for any purpose that would include:

(d) if a private entity either requires or requests someone's federal income tax return in order to perform nongovernmental functions not set forth in section 6103, there should be significant civil penalties of the sort provided in section 7431 and (and criminal penalties more punitive than those set forth in section 7213(a)(3)), including the right of private legal redress by taxpayers whose information is disclosed or used for any purpose that would include:

If you have any further questions, or if you wish me to amplify any phase of this matter or discuss it with you or a member of your staff, please contact me.

Thank you for your consideration of these comments.

Sincerely yours,

Edward M. Luria

Edward M. Luria

EML/bhs

Michigan Retirement Research Center

Michigan Retirement Research Center

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October 20, 1999

Lindy L. Paull
Chief of Staff
Joint Committee on Taxation
1015 Longworth
House Office Building
Washington DC 20515

Dear Ms. Paull:

This letter and enclosed draft report are sent to you in response to the request for input on the JCT Press release 99-03.

I am writing specifically concerning issues related to the use of confidential IRS data linked with responses to household surveys and with other administrative data sources for the purpose of statistical analysis to inform basic behavioral scientific research and public policy issues.

Understanding both the potential effectiveness of proposed public policy initiatives toward their goals and the potential effects of those policy initiatives on the lives of Americans are of vital importance to our nation. A strong scientific basis of informed public policies is critical to effective and beneficial policies. Toward that end, researchers in the scientific community must have access to the relevant information about individual behaviors and environments along a variety of dimensions. Many important research questions simply cannot be answered without confidential data combined from several interrelated sources. Access to data for statistical and behavioral analyses must and should be treated in a confidential and professional manner when appropriate, i.e., when confidentiality is a concern.

To assist your preparation of the JCT report, please find enclosed three copies of a draft report prepared for a meeting of a committee of the National Academy of Science on data confidentiality. I hope you find the document useful. If you have any questions please feel free to contact me.

Sincerely,

Lee A. Lillard

Lee A. Lillard
Director, Michigan Retirement Research Center

THE VALUE OF LINKED DATA IN AGING RESEARCH

Richard Woodbury
National Bureau of Economic Research

Alan Gustman
Dartmouth College and NBER

Lee Lillard
University of Michigan

Olivia Mitchell
University of Pennsylvania and NBER

Robert Willis
University of Michigan

Working Paper
September 1999

*This paper and much of the database development and research described in the paper has been supported by grants from the National Institute on Aging.

THE VALUE OF LINKED DATA IN AGING RESEARCH

Abstract

There is a growing tension between wanting to make data available to researchers and policymakers, on the one hand, and the pressure to restrict access to data to assure respondent confidentiality, on the other. This tension has emerged particularly in evaluating the uses of linked data, which combine information from two or more different sources. Our aim in this paper is to convey the enormous value of linked data in advancing research and in informing public policy on issues in aging. We believe that the value of the research necessitates the continued application of innovative data use methodologies and access restrictions that allow these scientific and highly policy-relevant research applications to go forward in an environment that also maintains a high level of privacy protection. The paper describes the research value associated with data linkages, and then summarizes a number of research applications that have relied on linked data. It draws to a significant extent on presentations made at a workshop in Washington, DC on May 19, 1999 at which leading scholars in aging and other research areas described their uses of linked data, and how essential those linkages have been to their study of issues in aging.

THE VALUE OF LINKED DATA IN AGING RESEARCH

What determines the health and economic and social circumstances of people as they age? What factors influence the decisions that people make? How are our circumstances and behaviors affected by public programs and policies, and what would happen if these programs and policies were changed? These questions and the many narrower questions imbedded within them depend on analyses of people. More specifically, they depend on information, or data, describing people's lives. And the better the data, the more we can learn from analyzing them. A wide range of data are used in social science research in aging. The goal of this paper is to highlight the enormous value of data, and particularly linked data for these purposes.

The paper is motivated in part by increasing pressures to restrict data use. Human subjects protection has long existed as a fundamental and critically important aspect of research involving people. While attention to human subjects protection has historically been directed to experimental research in which people participate as subjects in experimental trials, the importance of human subjects protection has extended more recently to most other forms of research and data collection. In particular, it has extended to the uses of *survey data*, through which people have provided self-reported information about their individual circumstances, and to the uses of *administrative data*, which have been collected by government agencies as part of their administration of public programs and policies. Most recently, it has extended to the uses of *linked data*, through which information from two or more data sources (such as surveys, administrative records, proprietary private databases, or other data) are linked together and integrated into more comprehensive databases.

The human subjects concern associated with these data derives from people's right to privacy. Specifically, to what extent can these detailed data be used for research while assuring the anonymity of individuals who are described in the data? There is a growing tension between wanting to make these data available to researchers and policymakers, on the one hand, and the pressure to restrict access to data to assure respondent confidentiality, on the other.

To address these issues, the science of human subjects protection has advanced in conjunction with our technological capabilities in implementing data linkages. A whole new area of methodological research has emerged, finding innovative ways to link and manipulate data to maximize its research value, while at the same time assuring the protection of individual confidentiality in the data. These methods specify the types of linkages that minimize the risk of identification, the physical and electronic environments that provide data security, and the data use protocols required for researchers using sensitive data.[1] The implication is that the careful application of linkage methodologies and the careful oversight of research environments can provide a high level of privacy protection, while still allowing research uses of very comprehensive and detailed linked data sources. We believe that the value of the research necessitates the continued application of innovative data use methodologies and access restrictions that allow these scientific and highly policy-relevant research applications to go forward in an environment that also maintains this high level of privacy protection.

The goal of this paper is not to describe these methodological advances, but rather to highlight what can be learned from research using linked data that could not be studied without these data linkages. Our aim is to convey the enormous value of these data in advancing research and in informing public policy. While the issues surrounding data linkage are relevant to many other forms of research, the focus of this paper is on research in aging, and on the significant benefits of linkages that supplement and enhance population-based surveys of older Americans. A workshop was held in Washington, DC on May 19, 1999 at which leading scholars in aging and other research areas described their uses of linked data, and how essential those linkages have been to their study of issues in aging.[2] This paper draws on presentations made at that workshop, as well as related research using linked data for research in aging.

The paper is organized as follows. Section I discusses the value of linkages in enhancing survey data, and describes some of the types of data linkages that have been used in recent research. Section II reviews selected studies that have used linked data on pensions and Social Security. Section III reviews selected studies that have used linked data on health and the receipt of health care services. Section IV summarizes the value of data linkage, particularly as it relates to policy evaluation.

I. Types of Data Linkages in Survey Data

Researchers working on issues in aging have used a wide range of survey data, including the Health and Retirement Survey (HRS), the Survey of Asset and Health Dynamics Among the Oldest Old (AHEAD), the National Long-Term Care Survey (NLTCS), the Current Population Survey (CPS), the Medicare Current Beneficiary Survey (MCBS), the Panel Study of Income Dynamics (PSID), the Survey of Income and Program Participation (SIPP), the National Longitudinal Surveys (NLS), the Survey of Consumer Finances (SCF), the Consumer Expenditure Survey (CES), the National Health Interview Survey (NHIS), the National Medical Expenditure Survey (NMES), the National Longitudinal Mortality Study (NLMS), and the National Nursing Home Survey. Each of these surveys contains self-reported information on various aspects of people's circumstances, though with varying emphasis. The information encompasses aspects of family relations and support within families, work history, economic circumstances, income and wealth, spending, employer provided benefits, benefits from public programs, health, functional ability, cognitive ability, housing and living arrangements, medical care, and many other aspects of people's lives.

While each of these survey data resources provides valuable information on the lives of Americans as they age, each has significant limitations as well. Some of these limitations are inherent in any data that relies solely on self-reported information. First, there are practical and financial limitations on the length of a survey. The administration of surveys is limited by the patience and willingness to participate of the survey sample. With limitations on survey length, each survey must be developed with a limited area of emphasis, and trade-offs must be made between the breadth and the depth of survey content. Second, survey responses can be biased. For example, there is a tendency for respondents to describe themselves in a more favorable light, or to provide responses nearer the average, or to respond differently depending on how a question is phrased. There is also a tendency to under-report income and assets, particularly at higher levels. Third, there are limits to people's memory and knowledge. To some extent, this limitation applies to events or circumstances in the past, so that the details are forgotten. But it also applies to current circumstances about which people have only limited knowledge, such as their pension coverage, or the cost of the medical services they receive, or the composition of their spending. And fourth, in part for the reasons already outlined, survey responses tend to be overly generalized and with limited specificity.

To address some of these limitations, many of the surveys listed above have been linked to other data sources. In each case, the linkages have provided enhanced data that would not have been available in the core survey. Many of these linkages are described in more detail in other sections of this paper, particularly as they relate to certain areas of research. An overview of several types of data linkage is provided here.

One type of linkage is between survey data and administrative records. For example, surveys have been linked to Social Security earnings and benefit histories maintained by the Social Security Administration. These links have provided far more detail than the surveys could obtain on the precise path of earnings over the life course, the movements of individuals in and out of the labor force, and the receipt of Social Security benefits, including those for disability. The resulting linked databases enable more elaborate and precise analysis of the inter-relationships between earnings, the accrual of Social Security benefits, labor market behavior, and other aspects of people's health and economic circumstances.

Surveys have also been linked to Medicare claims records maintained by the Health Care Financing Administration. These links provide more comprehensive information on the health events and chronic illnesses of older Americans, and the details of their medical treatment over time, including inpatient and outpatient hospital care, ambulatory and physician care, home health care, hospice care, skilled-nursing care and rehabilitation care. They also enable calculations of individual medical care costs, the composition of those costs, and the patterns of treatments and health expenditures of individuals over time. Another illustration of a linkage to administrative records would be drawn from tax return data filed with the Internal Revenue Service. These administrative data would enhance surveys through their detailed information on all categories of income (not just earnings), the deductions (such as mortgage interest) of those who itemize, and the financial details of housing sales. Administrative death records have also been linked to surveys, providing more detail on the timing and causes of death.

As a category of data linkage, administrative records have enormous capacity to enhance surveys with detailed and long-term historical information. These linkages also serve to enhance the analytic value of the administrative records by providing a breadth of health and economic and family information that is absent in the administrative data alone. Indeed government agencies routinely use administrative data linked to survey data to evaluate the implications of potential policy reforms. For example, Social Security records alone can not provide much information on how potential changes in Social Security policy will affect the overall economic circumstances of those people who would be affected by the change. To understand the broader implications of policy change on families, it is essential to link these administrative records to survey data that describe the broader health and economic circumstances of these families. The linked data resource is far more valuable for research than either the administrative records or the survey data would be independently.

An important additional benefit of the data linkages is that one can compare people's expectations or perceptions about aspects of their lives (such as Social Security or pensions or medical care) with documented records and actual policies. For example, how do people's expectations about their future Social Security and pension benefits compare with the calculated benefits that people are actually eligible to receive. Since people's perceptions influence the decisions that they make, such as how much to save, or whether to continue working, the accuracy of people's perceptions is an important issue to consider in developing good public policy.

Another type of linkage is between survey data and data collected from employers. For example, the Health and Retirement Study has encompassed a survey of employers that is linked to the survey of individuals. In particular, data has been collected on the detailed provisions of each company's pension plans. This enables researchers to analyze the precise relationships between these pension plan characteristics, the labor market decisions of older workers, and their health and economic circumstances as they age. Links are also being explored between survey data and the detailed establishment data collected by the Bureau of Labor Statistics. Other potential sources of firm data include the Annual Survey of Manufacturers; data collected by States as part of their administration of unemployment insurance programs; and other business surveys conducted by the Bureau of the Census, the Department of Labor, and other statistical agencies. Linkages between survey data and any of these establishment-level data resources have the potential to improve our understanding of the relationships between individuals and their employers, and how these relationships affect people's economic circumstances, and the decisions that they make as they age.

A third type of linkage is between survey data and geographic data. These geographic linkages enhance our knowledge of the environment in which individuals live, such as the average income and income distribution in a geographic area, the housing values, the racial composition of the population, the age composition, the education distribution, the climate, the health insurance environment, the local hospital facilities, and many other characteristics that vary geographically. Variations in State-specific policies and regulations may also be incorporated in survey data, such as Medicaid policies, welfare policies, minimum wages, workers compensation laws, and medical malpractice laws. The specificity of geographic data varies, often defined by region, or by State, or by county, or by zip code. As with other types of data linkages, this supplementary information enhances the ability of researchers to analyze relationships between the environment in which people live, the decisions that they make, and their well-being as they age.

In the remaining sections of this paper, we explore some of the topics of research that have been enhanced by linked data, drawing on presentations and selected research papers by a group of leading research scholars engaged in aging-related research.

II. The Use of Linked Data on Pensions and Social Security

A number of national surveys have been linked to Social Security records, or to pension data provided by employers. The most recent and most comprehensive effort to construct these linkages has been associated with the Health and Retirement Study (HRS). Employer-provided pension data has also been linked to the National Longitudinal Survey of Mature Women[3] and to the Survey of Consumer Finances.[4]

The HRS is a longitudinal survey of about 12,000 older Americans who were between ages 51 and 61 (and spouses of any age) when the survey began in 1992. Participants in the survey have been interviewed in 1992, 1994, 1996 and 1998, with plans to continue interviews every two years into the future. Self-reported survey information has been provided on employment, economic circumstances, health, and family relations. In addition, the survey data has been linked to actual earnings and benefit histories from Social Security records,[5] and to the actual provisions of employer-provided pension plans obtained from employers. The linkages to Social Security records were made only for survey respondents who provided explicit written permission. These linkages have enhanced the research that can be conducted using HRS data, particularly in analyses of labor market behavior, and in analyses of the economic circumstances of people as they age.

A number of studies have emerged using HRS data to evaluate the economic circumstances of older Americans, and the extent to which they have prepared themselves financially for retirement. The HRS contains high quality data on the assets of survey respondents, as traditionally measured. Thus a great deal is known from the core survey about financial assets (such as bank accounts, stocks and bonds, and mutual funds) and the net value of investments in housing. However, these assets represent a narrower measure of wealth than one would like to use to assess the preparation of older Americans for retirement. One would also like to measure the entitlements that people have to future pension and Social Security benefits, which for most households are much larger than what has been saved through financial or housing investments. The problem with self-reported measures of these benefits is that people are often unaware of exactly what they are eligible to receive from these programs. With the linked data, entitlements to pension and Social Security benefits can be calculated precisely. This enables researchers to construct an aggregate measure of wealth that is far more useful than would be possible with the unlinked HRS data.

The linked HRS data has been used to measure wealth, and to assess savings adequacy in studies by Gustman, Mitchell, Moore, Samwick, and Steinmeier.[6] These studies suggest that the median HRS household has wealth (including pension and Social Security entitlements) of about $325,000. Of that amount, only $67,000 is invested in financial assets and $60,000 in home ownership. By using the linked data, the researchers are able to compute additional wealth of $65,000 in future pension benefits, and $134,000 in entitlements to future Social Security benefits. Thus the linked data has enabled a much more thorough analysis of the preparation of households for retirement than would otherwise be possible. Of course, the real value of the detailed asset measures is not just in analyses of the median household, but in understanding the diversity of individual circumstances. Some households are financially well prepared for retirement, while others are not. The linked data enable analyses of the wide range of individual circumstances, so researchers can study the extent of inadequate saving, and perhaps more importantly, the reasons why some households have saved more than others.

Venti and Wise have focused on this question in particular, exploring how people have arrived at their current economic circumstances.[7] An important aspect of the linked data for their research has been its historical information on earnings. While the HRS survey data begin in 1992, the linked Social Security records go back to the very beginning of each respondent's working career. This has enabled Venti and Wise to look at how earnings have fluctuated and changed over the course of people's careers, and how these patterns relate to the savings that people have accumulated today. They have used the linked Social Security data to show how people with very similar earnings histories are approaching retirement with vastly different levels of asset accumulations. The link to Social Security records in this case has been important because of the long-term history of earnings that it has added to the data – information that could not possibly have been obtained through survey interviews today.

Yet another use of the linked Social Security and pension data has been in research on work and retirement decisions at older ages. There are many factors influencing labor market behavior at older ages, such as health, savings, and the availability of post-retirement benefits. Two of the biggest influences are Social Security and employer-provided pensions. But in order to understand how Social Security and pensions affect retirement, one must be able to calculate the financial characteristics of these plans, as they apply to individuals with specific employment and earnings histories. In other words, one needs to be able to calculate how future retirement benefits would change if someone worked another year, as compared with retiring earlier. There is no way to make these calculations accurately without knowing the details of people's earnings histories, and the detailed provisions of their pension plans – neither of which would be reported accurately in survey interviews.

Recent research by Courtney Coile and Jonathan Gruber illustrates the value of linked data in making these computations.[8] They use the linked HRS data to make individual-specific calculations of the "tax" or "subsidy" implicit in Social Security for individual workers as they age. They find that there is substantial variation in incentives across the population. At the median, they find a small subsidy on continued work between ages 62 and 64 -- equivalent to between 2.5 and 5.4 percent of earnings. However, due to the variability across individuals, about one-third of workers at age 62 have an implicit tax. The addition of private pension incentives does little to affect the work and retirement incentives at the median, but it substantially increases the variability in incentives across individuals. The key implication of this work is that one needs to incorporate individual-specific financial incentives in order to effectively study retirement decisions. And the calculations of individual-specific financial incentives can only be made accurately by using long-term historical information on earnings, and by applying the specific provisions of people's pension plans. The linkage between HRS data, Social Security records, and pension plan provisions from employers has been critical in enabling these types of analyses.

The linked data also enable more accurate projections about the future, and how future circumstances will be affected by changes in policy. For example, projections can be made about how work and retirement patterns will change in the future, and how they will respond to changes in pension coverage (such as the trend toward fewer defined benefit pension plans and more defined contribution plans), and to changes in Social Security (such as raising the age of eligibility for "normal" Social Security benefits). Linked data are also critical in analyses of how the economic circumstances of older people is evolving over time; and how the combination of economic circumstances and labor market behavior will affect the financial security of the Social Security program in the future.

Within the Social Security Administration, earnings records have been linked to a number of surveys, including SIPP, HRS, CPS and NLS.[9] Internally, the Social Security Administration has used linked data to analyze the implications of many types of policy reforms, including changing the age of eligibility for benefits, increasing widowhood benefits,[10] changing the progressivity of benefits, and providing benefits that increase with age. The Social Security Administration has also explored the historical circumstances leading to poverty at older ages, and the factors leading to disability applications and the awarding of SSDI benefits. SSA researchers also make projections about future levels of Social Security benefits, pensions, assets and earnings for older Americans in the future. These wide-ranging studies require information not just on earnings history (which are available within the Social Security data), but on the broader health and economic circumstances of people as they age. So again, it is the linkage between the survey data and the Social Security data that makes these analyses possible.

In the coming years, the hope is that survey data may be linked to additional information obtained from employer surveys and other administrative data. In the HRS project, there has been initial work in obtaining information on health insurance plans in addition to pensions. There is also potential for linking survey data to establishment data collected by the Department of Labor, the Census Bureau, and other government agencies. Some of these linkages have already been explored by Julia Lane, John Haltiwanger and others. For example, unemployment insurance records have been linked to both employer data and individual data at the Bureau of the Census. This has enabled analyses of job flows and their effect on the economic circumstances of people moving across jobs. Among the issues studied with these data are the gains in moving from low- to high-productivity firms, the role of technology at firms, and the impact of welfare-to-work programs. All of these projects have been enhanced by the availability of detailed firm information, linked to self-reported information from individuals.

A related project, the "Longitudinal Employer Household Dynamics Project," has used Social Security records as the crosswalk in establishing a national employee-firm data linkage. This project has involved analyses of how firm characteristics affect lifetime earnings and mobility patterns; and how relocation decisions of firms affect the longer-term employment histories of individuals.

It would be difficult to overstate the extent to which linkages to Social Security records have already enhanced research on labor market behavior, and on the economic circumstances and financial preparation for retirement of older Americans. Both the continued analysis of these data, and the development of new linkages to employer and administrative data are essential in maintaining up-to-date knowledge of aging and the well-being of older Americans.

III. The Use of Linked Data on Health and Health Care

At least two types of data linkages are important in enhancing research on issues of health and health care. The first links survey data to medical claims records, adding detailed information on the diagnoses and treatments received by individuals in the core surveys. Linkages between survey data and the Medicare claims records of survey participants is the primary example of this type of linkage for research in aging. Medicare records have already been linked to data in the National Long-Term Care Survey (NLTCS) and the Panel Study of Income Dynamics (PSID), and similar linkages are being developed for the Health and Retirement Survey (HRS) and the associated Survey of Asset and Health Dynamics Among the Oldest Old (AHEAD). An overview of the research value of linking Medicare records with survey data and a description of links that have been made with several national survey datasets is provided in Lillard and Farmer (1997).[11]

While adding medical claims information to survey data greatly increases the analytic value of the surveys, these linkages have been developed quite recently, so there have been few completed studies that have depended on these data. In this paper, we focus on the potential future research value of these data linkages.

The most important finding in research using the NLTCS has been its evidence of declining disability among older Americans.[12] While this finding would have emerged from the survey even without its linkage to Medicare records, the linkages allow investigators to more accurately measure the decline, and to assess its causes. By providing details about the progression of people's health, one can better differentiate between trends in chronic illness and trends in functional ability. One can also explore the relationships between specific medical conditions and their implications for functional ability. Researchers are just beginning to apply the data linkages in the NLTCS, but we expect them to be extremely valuable in this line of research.

Using Medicare claims data linked to the PSID, Lee Lillard and Jeannette Rogowski use survey information about the supplemental health insurance of respondents (Medigap plans) to estimate the effects of insurance coverage on Medicare expenditures.[13] Again, the key data resource issue is that they could bring together the survey information on private insurance coverage and other aspects of people's circumstances with the detailed medical claims and expenditure information in the Medicare records. They also applied the more than twenty year work history of sample members, and their spouses, to predict the probability of their having employer-provided health insurance coverage, and the detailed data on past health and wealth to predict the probability of their purchasing supplemental private health insurance.

In the HRS and AHEAD surveys, the linkages to medical claims data will be important in understanding the broader relationships between health and economic circumstances. One line of research will focus on the determinants of health care utilization. How do the financial circumstances of individuals affect the health care that they receive? How do the characteristics of insurance coverage affect health care utilization? What are the influences of self-reported health, marital status, employment, and other factors? All of these questions can be addressed in more detail if one knows the exact medical services that are received by people in the survey.

A related line of research deals with how health circumstances affect other aspects of people's lives. For example, what happens to the financial circumstances and labor market decisions of someone following a major health event, such as a heart attack or stroke? How do financial circumstances and living arrangements evolve following the onset of a chronic illness, such as diabetes or cancer? How do these impacts vary from one diagnosis to another? And how do these impacts change, depending on the course of treatment one receives for a major illness? Again, these analyses can be conducted with greater detail if one can follow the medical care history of a person (through claims data) at the same time that one follows their financial and employment and family histories (through survey data).

The second type of health-related data linkage relies on medical claims data (rather than survey data) as the core data resource. In these databases, linkages have been used to provide supplementary information on hospitals and geographically defined health care markets. The supplementation of medical claims data has been applied quite extensively in research over the past several years, particularly in analyses using Medicare claims records.

In one application of linked Medicare claims data, McClellan and coauthors have studied the effectiveness of alternative medical treatments for selected conditions.[14] These studies have relied on linked data describing the geographic distance of a patient from a hospital that performs a particular type of procedure. Because patients who are geographically closer to a particular hospital facility (such as a catheterization lab) are more likely to receive that treatment, independent of their health condition, McClellan has estimated the incremental effectiveness of treatments among those who are more likely to be treated because of their proximity. This analytic approach has enabled researchers to identify treatments that may be overused – having little or no effectiveness in treating incrementally more people.

A related application of the data has focused on geographic differences in medical care utilization more broadly. Skinner and Wennberg (and others associated with the Dartmouth Atlas) have focused extensively on this variation, finding enormous differences in medical care use from one area to another.[15] For example, in a case study of medical expenditures in Miami and Minneapolis, they find that the average number of days spent in an intensive care unit in the last six months of life is 1.3 in Minneapolis and 4.8 in Miami. The number of primary care physician visits is 76 percent higher in Miami; and the number of specialist visits is 440 percent higher. These dramatic differences raise questions of why some areas have different medical practice patterns than others, and whether the differences in care have an impact on health. By linking geographic data to the medical data, one can begin to explore these questions. For example, one can compare treatment facilities and physician concentrations across locations; one can compare insurance markets, such as HMO penetration, or malpractice laws, or Medicaid policy variation; one can compare health care markets, such as the number of hospitals and the extent of competition among providers; and one can compare economic variations across locations, such as income or wealth or poverty rates.

As an illustration of this work, Lee, McClellan and Skinner have analyzed the distribution of Medicare benefits across income groups, and how that distribution has changed over time.[16] Their methods have relied on Medicare claims data linked to income levels by zip code. Using this method, they have demonstrated a clear positive correlation between the average income of a neighborhood and average Medicare spending for men, and a much smaller correlation for women. They have also shown how the differences in Medicare spending by income drops dramatically between 1990 and 1995. This type of analyses could not have been conducted without bringing together the medical and geographic information into a linked database.

Many other links have been made between medical claims data and geographic data. For example, Kessler and McClellan have focused on differences in medical malpractice laws across States and how those laws affect medical practice patterns.[17] They find evidence that reducing the pressure of malpractice liability leads to fewer defensive medical practices – services provided to avoid malpractice liability with no health benefits. Cutler and McClellan have looked at differences in the insurance environment in different locations, and how those differences affect patterns of care.[18] They find that higher levels of managed care in health care markets lead to slower adoption of intensive treatment technologies. Staiger and McClellan have used linked data on hospitals to better understand the determinants of hospital quality.[19] Each of these areas of research depends on the ability of researchers to link and supplement existing data sources.

Other illustrations of Medicare data linkages have involved the detailed cancer treatment and outcome records maintained through the SEER program, linkages between Medicare records and Social Security records for those receiving disability benefits, linkages between Medicare and Medicaid records for those who are dually eligible, and linkages between Medicare records and death records.[20] The Medicare-SEER linkage has enabled researchers to better control for the clinical characteristics of cancer patients in studies of cancer treatment. The Medicare-Social Security linkage has enabled researchers to estimate the cost of eliminating the waiting period for Medicare among new SSDI beneficiaries, or the cost of providing Medicare to 64 year olds who discontinue their SSDI benefits. The Medicare-Medicaid linkage has enabled researchers to consolidate comprehensive information on all aspects of health care utilization including nursing home care and pharmaceuticals which are not well documented in Medicare data alone. The Medicare-Death Index linkage has enabled researchers to more carefully study medical practices and medical costs near the end of life.

What makes all of these analyses possible is the consolidation of information from multiple sources. Whether integrating survey data with detailed medical data, or integrating detailed medical data with geographic data, or integrating medical data from multiple sources or integrating data from all of these sources combined – the result is a linked database with greater depth and greater breadth that any single source of data would contain independently.

IV. Informing Public Policy

Population aging is widely recognized as one of the most important public policy challenges of the next several decades. The financial pressures on Social Security, Medicare and Medicaid, and the need for cost-saving policy reforms are among the central concerns in Congress today. The future health and economic security of individuals as they age is a critical component of these policy discussions. How can policies be reformed to assure the health and economic security of Americans in the future at a cost that is sustainable in the long-term? How do policies relate to the many economic and social trends in America – population aging, increasing longevity, younger retirement, increased saving in IRAs and 401(k) plans, decreases in chronic illness and disability rates, advances in medical technology, increases in health care costs, increasing mobility in employment, and increasing diversity in marital history and family relations. How do we even know the details of these economic and social trends as background in informing public policy?

In the research community, there is a fundamental appreciation for the value of data. This appreciation is not just for the purposes of advancing knowledge or advancing science in some abstract sense. It is also about informing policy. Data teaches us about the health and economic and social circumstances of older Americans today. Data teaches us about the decisions that people make under the influences of policy; and how the combination of circumstances and behavior and policy affect people's well being. Data enables us to identify trends and relationships, and use these trends and relationships to make projections about the future. Data enables us to identify the diversity of individual circumstances, and to evaluate the circumstances of those who are most disadvantaged or most vulnerable. Data enables us to evaluate and even simulate how things would change under different policy rules. And on a practical level, data allows us to estimate the cost of policy changes, a requirement of essentially all new legislation. And the better the data, the more accurate and reliable are the findings.

How does Social Security relate to pensions and savings as a source of retirement income security for Americans today? If the ages of eligibility for Social Security and/or Medicare were increased, or if benefits were reduced, would people work longer? Would they save more? Would they be able to purchase health insurance privately? How many people would experience severe hardship from such reform? How many Social Security dollars would be saved?

How much are people saving privately for retirement, and what determines whether people have saved a little or a lot? What can we project about the asset accumulations of households retiring in the future? What would happen if there were increased opportunities for retirement saving: through private plans (such as IRAs or 401(k) plans) or a savings component to Social Security, or some other government sponsored program? What are the health or family or economic circumstances that lead some people to save little or nothing for retirement?

How much do older Americans pay for medical care? What would be the effect on people's out-of-pocket health care costs, and the health care decisions that people make if Medicare financing were restructured? How does the distribution of costs relate to people's health condition, and the health care services that they need? Who are the Americans who are must disadvantaged or vulnerable in our health care system today, and who would be most vulnerable under a reformed system? What would happen if Medicare required larger premium payments or larger copayments? How much do Americans currently pay for prescription drugs, and what would happen if Medicare provided a prescription drug benefit? How would a Medicare reform package affect the public costs of the Medicare program?

There is almost no question in public policy that can not be addressed in a more informed way through analyses based on data. Linked data is important in providing greater diversity of information and greater detail. One can identify and carefully quantify relationships between the many aspects and complexities of life. And it is these complexities that are the fundamental challenge of good policymaking.

Some have suggested that the benefits of linked data can be achieved while avoiding the need for restricted data agreements to protect confidentiality. Instead it is suggested that linked data can be "masked," such as by rounding the data elements, or by making certain random adjustments, or by eliminating unusual or extreme values. But many of the policy questions posed above could not be answered with data that has been masked. For example, to estimate how a change in Social Security would affect retirement decisions, one needs a complex behavioral model that accurately quantifies the determinants of retirement, and how they relate to the financial incentives in retirement income programs (including both Social Security and employer-provided pensions). But the financial incentives of these plans are extremely sensitive to the details of the plans; and the age, years of service, and earnings history of each individual worker. If this information is masked, the financial incentives will be measured less precisely, and the ability of the researcher to relate the financial incentives to the retirement decisions of workers will be jeopardized. It is a short step to the erroneous conclusion that changing the Social Security benefit structure would have little effect on retirement, when the actual effects could be substantial. As with so many of the subjects discussed in this paper, and particularly those that relate the complexities of public policy to the complexities of people's behavior, one gains from information that is as detailed and as precisely measured as possible. Thus data masking is not an obvious solution.

There is an appropriate public concern about the uses of private information about individuals. As more data is collected about more aspects of our financial and medical and personal lives, there is a demand and a need for greater regulatory control of these data, and how they are used. And in the arena of population-based research, there is a need for advances in methodology that assure individual anonymity in the data. Decisions about how to address these issues require collaboration between data protection experts and researchers to ensure that we do not unduly reduce the value of linked data for research as we seek methods to ensure confidentiality. Our aim in this paper has been to reemphasize the value of data in understanding the health and economic circumstances of people as they age, and in informing the continuing evolution of good public policy.

ENDNOTES

1. In many cases, these innovative methodologies have been developed as part of data use agreements with the agencies providing the data. For example, HRS staff worked extensively with the Social Security Administration to develop data use protocols for the linked HRS data. The Health Care Financing Administration regulates uses of Medicare claims records, reviewing all potential research applications. The Bureau of Labor Statistics regulates uses of NLS data that is linked to a whole range of geographic data. The Census Bureau has developed "secure sites" where researchers can use sensitive data sources in a highly secure and carefully monitored research environment. In each of these illustrations, there is a procedure in place to assure that the research applications of the data do not compromise the security of the data or the anonymity of the individuals who are described in the data.

2. The speakers at the workshop, all of whom helped to inform this report, were Miron Straf (National Academy of Sciences), Steven Venti (Dartmouth College and NBER), Olivia Mitchell (University of Pennsylvania and NBER), Howard Iams (Social Security Administration), Thomas Steinmeier (Texas Tech University), Lee Lillard (University of Michigan), Mark McClellan (Stanford University and NBER), Jonathan Skinner (Dartmouth College and NBER), John Haltiwanger (University of Maryland), Julia Lane (American University), Richard Burkhauser (Cornell University), Michael Horrigan (Bureau of Labor Statistics), Susan Grad (Social Security Administration), Jerry Riley (Health Care Financing Administration), Marilyn Manser (Bureau of Labor Statistics), and Richard Hinz (Pension and Welfare Benefits Administration).

3. Gustman, Alan and Thomas Steinmeier, "Employer-Provided Pension Data in the NLS Mature Women's Survey and in the Health and Retirement Study," NBER Working Paper 7174, June 1999.

4. Samwick, Andrew, "New Evidence on Pensions, Social Security, and the Timing of Retirement," NBER Working Paper 6534, April 1998.

5. Mitchell, Olivia, Jan Olson and Thomas Steinmeier, "Construction of the Earnings and Benefits File (EBF) for Use with the Health and Retirement Survey,"in *Wealth, Work and Health: Innovations in Measurement in the Social Sciences*, forthcoming

6. Gustman, Alan, Olivia Mitchell, Andrew Samwick and Thomas Steinmeier, "Pension and Social Security Wealth in the Health and Retirement Study," in *Wealth, Work and Health: Innovations in Measurement in the Social Sciences*, forthcoming; Moore, James and Olivia Mitchell, "Projecting Retirement Wealth and Savings Adequacy in the Health and Retirement Study," Working Paper, 1998; Gustman, Alan, Olivia Mitchell, Andrew Samwick and Thomas Steinmeier, "Evaluating Pension Entitlements," in B. Hammond, O. Mitchell and A. Rappaport (eds.), *Forecasting Retirement Needs and Retirement Wealth*, University Pennsylvania Press, forthcoming.

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9. These illustration draw on the May 19, 1999 presentations by Susan Grad and Howard Iams of the Social Security Administration.

10. Iams, Howard, and Steven Sandell, "Cost Neutral Policies to Increase Social Security Benefits for Widows: A Simulation for 1992," *Social Security Bulletin*, Vol. 61, No. 1, 1998.

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20. These illustration are based on the May 19, 1999 presentation by Jerry Riley of the Health Care Financing Administration.

THE VALUE OF LINKED DATA IN AGING RESEARCH

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THE VALUE OF LINKED DATA IN AGING RESEARCH

Abstract

There is a growing tension between wanting to make data available to researchers and policymakers, on the one hand, and the pressure to restrict access to data to assure respondent confidentiality, on the other. This tension has emerged particularly in evaluating the uses of linked data, which combine information from two or more different sources. Our aim in this paper is to convey the enormous value of linked data in advancing research and in informing public policy on issues in aging. We believe that the value of the research necessitates the continued application of innovative data use methodologies and access restrictions that allow these scientific and highly policy-relevant research applications to go forward in an environment that also maintains a high level of privacy protection. The paper describes the research value associated with data linkages, and then summarizes a number of research applications that have relied on linked data. It draws to a significant extent on presentations made at a workshop in Washington, DC on May 19, 1999 at which leading scholars in aging and other research areas described their uses of linked data, and how essential those linkages have been to their study of issues in aging.

THE VALUE OF LINKED DATA IN AGING RESEARCH

What determines the health and economic and social circumstances of people as they age? What factors influence the decisions that people make? How are our circumstances and behaviors affected by public programs and policies, and what would happen if these programs and policies were changed? These questions and the many narrower questions imbedded within them depend on analyses of people. More specifically, they depend on information, or data, describing people's lives. And the better the data, the more we can learn from analyzing them. A wide range of data are used in social science research in aging. The goal of this paper is to highlight the enormous value of data, and particularly linked data for these purposes.

The paper is motivated in part by increasing pressures to restrict data use. Human subjects protection has long existed as a fundamental and critically important aspect of research involving people. While attention to human subjects protection has historically been directed to experimental research in which people participate as subjects in experimental trials, the importance of human subjects protection has extended more recently to most other forms of research and data collection. In particular, it has extended to the uses of *survey data*, through which people have provided self-reported information about their individual circumstances, and to the uses of *administrative data*, which have been collected by government agencies as part of their administration of public programs and policies. Most recently, it has extended to the uses of *linked data*, through which information from two or more data sources (such as surveys, administrative records, proprietary private databases, or other data) are linked together and integrated into more comprehensive databases.

The human subjects concern associated with these data derives from people's right to privacy. Specifically, to what extent can these detailed data be used for research while assuring the anonymity of individuals who are described in the data? There is a growing tension between wanting to make these data available to researchers and policymakers, on the one hand, and the pressure to restrict access to data to assure respondent confidentiality, on the other.

To address these issues, the science of human subjects protection has advanced in conjunction with our technological capabilities in implementing data linkages. A whole new area of methodological research has emerged, finding innovative ways to link and manipulate data to maximize its research value, while at the same time assuring the protection of individual confidentiality in the data. These methods specify the types of linkages that minimize the risk of identification, the physical and electronic environments that provide data security, and the data use protocols required for researchers using sensitive data.[1] The implication is that the careful application of linkage methodologies and the careful oversight of research environments can provide a high level of privacy protection, while still allowing research uses of very comprehensive and detailed linked data sources. We believe that the value of the research necessitates the continued application of innovative data use methodologies and access restrictions that allow these scientific and highly policy-relevant research applications to go forward in an environment that also maintains this high level of privacy protection.

The goal of this paper is not to describe these methodological advances, but rather to highlight what can be learned from research using linked data that could not be studied without these data linkages. Our aim is to convey the enormous value of these data in advancing research and in informing public policy. While the issues surrounding data linkage are relevant to many other forms of research, the focus of this paper is on research in aging, and on the significant benefits of linkages that supplement and enhance population-based surveys of older Americans. A workshop was held in Washington, DC on May 19, 1999 at which leading scholars in aging and other research areas described their uses of linked data, and how essential those linkages have been to their study of issues in aging.[2] This paper draws on presentations made at that workshop, as well as related research using linked data for research in aging.

The paper is organized as follows. Section I discusses the value of linkages in enhancing survey data, and describes some of the types of data linkages that have been used in recent research. Section II reviews selected studies that have used linked data on pensions and Social Security. Section III reviews selected studies that have used linked data on health and the receipt of health care services. Section IV summarizes the value of data linkage, particularly as it relates to policy evaluation.

I. Types of Data Linkages in Survey Data

Researchers working on issues in aging have used a wide range of survey data, including the Health and Retirement Survey (HRS), the Survey of Asset and Health Dynamics Among the Oldest Old (AHEAD), the National Long-Term Care Survey (NLTCS), the Current Population Survey (CPS), the Medicare Current Beneficiary Survey (MCBS), the Panel Study of Income Dynamics (PSID), the Survey of Income and Program Participation (SIPP), the National Longitudinal Surveys (NLS), the Survey of Consumer Finances (SCF), the Consumer Expenditure Survey (CES), the National Health Interview Survey (NHIS), the National Medical Expenditure Survey (NMES), the National Longitudinal Mortality Study (NLMS), and the National Nursing Home Survey. Each of these surveys contains self-reported information on various aspects of people's circumstances, though with varying emphasis. The information encompasses aspects of family relations and support within families, work history, economic circumstances, income and wealth, spending, employer provided benefits, benefits from public programs, health, functional ability, cognitive ability, housing and living arrangements, medical care, and many other aspects of people's lives.

While each of these survey data resources provides valuable information on the lives of Americans as they age, each has significant limitations as well. Some of these limitations are inherent in any data that relies solely on self-reported information. First, there are practical and financial limitations on the length of a survey. The administration of surveys is limited by the patience and willingness to participate of the survey sample. With limitations on survey length, each survey must be developed with a limited area of emphasis, and trade-offs must be made between the breadth and the depth of survey content. Second, survey responses can be biased. For example, there is a tendency for respondents to describe themselves in a more favorable light, or to provide responses nearer the average, or to respond differently depending on how a question is phrased. There is also a tendency to under-report income and assets, particularly at higher levels. Third, there are limits to people's memory and knowledge. To some extent, this limitation applies to events or circumstances in the past, so that the details are forgotten. But it also applies to current circumstances about which people have only limited knowledge, such as their pension coverage, or the cost of the medical services they receive, or the composition of their spending. And fourth, in part for the reasons already outlined, survey responses tend to be overly generalized and with limited specificity.

To address some of these limitations, many of the surveys listed above have been linked to other data sources. In each case, the linkages have provided enhanced data that would not have been available in the core survey. Many of these linkages are described in more detail in other sections of this paper, particularly as they relate to certain areas of research. An overview of several types of data linkage is provided here.

One type of linkage is between survey data and administrative records. For example, surveys have been linked to Social Security earnings and benefit histories maintained by the Social Security Administration. These links have provided far more detail than the surveys could obtain on the precise path of earnings over the life course, the movements of individuals in and out of the labor force, and the receipt of Social Security benefits, including those for disability. The resulting linked databases enable more elaborate and precise analysis of the inter-relationships between earnings, the accrual of Social Security benefits, labor market behavior, and other aspects of people's health and economic circumstances.

Surveys have also been linked to Medicare claims records maintained by the Health Care Financing Administration. These links provide more comprehensive information on the health events and chronic illnesses of older Americans, and the details of their medical treatment over time, including inpatient and outpatient hospital care, ambulatory and physician care, home health care, hospice care, skilled-nursing care and rehabilitation care. They also enable calculations of individual medical care costs, the composition of those costs, and the patterns of treatments and health expenditures of individuals over time. Another illustration of a linkage to administrative records would be drawn from tax return data filed with the Internal Revenue Service. These administrative data would enhance surveys through their detailed information on all categories of income (not just earnings), the deductions (such as mortgage interest) of those who itemize, and the financial details of housing sales. Administrative death records have also been linked to surveys, providing more detail on the timing and causes of death.

As a category of data linkage, administrative records have enormous capacity to enhance surveys with detailed and long-term historical information. These linkages also serve to enhance the analytic value of the administrative records by providing a breadth of health and economic and family information that is absent in the administrative data alone. Indeed government agencies routinely use administrative data linked to survey data to evaluate the implications of potential policy reforms. For example, Social Security records alone can not provide much information on how potential changes in Social Security policy will affect the overall economic circumstances of those people who would be affected by the change. To understand the broader implications of policy change on families, it is essential to link these administrative records to survey data that describe the broader health and economic circumstances of these families. The linked data resource is far more valuable for research than either the administrative records or the survey data would be independently.

An important additional benefit of the data linkages is that one can compare people's expectations or perceptions about aspects of their lives (such as Social Security or pensions or medical care) with documented records and actual policies. For example, how do people's expectations about their future Social Security and pension benefits compare with the calculated benefits that people are actually eligible to receive. Since people's perceptions influence the decisions that they make, such as how much to save, or whether to continue working, the accuracy of people's perceptions is an important issue to consider in developing good public policy.

Another type of linkage is between survey data and data collected from employers. For example, the Health and Retirement Study has encompassed a survey of employers that is linked to the survey of individuals. In particular, data has been collected on the detailed provisions of each company's pension plans. This enables researchers to analyze the precise relationships between these pension plan characteristics, the labor market decisions of older workers, and their health and economic circumstances as they age. Links are also being explored between survey data and the detailed establishment data collected by the Bureau of Labor Statistics. Other potential sources of firm data include the Annual Survey of Manufacturers; data collected by States as part of their administration of unemployment insurance programs; and other business surveys conducted by the Bureau of the Census, the Department of Labor, and other statistical agencies. Linkages between survey data and any of these establishment-level data resources have the potential to improve our understanding of the relationships between individuals and their employers, and how these relationships affect people's economic circumstances, and the decisions that they make as they age.

A third type of linkage is between survey data and geographic data. These geographic linkages enhance our knowledge of the environment in which individuals live, such as the average income and income distribution in a geographic area, the housing values, the racial composition of the population, the age composition, the education distribution, the climate, the health insurance environment, the local hospital facilities, and many other characteristics that vary geographically. Variations in State-specific policies and regulations may also be incorporated in survey data, such as Medicaid policies, welfare policies, minimum wages, workers compensation laws, and medical malpractice laws. The specificity of geographic data varies, often defined by region, or by State, or by county, or by zip code. As with other types of data linkages, this supplementary information enhances the ability of researchers to analyze relationships between the environment in which people live, the decisions that they make, and their well-being as they age.

In the remaining sections of this paper, we explore some of the topics of research that have been enhanced by linked data, drawing on presentations and selected research papers by a group of leading research scholars engaged in aging-related research.

II. The Use of Linked Data on Pensions and Social Security

A number of national surveys have been linked to Social Security records, or to pension data provided by employers. The most recent and most comprehensive effort to construct these linkages has been associated with the Health and Retirement Study (HRS). Employer-provided pension data has also been linked to the National Longitudinal Survey of Mature Women[3] and to the Survey of Consumer Finances.[4]

The HRS is a longitudinal survey of about 12,000 older Americans who were between ages 51 and 61 (and spouses of any age) when the survey began in 1992. Participants in the survey have been interviewed in 1992, 1994, 1996 and 1998, with plans to continue interviews every two years into the future. Self-reported survey information has been provided on employment, economic circumstances, health, and family relations. In addition, the survey data has been linked to actual earnings and benefit histories from Social Security records,[5] and to the actual provisions of employer-provided pension plans obtained from employers. The linkages to Social Security records were made only for survey respondents who provided explicit written permission. These linkages have enhanced the research that can be conducted using HRS data, particularly in analyses of labor market behavior, and in analyses of the economic circumstances of people as they age.

A number of studies have emerged using HRS data to evaluate the economic circumstances of older Americans, and the extent to which they have prepared themselves financially for retirement. The HRS contains high quality data on the assets of survey respondents, as traditionally measured. Thus a great deal is known from the core survey about financial assets (such as bank accounts, stocks and bonds, and mutual funds) and the net value of investments in housing. However, these assets represent a narrower measure of wealth than one would like to use to assess the preparation of older Americans for retirement. One would also like to measure the entitlements that people have to future pension and Social Security benefits, which for most households are much larger than what has been saved through financial or housing investments. The problem with self-reported measures of these benefits is that people are often unaware of exactly what they are eligible to receive from these programs. With the linked data, entitlements to pension and Social Security benefits can be calculated precisely. This enables researchers to construct an aggregate measure of wealth that is far more useful than would be possible with the unlinked HRS data.

The linked HRS data has been used to measure wealth, and to assess savings adequacy in studies by Gustman, Mitchell, Moore, Samwick, and Steinmeier.[6] These studies suggest that the median HRS household has wealth (including pension and Social Security entitlements) of about $325,000. Of that amount, only $67,000 is invested in financial assets and $60,000 in home ownership. By using the linked data, the researchers are able to compute additional wealth of $65,000 in future pension benefits, and $134,000 in entitlements to future Social Security benefits. Thus the linked data has enabled a much more thorough analysis of the preparation of households for retirement than would otherwise be possible. Of course, the real value of the detailed asset measures is not just in analyses of the median household, but in understanding the diversity of individual circumstances. Some households are financially well prepared for retirement, while others are not. The linked data enable analyses of the wide range of individual circumstances, so researchers can study the extent of inadequate saving, and perhaps more importantly, the reasons why some households have saved more than others.

Venti and Wise have focused on this question in particular, exploring how people have arrived at their current economic circumstances.[7] An important aspect of the linked data for their research has been its historical information on earnings. While the HRS survey data begin in 1992, the linked Social Security records go back to the very beginning of each respondent's working career. This has enabled Venti and Wise to look at how earnings have fluctuated and changed over the course of people's careers, and how these patterns relate to the savings that people have accumulated today. They have used the linked Social Security data to show how people with very similar earnings histories are approaching retirement with vastly different levels of asset accumulations. The link to Social Security records in this case has been important because of the long-term history of earnings that it has added to the data – information that could not possibly have been obtained through survey interviews today.

Yet another use of the linked Social Security and pension data has been in research on work and retirement decisions at older ages. There are many factors influencing labor market behavior at older ages, such as health, savings, and the availability of post-retirement benefits. Two of the biggest influences are Social Security and employer-provided pensions. But in order to understand how Social Security and pensions affect retirement, one must be able to calculate the financial characteristics of these plans, as they apply to individuals with specific employment and earnings histories. In other words, one needs to be able to calculate how future retirement benefits would change if someone worked another year, as compared with retiring earlier. There is no way to make these calculations accurately without knowing the details of people's earnings histories, and the detailed provisions of their pension plans – neither of which would be reported accurately in survey interviews.

Recent research by Courtney Coile and Jonathan Gruber illustrates the value of linked data in making these computations.[8] They use the linked HRS data to make individual-specific calculations of the "tax" or "subsidy" implicit in Social Security for individual workers as they age. They find that there is substantial variation in incentives across the population. At the median, they find a small subsidy on continued work between ages 62 and 64 -- equivalent to between 2.5 and 5.4 percent of earnings. However, due to the variability across individuals, about one-third of workers at age 62 have an implicit tax. The addition of private pension incentives does little to affect the work and retirement incentives at the median, but it substantially increases the variability in incentives across individuals. The key implication of this work is that one needs to incorporate individual-specific financial incentives in order to effectively study retirement decisions. And the calculations of individual-specific financial incentives can only be made accurately by using long-term historical information on earnings, and by applying the specific provisions of people's pension plans. The linkage between HRS data, Social Security records, and pension plan provisions from employers has been critical in enabling these types of analyses.

The linked data also enable more accurate projections about the future, and how future circumstances will be affected by changes in policy. For example, projections can be made about how work and retirement patterns will change in the future, and how they will respond to changes in pension coverage (such as the trend toward fewer defined benefit pension plans and more defined contribution plans), and to changes in Social Security (such as raising the age of eligibility for "normal" Social Security benefits). Linked data are also critical in analyses of how the economic circumstances of older people is evolving over time; and how the combination of economic circumstances and labor market behavior will affect the financial security of the Social Security program in the future.

Within the Social Security Administration, earnings records have been linked to a number of surveys, including SIPP, HRS, CPS and NLS.[9] Internally, the Social Security Administration has used linked data to analyze the implications of many types of policy reforms, including changing the age of eligibility for benefits, increasing widowhood benefits,[10] changing the progressivity of benefits, and providing benefits that increase with age. The Social Security Administration has also explored the historical circumstances leading to poverty at older ages, and the factors leading to disability applications and the awarding of SSDI benefits. SSA researchers also make projections about future levels of Social Security benefits, pensions, assets and earnings for older Americans in the future. These wide-ranging studies require information not just on earnings history (which are available within the Social Security data), but on the broader health and economic circumstances of people as they age. So again, it is the linkage between the survey data and the Social Security data that makes these analyses possible.

In the coming years, the hope is that survey data may be linked to additional information obtained from employer surveys and other administrative data. In the HRS project, there has been initial work in obtaining information on health insurance plans in addition to pensions. There is also potential for linking survey data to establishment data collected by the Department of Labor, the Census Bureau, and other government agencies. Some of these linkages have already been explored by Julia Lane, John Haltiwanger and others. For example, unemployment insurance records have been linked to both employer data and individual data at the Bureau of the Census. This has enabled analyses of job flows and their effect on the economic circumstances of people moving across jobs. Among the issues studied with these data are the gains in moving from low- to high-productivity firms, the role of technology at firms, and the impact of welfare-to-work programs. All of these projects have been enhanced by the availability of detailed firm information, linked to self-reported information from individuals.

A related project, the "Longitudinal Employer Household Dynamics Project," has used Social Security records as the crosswalk in establishing a national employee-firm data linkage. This project has involved analyses of how firm characteristics affect lifetime earnings and mobility patterns; and how relocation decisions of firms affect the longer-term employment histories of individuals.

It would be difficult to overstate the extent to which linkages to Social Security records have already enhanced research on labor market behavior, and on the economic circumstances and financial preparation for retirement of older Americans. Both the continued analysis of these data, and the development of new linkages to employer and administrative data are essential in maintaining up-to-date knowledge of aging and the well-being of older Americans.

III. The Use of Linked Data on Health and Health Care

At least two types of data linkages are important in enhancing research on issues of health and health care. The first links survey data to medical claims records, adding detailed information on the diagnoses and treatments received by individuals in the core surveys. Linkages between survey data and the Medicare claims records of survey participants is the primary example of this type of linkage for research in aging. Medicare records have already been linked to data in the National Long-Term Care Survey (NLTCS) and the Panel Study of Income Dynamics (PSID), and similar linkages are being developed for the Health and Retirement Survey (HRS) and the associated Survey of Asset and Health Dynamics Among the Oldest Old (AHEAD). An overview of the research value of linking Medicare records with survey data and a description of links that have been made with several national survey datasets is provided in Lillard and Farmer (1997).[11]

While adding medical claims information to survey data greatly increases the analytic value of the surveys, these linkages have been developed quite recently, so there have been few completed studies that have depended on these data. In this paper, we focus on the potential future research value of these data linkages.

The most important finding in research using the NLTCS has been its evidence of declining disability among older Americans.[12] While this finding would have emerged from the survey even without its linkage to Medicare records, the linkages allow investigators to more accurately measure the decline, and to assess its causes. By providing details about the progression of people's health, one can better differentiate between trends in chronic illness and trends in functional ability. One can also explore the relationships between specific medical conditions and their implications for functional ability. Researchers are just beginning to apply the data linkages in the NLTCS, but we expect them to be extremely valuable in this line of research.

Using Medicare claims data linked to the PSID, Lee Lillard and Jeannette Rogowski use survey information about the supplemental health insurance of respondents (Medigap plans) to estimate the effects of insurance coverage on Medicare expenditures.[13] Again, the key data resource issue is that they could bring together the survey information on private insurance coverage and other aspects of people's circumstances with the detailed medical claims and expenditure information in the Medicare records. They also applied the more than twenty year work history of sample members, and their spouses, to predict the probability of their having employer-provided health insurance coverage, and the detailed data on past health and wealth to predict the probability of their purchasing supplemental private health insurance.

In the HRS and AHEAD surveys, the linkages to medical claims data will be important in understanding the broader relationships between health and economic circumstances. One line of research will focus on the determinants of health care utilization. How do the financial circumstances of individuals affect the health care that they receive? How do the characteristics of insurance coverage affect health care utilization? What are the influences of self-reported health, marital status, employment, and other factors? All of these questions can be addressed in more detail if one knows the exact medical services that are received by people in the survey.

A related line of research deals with how health circumstances affect other aspects of people's lives. For example, what happens to the financial circumstances and labor market decisions of someone following a major health event, such as a heart attack or stroke? How do financial circumstances and living arrangements evolve following the onset of a chronic illness, such as diabetes or cancer? How do these impacts vary from one diagnosis to another? And how do these impacts change, depending on the course of treatment one receives for a major illness? Again, these analyses can be conducted with greater detail if one can follow the medical care history of a person (through claims data) at the same time that one follows their financial and employment and family histories (through survey data).

The second type of health-related data linkage relies on medical claims data (rather than survey data) as the core data resource. In these databases, linkages have been used to provide supplementary information on hospitals and geographically defined health care markets. The supplementation of medical claims data has been applied quite extensively in research over the past several years, particularly in analyses using Medicare claims records.

In one application of linked Medicare claims data, McClellan and coauthors have studied the effectiveness of alternative medical treatments for selected conditions.[14] These studies have relied on linked data describing the geographic distance of a patient from a hospital that performs a particular type of procedure. Because patients who are geographically closer to a particular hospital facility (such as a catheterization lab) are more likely to receive that treatment, independent of their health condition, McClellan has estimated the incremental effectiveness of treatments among those who are more likely to be treated because of their proximity. This analytic approach has enabled researchers to identify treatments that may be overused – having little or no effectiveness in treating incrementally more people.

A related application of the data has focused on geographic differences in medical care utilization more broadly. Skinner and Wennberg (and others associated with the Dartmouth Atlas) have focused extensively on this variation, finding enormous differences in medical care use from one area to another.[15] For example, in a case study of medical expenditures in Miami and Minneapolis, they find that the average number of days spent in an intensive care unit in the last six months of life is 1.3 in Minneapolis and 4.8 in Miami. The number of primary care physician visits is 76 percent higher in Miami; and the number of specialist visits is 440 percent higher. These dramatic differences raise questions of why some areas have different medical practice patterns than others, and whether the differences in care have an impact on health. By linking geographic data to the medical data, one can begin to explore these questions. For example, one can compare treatment facilities and physician concentrations across locations; one can compare insurance markets, such as HMO penetration, or malpractice laws, or Medicaid policy variation; one can compare health care markets, such as the number of hospitals and the extent of competition among providers; and one can compare economic variations across locations, such as income or wealth or poverty rates.

As an illustration of this work, Lee, McClellan and Skinner have analyzed the distribution of Medicare benefits across income groups, and how that distribution has changed over time.[16] Their methods have relied on Medicare claims data linked to income levels by zip code. Using this method, they have demonstrated a clear positive correlation between the average income of a neighborhood and average Medicare spending for men, and a much smaller correlation for women. They have also shown how the differences in Medicare spending by income drops dramatically between 1990 and 1995. This type of analyses could not have been conducted without bringing together the medical and geographic information into a linked database.

Many other links have been made between medical claims data and geographic data. For example, Kessler and McClellan have focused on differences in medical malpractice laws across States and how those laws affect medical practice patterns.[17] They find evidence that reducing the pressure of malpractice liability leads to fewer defensive medical practices – services provided to avoid malpractice liability with no health benefits. Cutler and McClellan have looked at differences in the insurance environment in different locations, and how those differences affect patterns of care.[18] They find that higher levels of managed care in health care markets lead to slower adoption of intensive treatment technologies. Staiger and McClellan have used linked data on hospitals to better understand the determinants of hospital quality.[19] Each of these areas of research depends on the ability of researchers to link and supplement existing data sources.

Other illustrations of Medicare data linkages have involved the detailed cancer treatment and outcome records maintained through the SEER program, linkages between Medicare records and Social Security records for those receiving disability benefits, linkages between Medicare and Medicaid records for those who are dually eligible, and linkages between Medicare records and death records.[20] The Medicare-SEER linkage has enabled researchers to better control for the clinical characteristics of cancer patients in studies of cancer treatment. The Medicare-Social Security linkage has enabled researchers to estimate the cost of eliminating the waiting period for Medicare among new SSDI beneficiaries, or the cost of providing Medicare to 64 year olds who discontinue their SSDI benefits. The Medicare-Medicaid linkage has enabled researchers to consolidate comprehensive information on all aspects of health care utilization including nursing home care and pharmaceuticals which are not well documented in Medicare data alone. The Medicare-Death Index linkage has enabled researchers to more carefully study medical practices and medical costs near the end of life.

What makes all of these analyses possible is the consolidation of information from multiple sources. Whether integrating survey data with detailed medical data, or integrating detailed medical data with geographic data, or integrating medical data from multiple sources or integrating data from all of these sources combined – the result is a linked database with greater depth and greater breadth that any single source of data would contain independently.

IV. Informing Public Policy

Population aging is widely recognized as one of the most important public policy challenges of the next several decades. The financial pressures on Social Security, Medicare and Medicaid, and the need for cost-saving policy reforms are among the central concerns in Congress today. The future health and economic security of individuals as they age is a critical component of these policy discussions. How can policies be reformed to assure the health and economic security of Americans in the future at a cost that is sustainable in the long-term? How do policies relate to the many economic and social trends in America – population aging, increasing longevity, younger retirement, increased saving in IRAs and 401(k) plans, decreases in chronic illness and disability rates, advances in medical technology, increases in health care costs, increasing mobility in employment, and increasing diversity in marital history and family relations. How do we even know the details of these economic and social trends as background in informing public policy?

In the research community, there is a fundamental appreciation for the value of data. This appreciation is not just for the purposes of advancing knowledge or advancing science in some abstract sense. It is also about informing policy. Data teaches us about the health and economic and social circumstances of older Americans today. Data teaches us about the decisions that people make under the influences of policy; and how the combination of circumstances and behavior and policy affect people's well being. Data enables us to identify trends and relationships, and use these trends and relationships to make projections about the future. Data enables us to identify the diversity of individual circumstances, and to evaluate the circumstances of those who are most disadvantaged or most vulnerable. Data enables us to evaluate and even simulate how things would change under different policy rules. And on a practical level, data allows us to estimate the cost of policy changes, a requirement of essentially all new legislation. And the better the data, the more accurate and reliable are the findings.

How does Social Security relate to pensions and savings as a source of retirement income security for Americans today? If the ages of eligibility for Social Security and/or Medicare were increased, or if benefits were reduced, would people work longer? Would they save more? Would they be able to purchase health insurance privately? How many people would experience severe hardship from such reform? How many Social Security dollars would be saved?

How much are people saving privately for retirement, and what determines whether people have saved a little or a lot? What can we project about the asset accumulations of households retiring in the future? What would happen if there were increased opportunities for retirement saving: through private plans (such as IRAs or 401(k) plans) or a savings component to Social Security, or some other government sponsored program? What are the health or family or economic circumstances that lead some people to save little or nothing for retirement?

How much do older Americans pay for medical care? What would be the effect on people's out-of-pocket health care costs, and the health care decisions that people make if Medicare financing were restructured? How does the distribution of costs relate to people's health condition, and the health care services that they need? Who are the Americans who are must disadvantaged or vulnerable in our health care system today, and who would be most vulnerable under a reformed system? What would happen if Medicare required larger premium payments or larger copayments? How much do Americans currently pay for prescription drugs, and what would happen if Medicare provided a prescription drug benefit? How would a Medicare reform package affect the public costs of the Medicare program?

There is almost no question in public policy that can not be addressed in a more informed way through analyses based on data. Linked data is important in providing greater diversity of information and greater detail. One can identify and carefully quantify relationships between the many aspects and complexities of life. And it is these complexities that are the fundamental challenge of good policymaking.

Some have suggested that the benefits of linked data can be achieved while avoiding the need for restricted data agreements to protect confidentiality. Instead it is suggested that linked data can be "masked," such as by rounding the data elements, or by making certain random adjustments, or by eliminating unusual or extreme values. But many of the policy questions posed above could not be answered with data that has been masked. For example, to estimate how a change in Social Security would affect retirement decisions, one needs a complex behavioral model that accurately quantifies the determinants of retirement, and how they relate to the financial incentives in retirement income programs (including both Social Security and employer-provided pensions). But the financial incentives of these plans are extremely sensitive to the details of the plans; and the age, years of service, and earnings history of each individual worker. If this information is masked, the financial incentives will be measured less precisely, and the ability of the researcher to relate the financial incentives to the retirement decisions of workers will be jeopardized. It is a short step to the erroneous conclusion that changing the Social Security benefit structure would have little effect on retirement, when the actual effects could be substantial. As with so many of the subjects discussed in this paper, and particularly those that relate the complexities of public policy to the complexities of people's behavior, one gains from information that is as detailed and as precisely measured as possible. Thus data masking is not an obvious solution.

There is an appropriate public concern about the uses of private information about individuals. As more data is collected about more aspects of our financial and medical and personal lives, there is a demand and a need for greater regulatory control of these data, and how they are used. And in the arena of population-based research, there is a need for advances in methodology that assure individual anonymity in the data. Decisions about how to address these issues require collaboration between data protection experts and researchers to ensure that we do not unduly reduce the value of linked data for research as we seek methods to ensure confidentiality. Our aim in this paper has been to reemphasize the value of data in understanding the health and economic circumstances of people as they age, and in informing the continuing evolution of good public policy.

ENDNOTES

1. In many cases, these innovative methodologies have been developed as part of data use agreements with the agencies providing the data. For example, HRS staff worked extensively with the Social Security Administration to develop data use protocols for the linked HRS data. The Health Care Financing Administration regulates uses of Medicare claims records, reviewing all potential research applications. The Bureau of Labor Statistics regulates uses of NLS data that is linked to a whole range of geographic data. The Census Bureau has developed "secure sites" where researchers can use sensitive data sources in a highly secure and carefully monitored research environment. In each of these illustrations, there is a procedure in place to assure that the research applications of the data do not compromise the security of the data or the anonymity of the individuals who are described in the data.

2. The speakers at the workshop, all of whom helped to inform this report, were Miron Straf (National Academy of Sciences), Steven Venti (Dartmouth College and NBER), Olivia Mitchell (University of Pennsylvania and NBER), Howard Iams (Social Security Administration), Thomas Steinmeier (Texas Tech University), Lee Lillard (University of Michigan), Mark McClellan (Stanford University and NBER), Jonathan Skinner (Dartmouth College and NBER), John Haltiwanger (University of Maryland), Julia Lane (American University), Richard Burkhauser (Cornell University), Michael Horrigan (Bureau of Labor Statistics), Susan Grad (Social Security Administration), Jerry Riley (Health Care Financing Administration), Marilyn Manser (Bureau of Labor Statistics), and Richard Hinz (Pension and Welfare Benefits Administration).

3. Gustman, Alan and Thomas Steinmeier, "Employer-Provided Pension Data in the NLS Mature Women's Survey and in the Health and Retirement Study," NBER Working Paper 7174, June 1999.

4. Samwick, Andrew, "New Evidence on Pensions, Social Security, and the Timing of Retirement," NBER Working Paper 6534, April 1998.

5. Mitchell, Olivia, Jan Olson and Thomas Steinmeier, "Construction of the Earnings and Benefits File (EBF) for Use with the Health and Retirement Survey,"in *Wealth, Work and Health: Innovations in Measurement in the Social Sciences*, forthcoming

6. Gustman, Alan, Olivia Mitchell, Andrew Samwick and Thomas Steinmeier, "Pension and Social Security Wealth in the Health and Retirement Study," in *Wealth, Work and Health: Innovations in Measurement in the Social Sciences*, forthcoming; Moore, James and Olivia Mitchell, "Projecting Retirement Wealth and Savings Adequacy in the Health and Retirement Study," Working Paper, 1998; Gustman, Alan, Olivia Mitchell, Andrew Samwick and Thomas Steinmeier, "Evaluating Pension Entitlements," in B. Hammond, O. Mitchell and A. Rappaport (eds.), *Forecasting Retirement Needs and Retirement Wealth*, University Pennsylvania Press, forthcoming.

7. Venti, Steven and David Wise, "The Cause of Wealth Dispersion at Retirement: Choice or Chance?," *American Economic Review*, 1998; Venti, Steven and David Wise, "Choice, Chance and Wealth Dispersion at Retirement," in S. Ogura, T. Tachibanaki and D. Wise (eds.), *Issues in*

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8. Coile, Courtney and Jonathan Gruber, "Social Security Retirement Incentives," in David Wise (ed.), *The Economics of Aging, Vol. 8* (preliminary title), University of Chicago Press, forthcoming; Coile, Courtney, "Social Security, Pensions and the Retirement Decisions of Couples," Working Paper, 1999.

9. These illustration draw on the May 19, 1999 presentations by Susan Grad and Howard Iams of the Social Security Administration.

10. Iams, Howard, and Steven Sandell, "Cost Neutral Policies to Increase Social Security Benefits for Widows: A Simulation for 1992," *Social Security Bulletin*, Vol. 61, No. 1, 1998.

11. Lillard, Lee and Melissa Farmer, "Linking Medicare and National Survey Data," *Annals of Internal Medicine*, Vol. 127, No. 8 (2): 691-695, 1997.

12. Manton, Kenneth, Larry Corder and Erik Stallard, "Chronic Disability Trends in Elderly United States Populations: 1982-1994, *Proceedings of the National Academy of Sciences*, 1997; Singer, Burton and Kenneth Manton, "The Effects of Health Changes on Projections of Health Service Needs for the Elderly Population of the United States," *Proceedings of the National Academy of Sciences*, 1998.

13. Lillard, Lee and Jeannette Rogowski. "Does Supplemental Private Insurance Increase Medicare Costs," RAND Working Paper, 1997.

14. McClellan, Mark, Barbara McNeil and Joseph Newhouse, "Does More Intensive Treatment of Acute Myocardial Infarction Reduce Mortality?" *Journal of the American Medical Association*, 1994; McClellan, Mark and Joseph Newhouse, "The Marginal Costs and Benefits of Medical Technology: A Panel Instrumental-Variables Approach," *Journal of Econometrics*, 1997; Geppert, Jeffrey, Mark McClellan and Olga Saynina, "Ventricular Arrhythmia in the U.S. Elderly Population: Treatments, Expenditures and Outcomes, 1984-1995," Working Paper, 1997.

15. Skinner, Jonathan and John Wennberg, "How Much is Enough? Efficiency and Medicare in the Last Six Months of Life," NBER Working Paper No. 6513, 1998; Skinner, Jonathan and John Wennberg, "How Efficient is Medicare?," in *Frontiers in the Health Policy Research, Vol. 3*, MIT Press, forthcoming.

16. Lee, Julie, Mark McClellan and Jonathan Skinner, "The Distributional Effects of Medicare," NBER Working Paper 6910, January 1999.

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19. McClellan, Mark and Douglas Staiger, "The Quality of Health Care Providers," Working Paper, 1998; McClellan, Mark and Douglas Staiger, "Comparing Hospital Quality at For-Profit and Not-for-Profit Hospitals," in D. Cutler (ed.), *Non-Profit Hospitals* (preliminary title), University of Chicago Press, forthcoming.

20. These illustration are based on the May 19, 1999 presentation by Jerry Riley of the Health Care Financing Administration.

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September 17, 1999

Lindy L. Paull, Chief of Staff
Joint Committee on Taxation
Room 1015 LHOB
Washington, D.C. 20515

RE: Announcement 8/17/99 Federal Register
Taxpayer Confidentiality and Return Study

This letter is written on behalf of more than 10,000 Members of the National Association of Enrolled Agents (NAEA). Members of NAEA are federally authorized tax practitioners whose authority to represent taxpayers before the Internal Revenue Service (IRS) is regulated by United States Treasury Department Circular 230, Title 31 Code of Federal Regulations Subtitle A, as amended. NAEA Members have established their expertise in federal tax matters by either passing the Internal Revenue Service's comprehensive two-day examination on federal taxation or by serving as an IRS employee in an appropriate job classification for at least five years. NAEA Members maintain this level of expertise by completing a minimum of 30 hours of continuing professional education each year. Our Members work with more than 4 million (4,000,000) individuals and small business taxpayers annually.

It is in our role as the voice for our Members and the general taxpaying public that NAEA submits this letter and offers the following comments on taxpayer confidentiality, specifically (a) the adequacy of present-law protection governing taxpayer privacy; (b) the need, if any, for third parties, including those presently authorized under the Code, to use tax return information; (c) whether greater levels of voluntary compliance can be achieved by allowing the public to know who is legally required to file tax returns but does not do so; (d) the interrelationship of the taxpayer confidentiality provisions in the Internal Revenue Code with the Freedom of Information Act, the Privacy Act, and section 6110 of the Code; (e) the impact on taxpayer privacy of sharing tax information for the purposes of enforcing State and local tax laws (other than income tax laws), including the impact on taxpayer privacy intended to be protected at the Federal, state and local levels under the Taxpayer Browsing Protection Act of 1997; and (e) the extent to which the current disclosure provisions provide taxpayers, exempt organizations, and tax practitioners with sufficient guidance.

(a) Present Law Protection

While provisions intended to be safeguards against unauthorized disclosure of information are presently in effect, the use of social security numbers, by which the IRS identifies taxpayers, are also used by private and other public sectors to catalog individuals. Until such time as an alternative "identifying number" system is devised, implemented and used in conjunction with social security numbers for federal income tax purposes, the potential for unauthorized disclosure of tax return information remains at an unacceptable level.

(b) Third Party Use

Current disclosure law (IRC 6103(e)) does not invalidate the right to disclosure of information to persons who are on a civil matter "fishing expedition". An officer of a Court can subpoena third party records, including tax returns, by simply issuing the proper 'wish list' mandate. In civil matters (ie; divorce), where the disclosure of tax return information is to be used for the economic benefit of non-governmental entities, it is recommended that any subpoena mandating the disclosure of tax return information from federally authorized tax practitioners require an original signature of the Judge assigned to the specific court proceeding.

Members Licensed to Represent Taxpayers Before The Internal Revenue Service

In addition, the services offered by any governmental agency, including the Internal Revenue Service, should not include the public disclosure of tax return information for income verification purposes. The tax data collected by the Internal Revenue Service should remain, as it was initially intended, a matter of privacy between the government and the taxpayer.

(c) Public Notice of Non-Filers

Congress has yet to guarantee that IRS maintains and/or is provided with 100% accurate information on or about taxpayers. Until such time as taxpayers and the general public can be guaranteed that the IRS records are correct, public disclosure of non-compliant taxpayers cannot and should not be considered. IRS relies on their Information Return Program (IRP) to detect what they consider to be non-filers (taxpayers who, according to IRS records, should have but have not filed tax returns). Information returns, such as forms W-2s and 1099s, provided by payers are matched by social security numbers to the tax returns with the same social security number. If the information provided by payers and/or input into the Integrated Data Retrieval System (IDRS) maintained by IRS does not match, regardless of whether a tax return has or has not been posted to that taxpayer account, a proposed assessment based exclusively on the IRP is sent to the taxpayer.

Public notice of non-filers will not increase voluntary compliance; but will serve to discredit many taxpayers who are caught up in a computer 'snafu' with the IRS. Public disclosure of a non-filer status is not a threat to those persons who elect, for whatever reason, not to file a tax return as required. Voluntary compliance can only be achieved through education.

(d) Interrelationship of Taxpayer Confidentiality with Other Laws

On July 4, 1967, Congress enacted the Freedom of Information Act (FOIA) as the legal basis for the public availability of federal agency records. Subsequent to enactment of the FOIA, Code provisions were enacted providing for disclosure of IRS written determinations (Code Sec. 6110) and disclosure of return and return information (Code Sec. 6103).

The FOIA classifies government information into three categories, with different requirements as to the degree of publicity required. The first category is information that must be published in the Federal Register. This includes IRS regulations, revenue ruling, and revenue procedures. The second category is information that is not required to be published in the Federal Register, but must be made available for public inspection and copying. This includes statements of policy and interpretations that have been adopted by the IRS, as well as administrative staff manual and instructions to staff that affect a member of the public. The third category is documents that a member of the public may obtain by making a request for the information. Potentially, this includes all information in the hands of the Executive Branch, including the IRS, that is subject to procedures for making such requests, unless the material requested falls into one of the exemptions listed in the FOIA.

The IRS has authority to assess actual costs, but is it also directed to furnish documents at a reduced charge, or without charge, if it determines that disclosure of the is in the general public interest. "Actual costs" for disclosure of an IRS written determination or background file document include the cost of (1) searching, (2) deleting identifying details and excepted material and (3) making copies. (Code Sec. 6110(j)(1)).

The Disclosure of Official Information Handbook (IRM 1272) contains instructions and guidelines relating to disclosure of information from tax returns and other Service documents, including disclosure under the Freedom of Information Act and the Privacy Act, and Sections 6103, 6104, and 6110.

In general, any written determination, including the request for a determination, supporting documents, and communications with the IRS regarding the determination (except with the Justice Department concerning pending cases or investigations), must be made available by the IRS for public inspection. (Section 6110(a) and (b))

The IRS is required to delete the identifying information of the taxpayer seeking the determination and the identification of all others; trade secrets and commercial or financial information that are privileged or confidential; and information that would constitute a clearly unwarranted invasion of privacy. (Section 6110(c))

Unfortunately, the IRS is held only to the standard of intentional or willful disregard in performing the above deletions. Taxpayers who believe that the IRS has underestimated the intent of the disclosure and privacy laws must contemplate judicial proceeding in order to effectuate a resolution when in disagreement with the IRS as to their standards of protecting taxpayers right to confidentiality and privacy.

The interrelationship of taxpayer confidentiality provisions in section 6110 of the Code with the Freedom of Information Act and the Privacy Act appear to be consistent and equitably applied with the exception that disclosure under Section 6110(a)and (b) should require the consent from the involved taxpayer(s) that IRS has properly deleted all taxpayer identifying information, trade secrets and similar confidential information prior to the public disclosure.

(e) Taxpayer Confidentiality and the Taxpayer Browsing Protection Act
Internal Revenue Code Section 6103, inclusive of subsections (a) through (q), details the circumstances under which tax return information can be disclosed. Our Members agreed that disclosure of tax return information to administrative agencies and judicial branches of the United States government, States, territories and political subdivisions thereof is necessary and warranted; however, additional safeguards are need for disclosure of taxpayer identity information to the press and other media (Section 6103(m)). Our Members believes that IRS fulfills its obligation and responsibility to notify taxpayers "at their last known address", as required throughout the Code and Regulations, and that providing the press and other media with tax return information regarding taxpayers who are due a refund crosses the line on the intent to provide taxpayers with the right to confidentiality.

The Taxpayer Browsing Protection Act prohibits the inspection or disclosure of any return or return information by federal, state and local government employees for purposes other than authorized. Present law provides that unauthorized inspection or disclosure of tax return and tax return information may be punishable by a fine of $1,000 and/or imprisonment. Our Members believe that the seriousness of such infringement on taxpayer's right to confidentiality should be punishable by a fine of no less than $5,000 and/or imprisonment for a period not less than one (1) year.

(e) Sufficient Guidance
Procedural Rule (26 C.F.R.) 601.702(c), the Freedom of Information (5 U.S.C. 552) and Privacy (5 U.S.C. 552a) Acts, IRC 6103(a), and IRM 1272 (Part 200), provide all taxpayers and federally authorized tax practitioners with sufficient guidance on the type of information that is available for disclosure and the procedures to be followed in making such requests for information. Our Members do not need nor require additional guidance in this subject at this time.

It is the belief of our Members that the intent of Congress is to provide all taxpayers with the right to confidentiality, regardless of who "wants" to know.

Respectfully submitted,

Mary L. Javor

Mary L. Javor
Enrolled Agent

41 A Brent St.
Dorchester, MA 02124
Dec. 2, 1999

Ms. or Mr. Lindy Paull
Joint Committee on Taxation
1015 Longworth House Office Bldg.
Washington, DC 20515

Dear M. Paull:

I am writing to express my concern about and opposition to two measures that I understand are among the many issues your committee is considering. The two measures are publishing names of people who do not file tax returns, and giving federal tax information to state and local law enforcement authorities. I am opposed to both of these because they would violate individual privacy. The IRS is already intruding on people's privacy enough in the course of collecting taxes; it does not need to look for more ways to do that.

Thank you for your consideration.

Sincerely,

Becky Pierce

RUSS ASSOCIATES

SEP 27 1999

September 19, 1999

Lindy L. Paull
Chief of Staff, Joint Committee on Taxation
Room 1015 Longworth House Office Bldg.
Washington, D.C. 20515

Dear Ms. Paul,

As a member of the general public, and a small businessman, I'd like to express my concerns with the privacy issue now before your group.

I and a clear majority of my associates are not comfortable with what we see as lax if not downright uncaring adherence to personal privacy issues in the federal government in general, and especially with the Internal Revenue Service. I believe the current laws, if adequate, are not being adequately enforced. If enforcement is not the issue, then the laws need strengthening. Data that I voluntarily provide the IRS as a solid law abiding citizen is private and should not be shared with other agencies or groups of any nature without my express permission. In creating the many laws involving taxation, I do not believe the Congress intended re-distribution or release of personal data. Yet we see instances of this reported frequently in the news. Most disturbing of all is the rising instances of personal data being exposed over the Internet. This is abuse in the fullest sense and should be stopped, and those responsible for such actions penalized severely. Our tax laws are based on voluntary reporting of income, and trust in the system to fairly and equitably administer that reporting. Privacy violation is at best counterproductive, and perhaps criminal.

While the IRS has recently tried to make the case that they have reformed and that they are much more human, etc. the jury is certainly still out on the issue. I realize theirs is a tremendous task, often hindered by weak employees and unscrupulous taxpayers. Release of privacy information only aggravates the task, and further undermines the confidence we should have in our tax system. Because of the past aggressive efforts of the IRS, the severe and often insensitive application of rules and law, and yes, questionable behavior of some employees, the everyday citizen sees the IRS as a bogeyman. They run scared. Fact is that's completely justified by their collective behavior — aided and abetted to some degree by the

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Congress itself. We should respect and support the legal and proper tax collection efforts because it is the (current) mechanism for financing our society. Release of privacy information outside the few individuals who 'must' view the information, unnecessarily adds to that negative image and undermines our society. We need better control and monitoring.

I also find fault with the increasingly widespread sharing of privacy information with state and local agencies. I've heard many of the arguments of how this is good management, saves money, time, etc. While there may be truth in those arguments, the fundamental issue of a citizens right of privacy must and will prevail.

I ask you, on my behalf, to make the case to your group that the pendulum has swung about as far as should be allowed to go. It's time to bring it back to a rational balance and respect the integrity and diligence of the average American citizen taxpayer. I willingly pay my taxes and reserve the right to grumble about them, or the process, but I pay them nonetheless. I also reserve my right to hold and maintain personal information deemed private by me, the courts, and the general population, releasing it only in those instances where **I** choose to do so.

Sincerely,

Jack E. Russ

Jack E. Russ

John A.Russell
1540 Pickwood Ave.
Fern Park, Fl 32730

Sept 10, 1999

SEP 15 1999

Mr. Lindy L. Paull
Chief of Staff, Joint Committee on Taxation
Room 1015 Longworth House Office Building,
Washington, D. C. 20515

re: Privacy Protection

Dear Mr. Paull,

I am a Sr.Citizen who has concern about the inadequacy of the current protections governing privacy in general and mine in particular.

It is a requirement that I provide an intrusive amount of personal information to various state and Federal Government agencies; However, I feel that information be used ONLY for the requisite purpose, and not be shared with other agencies.

The Big Brother syndrome in the Federal Government has already gone amuck and must be reigned in. A prime example would be the infamous IRS, a taxpayers information should be sacred and access should be limited by decree of the court. Misuse of my data by federal employees would be contrary to the Constitution of the United States that ensures that legal safeguards are to be used to protect citizens from abuse of public officials.

A recent situation in Florida had the drivers license information supplied to an out of state firm to generate a master file on individuals that would be available to other agencies. The out rage by citizens had this practice stopped in its tracks. My recollection is that the data compilation effort was funded by the federal government.

Banks are another problem for citizens to keep their information private. The proliferation of data to other banking endeavors, e.g., Mutual Fund agents, insurance, credit cards, etc.

I know that I have touched on only a few of the invasions of privacy by Government and Corporate America, however, all transfer of information without the individuals signed consent on a one item card/form, in lieu of the present policy that is utilized by many outfits that incorporate a consent phrase that says that information will be shared with other parties. A prime example of this is the medical industry.

Please protect our privacy, and keep in mind that your privacy is also in jeopardy.

Thank you

John A. Russell

John A. Russell

Mr. Joel E. Rynning
24 Willow Gln. NE
Atlanta, GA 30342

SEP 27 1999

Lindy L. Paull, Chief of Staff,
Joint Committee on Taxation,
Room 1015 Longworth House Office Building,
Washington, D.C. 20515

Dear Sir:

America needs greater protection on privacy issues re taxes. There should be severe penalties for Federal employees violating confidentiality rules. No taxpayer information should be shared with State or Local governments. The more people have access to this information the greater the odds that it will be misused.

I dont trust the IRS! Perhaps its a sign of the times but after reading about IRS employees misusing tax information I think I have reason to be concerned. Hopefully a Flat Tax or Fair Tax will soon be enacted which will be a real blessing for American Tax payers!

Sincerely

Joel E. Rynning

-112-

STATE OF ALABAMA
DEPARTMENT OF REVENUE
MONTGOMERY, ALABAMA

STATE OF ALABAMA RESPONSE TO A STUDY BEING CONDUCTED BY THE JOINT COMMITTEE ON TAXATION (JCT) REGARDING STATES' USE OF FEDERAL DATA

WHAT DOES THE STATE USE THIS FEDERAL TAXPAYER DATA FOR:

Federal Tax Data received by the Alabama Department of Revenue is used only for the purpose of administering the Revenue Laws applicable to the Department of Revenue. More specifically, this information forms the very foundation of several very important Individual & Corporate Tax Division, Income Tax related compliance programs. These programs range from one that identifies taxpayers who have only omitted income items, to programs that identify those taxpayers who have not even filed a required Alabama Income Tax Return with the Department.

Categorically, the Alabama Department of Revenue currently uses the following types of Federal Tax Data as provided by the Internal Revenue Service:

(1) Revenue Agent Reports (RAR's), hard paper copies (used to identify and then correct significant income, expense, and/or deduction reporting errors)
(2) CP-2000 Reports (extract data, used primarily to identify income omissions, and initiate action to correct)
(3) IMF\IRTF (extract data, used to identify non-filers, and then take whatever action is appropriate & necessary to secure delinquent returns, taxes, interest, etc.)
(4) IRMF (extract data, will be used to identify, and track out of state payments made to Alabama resident taxpayers, and determine if such payments were properly reported on related Alabama Income Tax Returns. Also, could be used to establish a master "income data base" that could be used to determine taxpayer liability in non-filer no response situations.)
(5) Federal Income Tax Returns, Transcripts, etc., (hard paper copies, used in a wide variety of circumstances to confirm withholding amounts, reconcile income differences , explain filing status questions, clarify IRS change and abatement issues, etc.
(6) Non-Itemizer (extract data, used to determine which recipient of state Tax refunds need not receive Form 1099G)
(7) Taxpayer Address Request (TAR), extract information taken from the IRS Individual Master File (IMF), used to help the state locate delinquent taxpayers

WHAT ALTERNATIVES, IF ANY, EXIST TO USING THE FEDERAL TAX DATA:

Considering the financial constraints that this state is currently operating under, and will probably be subject to in the foreseeable future, we believe there is no reasonable and practical alternative to our use of Federal Tax Data that would allow us to obtain the same measure of fairness, and equity in the daily administration of our tax laws.

THE IMPACT ON TAXPAYER BURDEN:

Not only is the burden to the taxpayer reduced as the result of the FedState Information Exchange Program, i.e., having to undergo only one audit instead of two, etc., but the cost to the various Federal and State agencies is significantly reduced by eliminating or at least minimizing duplicate enforcement and compliance efforts.

WHAT STEPS HAVE BEEN TAKEN TO PROTECT FEDERAL TAX DATA FROM UNAUTHORIZED ACCESS (UNAX):

We are in the process of improving a working Federal Tax Information "Tracking and Control System" which already detects and deters unauthorized access attempts. We have and will continue to provide extensive awareness training to all employees using Federal Tax Information regarding the recognition and reporting of Unauthorized Access occurrences, attempts, etc.

REVENUES GENERATED AS A RESULT OF DEPARTMENT'S USE OF FEDERAL TAX DATA:

Twelve Month Period Ending December 31, 1998

Nr. Of IRS Reports Reviewed:	32,449
Nr. Of Adjustments Made:	9,167
Total Billings:	$11,248,482.
Total Collections:	$ 6, 416,091.
Dollar Amount - Uncollected Files Sent to Collection Services Division:	$ 5,387,649.

Mike Huckabee
Governor

Arkansas Department of Human Services
Office of the Director

329 Donaghey Plaza South
P.O. Box 1437
Little Rock, Arkansas 72203-1437
Telephone (501) 682-8650 FAX (501) 682-6836 TDD (501) 682-7958

September 27, 1999

SEP 29 1999

Ms. Lindy L. Paull
Chief of Staff
Joint Committee on Taxation
1015 Longworth House Office Building
Washington, D.C. 20515

Re: JCT Press Release: 99-03

Dear Ms. Paull:

Thank you for the opportunity to submit written comments regarding those provisions of the Internal Revenue Code (Code) which prohibit disclosure of tax returns and return information. The Joint Committee's review of this subject is particularly timely. The Arkansas Department of Human Services (ADHS) recently received an interim Safeguard Review Report (Report) prepared by the Internal Revenue Service (IRS). **The report brings to light several matters which may have a significant fiscal and programmatic impact upon Arkansas and other states.**

The ADHS administers several federal/state cooperative public assistance programs within the State of Arkansas. Those programs include: Medicaid, Food Stamps and Temporary Assistance to Needy Families (TANF). The Code authorizes the ADHS to receive tax return information in furtherance of the administration of those programs. In some instances federal laws or rules governing the administration of those programs mandate that ADHS receive and utilize the tax return information when determining an individual's eligibility and benefit levels of public assistance applicants.

The aforementioned Report set forth several findings and recommendations concerning the ADHS' utilization of tax return information. ADHS acknowledges the need to limit disclosure of tax return information. However, implementation of several Report recommendations may have a significant impact as ADHS strives to implement the congressionally mandated welfare reform. A brief discussion of the issues follow:

(1) <u>Finding</u>: "The return information furnished under IRC§6103(I)(7) may not be disclosed to, or exchanged with or utilized by any other state agency or other party."

. Discussion: ADHS has the primary responsibility to implement the State's welfare reform initiative. However, ADHS cannot accomplish this objective alone. Effective implementation is dependent upon the efforts of the State's Department of Education, Department of Labor, Department of Health, Employment Security Division and Office of Child Support Enforcement. If ADHS is required to redact an individual's record before referring that individual for the services offered by a sister agency, the receiving agency may be unable to accurately access the particular needs of the individual. This result not only thwarts the spirit and intent of welfare reform, it may deprive the individual of services necessary to achieve and maintain self sufficiency.

ADHS suggests that the Joint Committee consider authorizing re-disclosure or exchange to other state agencies if the redisclosure or exchange furthers the purpose for which the initial disclosure is authorized.

(2) Finding: "The [ADHS] uses contractors to oversee the entire computer function for the eligibility programs."

Discussion: The ADHS receives and processes tax return information through mainframe computers maintained and operated by the Arkansas Department of Information Services (ADIS). ADIS is the separate state agency responsible for establishing the statewide information technology infrastructure. The processed data is transmitted to a database accessible to ADHS. This database is maintained by TRW, a contractor engaged by ADHS. The IRS has determined that these contractual relationships result in a prohibited re-disclosure by ADHS.

The data processing systems utilized by ADHS, including the TRW contract, were approved by federal agencies such as the Department of Agriculture and the Department of Human Services. In some instances the federal agencies provided congressionally authorized enhanced federal funding to develop and implement the data processing systems. In other words, while ADHS adhered to federal public assistance program laws and rules, it may have violated conflicting rules established by the Code.

The ADHS suggests that the Joint Committee review the various obligations imposed upon the states and take necessary action to resolve or eliminate the real or potential conflicts between program administration requirements and Code requirements.

(3) Finding: "Disclosures of FTI are being made by ADHS to a representative of the taxpayer."

Discussion: The ADHS serves a broad array of individuals. A significant number of these individuals lack the capacity (physical or mental) to personally access the service delivery system. Consequently, the ADHS permits third parties to act on behalf of the individual. The

Code permits a court appointed guardian to act as a personal representative of the individual. However, the IRS has apparently applied a narrow definition of personal representatives, such that only those fiduciaries acting pursuant to a court order are deemed qualified to receive tax return information. The IRS' interpretation of the Code does not permit an individual to authorize third parties to access tax return information. The simple truth is that the population served by ADHS does not have the financial wherewithal to access the judicial system. Requiring impoverished individuals to expend limited resources on legal niceties as a condition precedent to receipt of public assistance is antagonistic to the foundation of the programs administered by ADHS.

The ADHS suggests that the Joint Committee consider relaxation of these stringent requirements so that third persons acting on behalf of and in the best interest of a public assistance recipient may review the recipient's tax return information.

(4) Finding: "Physical security of the building and work areas visited does not meet the two-barrier minimum standard."

Discussion: The ADHS is a human services agency. The ADHS makes every reasonable effort to offer its services in an open and accessible environment. Additionally, the ADHS has expended significant human and economic resources to assure compliance with requirements imposed by the Americans with Disabilities Act (ADA).

A significant portion of the population serviced by ADHS has one or more ADA qualifying impairments. Proper service delivery requires ADHS employees have work station access to client records. Those records may contain tax return information. If the ADHS satisfies the IRS imposed two-barrier standard ADHS is at risk of violating ADA standards. More importantly, impaired individuals may be unable or unwilling to overcome the physical plant barriers, thus being deprived of necessary services. This requirement is particularly troublesome because the affected population is frequently composed of those most in need of ADHS services.

The ADHS recognizes the need to maintain a safe level of security. Virtually every ADHS program contains strict confidentiality requirements. These requirements severely limit the accessibility of client records. The ADHS believes that the existing program requirements are adequate to assure that all client information, including tax return information, is safeguarded as specified in IRS Publication 1075 §5.9.

Finally, if the Joint Committee is unable to address the foregoing issue, the ADHS respectfully requests that Congress remove the requirement that states receive tax return information as a condition precedent to participation in federally funded public assistance programs. The safeguarding procedures are so burdensome that the cost of compliance may far outweigh the benefits of accessing the information.

Again, thank you for the opportunity to comment on this important matter. If I, or my staff, can be of further assistance please contact me at the above address or telephone number.

I am enclosing a diskette as you requested. It is in WordPerfect 6.1 format.

Sincerely,

Kurt Knickrehm
Director

KK:dh

Enclosure

cc: Honorable Tim Hutchinson
Honorable Blanche Lincoln
Honorable Jay Dickey
Honorable Asa Hutchinson
Honorable Vic Snyder
Honorable Marion Berry
Honorable Mike Huckabee
Mr. Robert Uhar

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
OFFICE OF THE EXECUTIVE DIRECTOR
450 N STREET, MIC:73, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0073)
TELEPHONE: (916) 327-4975
FAX: (916) 324-2586

September 30, 1999

OCT 01 1999

Ms. Lindy Paull, Chief of Staff
Joint Committee on Taxation
Room 1015 LHOB
Washington, D.C. 20515

Dear Ms. Paull:

In response to the Joint Committee on Taxation's (JCT) request for comments supporting use of Internal Revenue Service (IRS) data by state agencies, the California State Board of Equalization (Board) appreciates the opportunity to provide the following information in support of the Board's continuing need for federal taxpayer data from the IRS.

By way of background, the Board is responsible for administration of California's sales and use, fuel, alcohol, tobacco, and other taxes, and for the collection of fees that fund specific state programs. In addition to administering key revenue programs, the Board plays a significant role in California property tax assessment and administration. The Board also acts as the appellate body for California's franchise and personal income tax appeals.

The Board collects taxes and fees that provide more than 36 percent of the annual revenue for state government and essential funding for local government in California. In fiscal year 1997-98 taxes and fees collected by the Board totaled $33.17 billion in revenue for programs supporting education, health care, public safety, transportation, social services, housing, and natural resource management programs.

The Board and the IRS currently participate in an Exchange of Information Agreement that is beneficial to both agencies. Under the current agreement, each agency provides confidential information for the purposes of tax administration. The existing agreement specifies the types of tax information that may be exchanged, the procedures and protections that must be followed, the format of exchange, and the use of data.

Each year, the Board is required to complete a need and use review for the IRS to ensure the confidential information received is necessary and is being used in a manner that is consistent with the Exchange of Information Agreement guidelines. In addition, the IRS audits the Board on a regular basis to ensure that the Board adequately safeguards all federal tax data.

What Is Confidential Federal Taxpayer Data Being Used For?

Many of the programs administered by the Board utilize federal tax data. The information is used for collection purposes, audit leads, identification of non-filers, verification of taxpayer supplied data, and general assistance in various aspects beneficial to tax administration. More specifically, the Board uses confidential federal taxpayer information to:

- Locate tax debtors, especially those who are out of state and cannot be located through the post office or other skip tracing methods. The data also assists in confirming correct ownership of businesses and identity of officers or partners.

- Identify the amount and sources of tax debtors' income and assets. The Board reviews federal returns to identify payers of interest and dividend income as possible levy sources, and examines depreciation and business income/expense schedules to determine a tax debtor's assets and income. Data is also used to verify sales and purchases and to obtain information on bad debts, sales of assets, and corporate officer compensation.

- Verify the accuracy of taxpayer-supplied information, for example, to substantiate taxpayer claims of hardship.

- Justify a discharge of accountability (write-off) of a tax debtor's liability when no other sources of information are sufficient or available to ascertain the debtor's insolvency or inability to pay. The term "write-off" as used by the Board means removal of the debtor's account from active collection, although technically the debtor remains legally liable for the debt.

- Develop audit leads which may generate additional revenues for the state of California.

- Assist in establishing cost of sales and inventories for mark-up tests, in obtaining information on gross receipts issues and equipment acquisitions and disposals.

What Alternatives, If Any, Exist To Using Federal Tax Data?

It should be noted that, because of the stringent requirements that accompany use of federal data, the Board attempts to use alternate sources of data whenever feasible. Nonetheless, while the Board obtains taxpayer information from other state and federal agencies, the data obtained from the IRS is often not available from other sources. For example, specific schedules from federal returns are used to verify or contradict findings in Board audits. The IRS also provides audit information when there is a change in taxable income over $10,000.00. Such information is not otherwise available.

What Is The Impact On Taxpayer Burden?

If federal tax information were not available, state agencies would require more information directly from taxpayers. State income tax returns, for example, would need to be revised to obtain the same degree of detail as the federal returns in order to allow for the same level of collection information on debtors. This would generate a greater overall taxpayer burden since taxpayers would be required to file more detailed state returns – essentially duplicating the effort and resources expended on filing and preparing federal returns. In addition, audits of taxpayers would be duplicated at the state level.

What Steps Are Taken To Protect Federal Data?

The Board takes proactive steps to ensure that there is no unauthorized access of federal data. The Board has no on-line or direct access to IRS information. The information obtained is tightly controlled and made available only to employees with a "need to know" in connection with performing their respective job duties. Requests for hard copy IRS information can only be made by specifically authorized employees of the Board. Once an authorized employee receives confidential information, it is strictly controlled within the Board.

The Board makes a continuous effort to educate employees of the requirements and responsibilities in handling federal data. Written policies exist within the Board to ensure security. Each year, every Board employee is required to sign the Board's "Confidentiality Statement," in which they are advised that it is a criminal act to disclose or browse both federal and state data and they are informed of the possible consequences of such actions. In addition, Board employees are currently completing a Boardwide Information Security training class which specifically addresses the proper procedures required to protect federal data.

What Information Does The Board Give To IRS?

The Board provides the IRS with audit reports of $100,000 or more of additional gross receipts. Audit reports for arbitrary accounts where the taxpayer was assessed a failure to file penalty and all jeopardy determinations, regardless of the amount, are also provided to the IRS. During the period from September 1, 1998 through August 31, 1999, 405 audit reports were sent to the IRS.

IRS agents routinely visit various district offices to review taxpayer files and return data, information on ownership, copies of audit workpapers, sales tax returns, and registration information. Currently there exists a joint IRS/BOE Audit Project in the Orange County District in which IRS employees contact the Board's district offices to obtain audit reports and taxpayer file information or discuss accounts with the Board's audit staff.

The Board's Fuels Division provides the IRS with test results of fuel samples and shares information with the IRS in joint investigations.

The Board participates with the IRS in the many Fed/State Committees in which information is exchanged. These committees include the Compliance Research and Information Sharing

Committee, Joint Collections/Locator Services Committee, Joint Training Committee, Taxpayer/Preparer Education and Issues for Small Business Committee, to name a few.

What Revenues is Generated by Use of IRS Data?

The Board, in general, is unable to track specific revenues generated through the CP2000 and RAR programs since the information obtained from the IRS is used along with information obtained through various other sources. It is not possible, when utilizing numerous sources simultaneously, to credit a single source for a particular dollar amount. However, the Board has been able to substantiate revenues in a few special projects as follows:

- In a single project that was designed using only IRS CP2000 data, the Board was able to establish approximately $1 million of additional state revenues.

- The IRS Bar and Restaurant Team (BART) provided the Fresno District with seven leads on bars and restaurants that had underreported their sales. These seven leads resulted in audit assessments averaging $20,000 each.

- The Fuel Tax Division has generated $1.7 million in dyed diesel fuel penalties as a direct result of IRS information. Moreover, by cooperating with Federal initiatives and mirroring the state's fuel programs after the Federal programs, there has been an annual increase of over $55 million in state fuels revenue.

The Board intends to continue projects such as these where revenue results can be quantified.

What Are Examples of Improved Taxpayer Service?

In addition to the taxpayer benefits that have already been discussed under "Impact on Taxpayer Burden," exchange of information improves taxpayer services in the following ways:

- The ability to locate taxpayers allows the Board the opportunity to contact taxpayers for voluntary payments rather than initiating involuntary collection procedures. The IRS information may enable us to contact a debtor who has moved out of California and inform the debtor of the liability. The ability to make the contact may result in the debtor learning of an obligation sooner and may save the taxpayer additional interest amounts.

- The ability to exchange of information relieves the taxpayer of the burden of locating IRS returns and/or schedules when the Board may obtain the returns directly from the IRS. There are instances where the income tax returns supports the taxpayer's position and allows the Board to relieve liabilities.

- The public benefits when deficient/delinquent taxpayers pay their fair share so that the rest of the taxpaying public does not bear an unfair burden.

- Improved tax compliance through the exchange of information enables all taxpayers compete in a fair market.

In summary, while the Board does not collect income tax, it is an integral part of the tax structure of the state of California. To effectively identify non-compliant taxpayers, conduct audits, and collect outstanding liabilities, it is essential that the Board continue to receive IRS data.

Again, we appreciate the opportunity to provide the JCT with this information. If you have any questions regarding this matter, please feel free to contact the Board's Disclosure Officer Tina Morin at (916) 324-2063.

Very truly yours,

E. L. Sorensen, Jr.
by TWB

E. L. Sorensen, Jr.
Executive Director

cc: Mr. Harley T. Duncan, Executive Director
Federation of Tax Administrators
Suite 348
444 N. Capitol Street, NW
Washington, DC 20001

Ms. Tina Morin

STATE OF COLORADO

DEPARTMENT OF REVENUE

State Capitol Annex
1375 Sherman Street
Denver, Colorado 80261

OCT 13 1999

September 24, 1999

Joint Committee on Taxation
Lindy Paull
Chief of Staff
Room 1015 LHOB
Washington, D.C. 20515

Dear Ms. Paull:

It has come to my attention that your agency is reviewing the sharing of tax information between the Internal Revenue Service and state tax agencies. The loss of this information would have a profound effect on the Colorado Department of Revenue.

We currently receive most of our federal information via magnetic tape. This information is the cornerstone of our income tax compliance program. To lose this information would require the department to supplement our enforcement efforts by hiring additional personnel. We would then most likely audit some of the same taxpayers the IRS had previously audited. This duplication of effort seems unwise and unnecessary in the current operating mode of smaller budgets and reduced staff. We take the safeguarding of federal information very seriously.

The IRS just completed their annual need and use review. This review focused primarily on current safeguards in place for the protection of the federal data. They made several minor recommendations that we immediately implemented. In addition to the recommended federal procedures, our Disclosure Officer receives a report every month of all accesses to the federal data base. This report lists all social security numbers accessed the previous month. If the accessed SSN is not on our accounts receivable file, a comment is required to be posted. This comment should state the reason for the access and the use of the information. If none of the obvious reasons to access a record is present, the employee must provide the disclosure officer with an explanation as to why the account was viewed. All employees and their supervisors are required to sign a form stating they understand the need and use of this information. They all understand the information is to be used for tax purposes only and a monetary penalty may be imposed along with other civil penalties if they perform an unauthorized access.

As expressed earlier, federal income tax information is our primary source of information in making income tax audit adjustments. The Colorado Individual Income Tax Return starts with federal taxable income. From the federal information we perform an underreporter project that compares reported Colorado federal taxable income to reported federal taxable income on the Colorado return. Additional assessments are also made from the CP-2000 tapes. The

DR 4729 (03/94)

department's primary individual income tax non-filer project compares federal filings with state filings. These four projects accounted for more than 23 million dollars in assessments last year which represents 44% of the total assessments our income tax audit group makes.

The loss of this information would put a significant hardship on the State of Colorado and Colorado taxpayers. The cost to both would be significant in terms of both time and money to recreate the federal audit adjustment.

The department also uses this information for statistical purposes. These statistics help provide other areas in Colorado government information to make informed decisions regarding economic activity.

Please consider the ramifications to the states when making any decisions regarding the sharing of this information. If you need any additional information, please contact me at 303-866-3714.

Sincerely,

John Vecchiarelli
Senior Director
Colorado Department of Revenue

STATE OF FLORIDA
DEPARTMENT OF REVENUE
TALLAHASSEE, FLORIDA 32399-0100

L. H. FUCHS
EXECUTIVE DIRECTOR

OCT 05 1999

September 28, 1999

Ms. Lindy Paull, Chief of Staff
Room 1015 LHOB
Washington, D.C. 20515

Dear Ms. Paull:

The Federation of Tax Administrators (FTA) has made us aware of the Joint Committee on Taxation's study regarding privacy and confidentiality of taxpayer data. The Florida Department of Revenue uses Federal tax information (FTI) extensively and we strongly encourage Congress to allow that use to continue. This letter provides specific information to the Committee concerning our Agency's use of Federal tax information.

While the State of Florida does not have an income tax on individuals, the 36 taxes the Department of Revenue does administer include a tax on income produced by corporations and fiduciaries. We utilize adjusted gross income reported on the Federal corporate income tax return as a basis, thereby reducing taxpayer burden. We also administer taxes on fuels and the value of estates, which are similar to the Federal taxes in those areas. In addition, we administer a tax on the value of intangible personal property held by individuals and businesses. But Florida's most predominant source of income is derived from our sales and use tax. The Department utilizes FTI to some extent in the administration of each of these taxes.

Corporate Income Tax

Data from the IRS's Business Master File and Business Returns Transaction File (BMF/BRTF) tape extract programs are used to identify new accounts, identify changes to addresses or other social information, and to identify leads for audit selection or other compliance and enforcement activity. Utilizing information from the BMF file, 21,100 new corporate accounts and 9,680 new fiduciary accounts were identified during 1998. In addition, 355 fiduciary accounts were reactivated and 3,338 fiduciary accounts were updated.

Under our agreement with the IRS, we are provided with photocopies of agreed Revenue Agent's Reports (RAR's) when completed on Florida corporations. Recoveries generated from the use of Federal RAR's during 1998 totaled $4,590,726.19.

Fuel Tax

The Florida Department of Revenue is an active participant in the Federal Highway Administration's Fuel Tax Evasion Task Force. Through the task force, state revenue agents work closely with IRS agents to combat fuel tax evasion and fraud by sharing information on specific cases under information sharing agreements. The most measurable benefit of the task force is in the sharing of information identifying Federal dyed diesel violations. In 1998, we received 108 referrals of dyed diesel violations on Florida highways from the IRS. State penalty assessments were issued based on 105 of those referrals, totaling $147,052.06.

Estate Tax

We work closely with IRS estate tax examiners in our review of estate tax files. To close a Florida estate tax file, we must have evidence that the Federal estate tax file has been closed. Prior to January 1, 1999, IRS provided our agency with photocopies of Federal estate tax closing letters on Florida estates, which were used to either validate information provided by the estate or to close the State file when documentation had not been provided by the estate. In lieu of using hard copies of Federal closing letters, we plan to establish a process to match State estate tax closing information with Federal estate tax closing information provided to our Agency by IRS on the BRTF extract.

Intangible Personal Property Tax

Florida's intangible tax is based on the value of stocks, bonds, accounts receivable, or other intangible property held by individuals, corporations, partnerships, associations, trusts, or other fiduciary entity. We utilize information from the Federal extract tape program to identify new accounts and update account information on individuals and businesses that are, or may be, liable for Florida intangible tax.

During 1998, we identified 28,146 new accounts from the Individual Master File (IMF), representing individual or joint accounts that potentially owed Florida intangible accounts. Individual accounts are identified based on value of stocks, bonds, or other intangibles reported to the IRS on individual income tax returns. While this information may be available on information returns filed with the Department of Revenue by stockbrokers, the IRS data is still the best source of this information. New corporate and fiduciary accounts as described above are also added to the intangible database as potential intangible tax filers. New accounts, both individual and business, identified from the IRS extract tape program are mailed intangible return packages, including instructions on what property is taxable as well as how, when, and where to file.

During reviews of intangible tax accounts, state auditors or investigators routinely check individual income tax returns to identify the specific intangible assets reported to the IRS on Schedule B of the individual Federal income tax return. If this information is not made available by the taxpayer, or if we have suspicion that the taxpayer may not provide us with the actual return filed, we have the ability under our current information sharing agreement to request photocopies of the taxpayer's income tax return from the IRS.

Sales and Use Tax

Florida tax auditors and investigators routinely match gross sales reported on Florida sales and use tax returns against gross sales reported to the IRS. These figures sometimes come from business returns, but frequently come from Schedule C of the taxpayer's individual Federal income tax return. Under our current agreement with the IRS, this information, when needed, may be obtained in response to a specific request or from a review of IMF extract tape information.

We are working to improve our sales and use tax databases by capturing social security numbers and Federal employer identification numbers of registered dealers to better enable us to match against gross sales data on the IMF extract. Identifying unreported sales or other discrepancies will benefit both the IRS and the Florida Department of Revenue.

In addition to utilizing FTI directly in the administration of taxes as discussed above, we also use it extensively in our Office of Research and Analysis. Federal extract data is critical to our research and analysis program because we do not have any other readily available means of finding and segregating unregistered taxpayers and/or occupations. The Federal extract program allows us to compare similar data that is reported to both IRS and the Department of Revenue. Federal extract data is used extensively in creating revenue estimates and in the analysis of proposed tax legislation.

Our agency is very sensitive to the IRS's unauthorized access (UNAX) issues. We have updated our policy directive on confidentiality to specifically prohibit unauthorized access and use of FTI, as well as state taxpayer information. We have posted warning banners on our mainframe tax database to make employees entering the system aware of UNAX issues and penalties. We have received copies of the video, STOP UNAX IN ITS TRACKS, produced by IRS for state tax agencies, which will be featured in a new security awareness program currently being developed for all staff. We are working to develop programs to aid in discovery of UNAX violations.

The Florida Department of Revenue would very much like to continue our information exchange program with the IRS. In addition to the uses and benefits stated above, we believe the IRS also benefits from this program. We frequently provide sales and use tax information to IRS agents attempting to determine unreported income from businesses in the state. It would be very difficult to derive information from other sources that would have the same level of reliability and value. If you have any questions, please contact either my office at (850)488-5238, or our Industry and Intergovernmental Relations Director, Bebe Blount, at (850)921-4418.

Sincerely,

L. H. Fuchs

L. H. Fuchs

LHF/bh

cc: Harley T. Duncan

BENJAMIN J. CAYETANO
GOVERNOR

MAZIE HIRONO
LT. GOVERNOR

RAY K. KAMIKAWA
DIRECTOR OF TAXATION

MARIE Y. OKAMURA
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

SEP 24 1999

September 17, 1999

Ms. Lindy Paull
Chief of Staff
Joint Committee on Taxation
Room 1015 LHOB
Washington, D.C. 20515

Dear Ms. Paul:

We were informed of the JCT's study regarding privacy and confidentiality of taxpayer data and the possibility of limiting the sharing of this extremely vital information with state tax agencies. We would like to take this opportunity to strongly request the continuation of the states' ability to obtain taxpayer information from the Internal Revenue Service (IRS) for tax administration purposes.

The Hawaii Department of Taxation and the IRS entered into an Agreement on Coordination of Tax Administration, which provided for the reciprocal sharing of taxpayer information, cooperative activities, and the safeguarding of all confidential taxpayer data.

We request and receive copies of federal tax returns and/or computer transcripts for income tax compliance purposes (e.g. nonfiler of state returns). We also receive Revenue Agent Reports (RAR) and CP2000 adjustments on Hawaii taxpayers, which generate approximately 2,500 adjustments in the amount of about $6 million per year. In addition, we yearly order and receive computer files containing federal tax information on individuals (IMF/IRTF) and businesses (BMF/BRTF) that are used for statistical and compliance purposes. This information became all the more important when this state in 1995, to ease the tax filing burden, incorporated a single page return that starts with the federal adjusted gross income. This was made possible because of the availability of return information through our reciprocal exchange agreement with the IRS.

In return, the state provides the IRS with copies of all state income tax adjustments and copies of state tax returns upon request for compliance purposes. In addition, we provide the IRS with magnetic tapes of our Comprehensive Net Income Tax System (CNIT) and our General Excise and Withholding System (GEW) for tax compliance use and audit selection.

Due to the highly confidential nature of tax return information, we undergo yearly need & use and safeguard reviews by the IRS. We constantly remind our employees of the confidential nature of this information and the applicable penalties for any unauthorized disclosures. We also require all employees to view video tapes of an IRS disclosure class and on Unauthorized Access (UNAX).

The Hawaii Department of Taxation has a critical need for confidential IRS taxpayer information and again urge you to allow state tax agencies to continue their reciprocal exchange programs.

Our exchange of information agreements also accrue to the benefit of the Internal Revenue Service as well. We have had joint compliance projects in which state tax information was used as a basis for millions of dollars in federal assessments and collections.

Very truly yours,

RAY K. KAMIKAWA
Director of Taxation

cc: Harley T. Duncan, FTA (via fax)

Encl. diskette

A:\kam11.wpd
MW

Illinois Department of Revenue
101 W. Jefferson St.
Springfield, IL 62702

SEP 28 1999

September 24, 1999

Ms. Lindy Paull, Chief of Staff
Room 1015 LHOB
Washington, D.C. 20515

Dear Ms. Paull:

The Illinois Department Of Revenue has been sharing information with the IRS for over 25 years. Information has been shared as provided in our Information Sharing Implementing Agreement as specified in IRC 6103. We have always been concerned over protecting the confidentiality of this information as well as our confidential information and remain vigilant to protecting the rights of taxpayers.

The following list is information received from the IRS.

MAGNETIC MEDIA EXTRACT PROGRAMS

TAPES	USE
. Individual Master File (IMF)	Identify nonfilers and underreporters
. Individual Returns Transaction File (IRTF)	Prepare the returns identified by the IMF
. Business Master File (BMF)	Same as IMF except for business
. Business Returns Transaction File (BRTF)	Same as IRTF except for business
. Levy Extract	Identify assets of delinquent taxpayers
. CP 2000	Identify underreported income
. Exam/Appeals Extract	Identify Federal changes and verify corrections to state returns
. Non-Itemizer	Identify individuals who did not itemize so the state is not required to issue 1099G's
. Taxpayer Address Request (TAR)	Find a better address for a taxpayer

NON-MAGNETIC MEDIA

. Revenue Agent Reports (RAR)	Identify changes in the taxpayer's income
. Individual Requests (SC-16's)	Verify information on state returns
. Referrals	Identify potential audit candidates

The following list is the information sent to the IRS.

. Tape of Illinois filers with reported AGI's greater than reported to the IRS	Identify non-compliant taxpayers
. Tape of Illinois filers not filing Federal returns	Identify non-compliant taxpayers
. Refund amounts	Offset against IRS liabilities
. Audit Reports of underreporting receipts	Audit leads
. Motor fuel tax and income tax referrals	Audit leads
. Tax protester information	Compliance

The information we receive from the IRS could not be obtained from any other sources. Revenue generated from the exchanges include 500 thousand from the CP-200 program, 14 million from RAR's and 16.5 million from the other tape matching programs. The benefit from the other programs is not as easily identified but is considered substantial. The greatest benefit of all is the time savings for the Revenue Department and the taxpayer. When we obtain the information easily from the IRS less of a burden is placed on the taxpayer to provide copies or other documentation. This filing season we are striving to have one stop shops in our major Taxpayer Service locations. The more the IRS and states cooperate the more efficient the operation and the ultimate winner is the taxpayer.

All employees including contractual are made aware of the confidentiality issues through the Employees Handbook as well as a Disclosure/Freedom Of Information Booklet.

If you have any questions or, please feel free to contact me at 217-782-7385.

Sincerely,

Dwight Reese, Manager
Office Programs Division

Illinois Department Of Revenue
P.O. Box 19012
Springfield, Illinois 62794-9012

cc: Harley Duncan

STATE OF
IOWA

DEPARTMENT OF REVENUE AND FINANCE
GERALD D. BAIR, DIRECTOR

September 30, 1999

OCT 01 1999

Lindy Paull, Chief of Staff
Room 1015 LHOB
Washington, DC 20515

Re: Study of State Uses of Federal Tax Information

Dear Ms. Paull:

I am writing this letter in response to a study be conducted by the Joint Committee on Taxation (JCT) concerning the privacy and confidentiality of taxpayer data, whereby the results may limit the amount of Internal Revenue Service data that can be shared with the state tax agencies. The receipt of federal tax information is of tremendous value to our state tax agency and if limited would adversely affect our state's administrative processes, revenues, and most importantly, our customers.

Since Iowa's individual and corporate income tax laws parallel the Internal Revenue Code very closely. The Iowa Department of Revenue and Finance receives and utilizes the following federal data on a regular basis.

- Income Tax Master File (IMF)
- Business Tax Master File (BMF)
- Revenue Agent Reports (RARs)
- CP2000 (Under reported income reports)

In addition to the data received on a regular basis, special requests for specific federal data are frequently made each year via Form 8796, Request for Information. Examples of such requests include:

- Copies of federal tax returns and transcripts
- Tax practitioner information
- Updated taxpayer addresses
- Copies of W-2 statements

Non-filer and selective audit programs are generated by the state to primarily promote tax compliance and provide tax reporting consistency and equitability for each Iowa taxpayer. Federal data from the IMF and BMF files are frequently used to identify state non-filers and supplement state data in the selective and under reporting audit programs administered by the Iowa Department of Revenue and Finance. The information obtained from these federal data sources is critical to the administration and success of Iowa's compliance programs. Federal data used in the administration of

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state compliance programs significantly decreases the amount of information needed and requested from the taxpayer for each state audit. Limiting the amount of federal information received by the state would require more information to be obtained and submitted by the taxpayer. Taxpayers would not only have to provide information to the IRS for federal audit purposes, but would be subject to the same requests during state audit processes. In addition, a duplication of effort by the IRS and state tax agency would occur. Thus, reduction of customer services, creating a burden on the citizens of Iowa, and promotion of duplicate efforts performed by the federal and state agencies would occur.

The IRS and state tax agencies have a common goal to administer tax laws, promote tax compliance, and provide quality customer service. By working together, these goals can be obtained more efficiently and consistently with less burden on the taxpayer. Many successful joint federal-state compliance projects have proven to be less intrusive and more productive.

Limiting the amount of federal data shared with the states would increase the number of employee hours needed to administer existing compliance programs. Additional examiner, auditor, and technical resources at the state level would be necessary in order to maintain the current level of state compliance programs. Adding staff resources in order to maintain the existing compliance programs would theoretically cost the citizens of Iowa. At the same time, the state's revenue stream would also suffer if the level of revenues received decreased as a result of limited federal information. Without sharing of information many taxpayers could be subject to duplicative audit efforts, i.e., the same taxpayer could be subject to not only a time consuming federal audit, but also a state income tax audit.

Although federal data is utilized to supplement and improve the efficiencies of many compliance programs administered by the Iowa Department of Revenue and Finance, a significant amount of the state's revenue stream is directly attributable to the sharing of specific federal audit data. State revenues generated as a result of information received from IRS which includes federal audits (RARs) and underreporting of income reports (CP2000) and federal tapes for the last three state fiscal years are as follows:

	FY1999	FY1998	FY1997
Federal Audits	3,821,907	2,414,979	3,416,379
CP2000	1,450,377	1,656,074	1,512,598
Federal Tapes	1,146,978	1,061,216	1,422,090
Totals	6,419,262	5,132,269	6,351,067

Tax data, whether federal or state, are subject to stringent security and confidentiality guidelines. Iowa has passed a statute similar to IRS restricting unauthorized access to confidential information when there is not a "need to know." We train and update our employees on an annual basis regarding the provisions of federal and state confidentiality statutes and the ramifications for violating those statutes. Each employee signs a statement on an annual basis. In summary, limiting the sharing of tax information between federal and state agencies, would be a disservice to taxpayers. The costs associated with tax administration would increase. State and federal revenue streams would decrease.

Iowa is committed to continually improve the services provided to our citizens. Information obtained from the IRS plays an important part in being able to meet this goal. By working together, we can continue to improve upon the services that are provided for our citizens.

If you have any questions or need further information, please let me know. I can be reached at (515) 281-3204.

Sincerely,

G.D. Bair
Director

STATE OF KANSAS
Bill Graves, Governor

Jeff Scott, Director
Division of Tax Operations
Kansas Department of Revenue
915 SW Harrison St.
Topeka, KS 66612-1588

DEPARTMENT OF REVENUE
Karla Pierce, Secretary

(785) 296-6431
FAX (785) 296-8974
Hearing Impaired TTY (785) 296-3909

Division of Tax Operations

September 29, 1999

OCT 05 1999

Joint Committee of Taxation
Lindy Paull, Chief of Staff
Room 1015 LHOB
Washington, D.C. 20515

Dear Ms. Paull:

This is the Kansas Department of Revenue's response to the FTA Bulletin on the Congress Studying States' Use of the Federal Data.

To the first question:
What the confidential federal taxpayer data is being used for, explaining the use for, explaining the use as specifically as possible:

Kansas use of Federal Data is to review individual Income tax accounts for compliance to research for Non-filers and underreporters within the state. We have a Tax Discovery system that houses the Federal Data that is submitted for review in a location of the Compliance Management section of Kansas Department of Revenue.
The programs that are established currently in the Tax Discovery Location are:

- The IMF/IRTF in which these account are matched against Kansas tax records and reviewed and placed into various states within the Tax Discovery Location one is for Nonfilers the other is for Underreporters. This location within Tax Discovery allows the cases to be managed in various stages so they can be monoitored for compliance and assessments of liability to the customers accounts within the worklfow of the state. The IMF/IRTF are also within the Kansas Department of Revenue used for Statiscal information anyalyzing specific data of income and filing status of customers within Kansas.
- The CP2000 program, an IRS program for computer audits of Kansas customers, is also housed in the Tax Discovey location and is researched for both Nonfilers and underreporters. The screening and matching of Kansas Data to the Federal Data is done through a Sub-System referred to as ACSS subsystem of the Astra Compliance Management system to determine which states the CP2000 accounts go into within the Discovery location so the accounts can be managed. Letters of non-filers and underreporters are then sent to customers for compliance by Customer Representative as the accounts get reviewed. They are also put in various states to determine whether they need second letters or assesment to the accounts.
- The Revenue Agents Reports (RAR's) are also housed within the Tax Discovery location. They also are submitted through the ACSS subsystem for review and analyzing to determine if they are Nonfilers and Underreporters. They are also mangaged in the Astra Compliance Management system

Tax Discovery Location which allows them to go through various work flow states so the nonfiled letters and underreporter letters and assessments can be done.

These programs are very helpful in providing good compliance for the Kansas Department of Revenue and are also a helpful tool for updating Individual Income tax records information on Kansas Customers.

To the Second Question:
What alternatives, if any, exist to using the federal tax data:

The other alternative that Kansas would result to using would be;

- To have redesign a matching process within are own systems to try to identify non-filers and underreports.
- Coordinate better methods of matching within other Kansas State Agencies to identify nonfilers and underreports which would take some design developments depending on what types of information each of the other states agency could provide.
- Coordinate better methods of matching programs with other States and the information that could be exchange which would entail developing programs of exchange of information to be more enhance than what they currently exist.
- Develop a process to work with the various business communities withing the state for education and exchange of data they have for our compliance efforts.

To the Third Question:
What Impact on the taxpayer burden:

- This would create much involvement with the Taxpayers of Kansas. This would require a process to reeducate them for compliance by having to request they file their Kansas tax returns and provide completed copies of the federal return and supporting schedules instead of using the Federal IRS Data for matching and comparison.
- This would also have to communicate to tax preprarers , CPA's etc. the need for the federal return and supporting schedules instead of utilizing the Federal
- This would also create redevelopment of the work flow for the returns and how they are maintained and the record keeping. Currently with the IMAGED system captures only basic Kansas information is captured and this would create the need to have more forms and data capture to be maintained in the current system to be able to keep the compliance process in motion. This would create system enhancement and changes also to be able to Image this data.
- Without the Federal Data the automated information would create a heavy manual process work load for both programmers and associates to handle the information we would have requested from the taxpayers of Kansas. Many work areas would require additional procedures for the work flow.

To the Fourth Question:
What Steps you have taken, or heightened sensitivity you have shown, to protecting federal data from Unauthorized Access:

- Strict levels of Security are maintained by the system administrators of the Kansas Department of Revenue to document all systems and the various work flow usage of the Federal Data. Reports and records are kept of any users who access the systems that maintain any Federal Data.
- Kansas Department of Revenue requires all associates to sign a secrecy oath which is in compliance with the Internal Revenue Code Section 7213 (a) (2).

- Reports of the data that is used through the Federal State exchange of information is complied and provided to the IRS of the information on the IMF/IRTF, CP2000, RAR's and the activity as required by the IRS safeguard standard.

The Kansas Department of Revenue has been going under many system and processing changes with the Project 2000 designing so there are many processes areas still underconstruction and redesign. Therefore, it would difficult to provide an accurate statistical record of the Federal Data. Answering the questions above should be of some help with your survey.

If there are other questions that the Kansas Department of Revenue could provide a response to regarding the above information, please feel contact me.

Sincerely,

Sylvia Champney

Sylvia Champney
Fed/State Coordinator

Cc: Jeff Scott, Director
Division of Tax Operations

STATE OF LOUISIANA
DEPARTMENT OF REVENUE

OCT 0 7 1999

M. J. "MIKE" FOSTER, JR.
GOVERNOR

September 22, 1999

BRETT CRAWFORD
SECRETARY

Joint Committee on Taxation
Attention: Ms. Lindy Paull, Chief of Staff
Room 1015 LHOB
Washington, DC 20515

Dear Ms. Paull:

We in the State of Louisiana would like to assure the Joint Committee on Taxation (JCT) that federal taxpayer data provided to the Louisiana Department of Revenue is used only to assist in the collection of state taxes. Furthermore, this data is sufficiently protected according to Federal guidelines, and both the state and the taxpayer benefit from the exchange of tax data.

Our agency responded to the survey conducted by General Accounting Office (GAO), and I am writing these comments to the Committee to provide feedback on its study regarding privacy and confidentiality of taxpayer data. Any federal tax data received is used solely for tax administration purposes. We are the tax collection agency for the State and we also have a state confidentiality law that allows us to share state tax data with the Internal Revenue Service.

As reported to GAO, the federal data that we obtain is used specifically as follows:

- Tape extracts are used to identify and assess non-filers and verify accuracy of data submitted by the taxpayer. This is done only when the taxpayer has not voluntarily done so.

- RARs (revenue audit adjustment reports) are used as a basis for adjusting the Louisiana return and making additional assessments.

- Returns or return information are used to determine income sources, establish state of residency, determine filing status, compare to information filed on state returns, determine reason for adjustments on federal returns, determine enforcement action taken by IRS, determine types of deductions claimed since state returns piggyback federal returns, and to review client listings of tax preparers, etc. Assessments are sometimes generated from this information.

Post Office Box 201 • Baton Rouge 70821-0201
Telephone 225-925-7537 • (TDD) Telephone 225-925-7533
www.rev.state.la.us

We have no other alternative sources for the federal tax data that we receive. Several years ago our state sought to reduce taxpayer burden by simplifying the state income tax return and using the federal adjusted gross income as the starting point on the state return. Therefore, this "piggyback" of the federal return means that federal tax data is vital in many instances to validate income taxable by this state, as well as other elements of the return, such as filing status and exemptions.

Additionally, whenever we can work jointly with federal tax representatives it saves the taxpayer time, as well as reduces the duplication of effort of both the federal and state agencies. The sharing of individual and business audit information, joint audits, and joint projects, such as in the areas of the gaming industry and installment agreements, are initiatives that benefit all three parties.

The taxpayers of Louisiana have benefited from the revenue generated from the Federal/State exchange program. The average annual revenue from RARs and the return tape extracts for the last four fiscal years was as follows:

- RARs $ 3,313,137
- Tape extracts $15,033,325

This department has been vigilant in the area of protecting federal tax data from unauthorized use or access. We have partnered with the IRS on this issue through their safeguard reviews, need and use audits, and open and straightforward communication about any questionable areas, in addition to our regular self-assessment. The guidelines provided for security of federal data are followed and communicated to all involved persons in our agency. To underscore the importance of securing this data and also the Unauthorized Access (UNAX) requirements, the IRS recently conducted a thorough training session at our Baton Rouge office. They have provided us with materials and videos that we will use in training our employees, and they have agreed to conduct more of these training sessions along with our Disclosure Officer/Federal-State Coordinator.

Both taxpayers and this state would be affected if changes were made in the availability of federal information. While conducting your study of the privacy and confidentiality of taxpayer data, we hope that you will consider that this state needs the federal tax information that the Department of Revenue now receives to administer its tax laws and generate revenue for the state's citizens. We use it only for the purposes agreed to and as required by law, and we take steps to adequately protect the data provided to our Department. Taxpayers benefit from simplified tax returns, time saved in dealing with federal and state tax representatives, and the additional revenue that results.

Sincerely,

Brett Crawford
Secretary
(225) 925-7680

BC/hh

MINNESOTA Department of Revenue
Assistant to the Commissioner
Mail Station 7100
Phone (651) 282-5778
St. Paul, MN 55146-7100
Fax (651) 297-5309

OCT 08 1999

Date: October 1, 1999

To: Lindy Paull, Chief of Staff
Joint Committee on Taxation

From: Jack Mansun, Assistant to the Commissioner
Minnesota Department of Revenue

Subject: States' Use of Federal Data

I am sending this letter in support of continuing to allow the State of Minnesota and other states access to and use of IRS information. As you conduct your study of the privacy and confidentiality of this information, please consider my comments in your analysis.

The state receives many benefits from the sharing of this information, all of which helps us administer our tax system. More importantly, this two-way exchange of data reduces the burden placed on taxpayers. It also helps to minimize the requirements for submission of redundant information to both the states and the Internal Revenue Service.

I have included several pages which outline how the Minnesota Department of Revenue is using this information to further our mission of achieving compliance with the state tax laws.

Thanks for your consideration of these comments.

If you would like additional information or need our help in anyway, please call me at (651) 282-5778.

Sincerely,

Jack Mansun

Jack Mansun

TDD: (651) 282-5778

Minnesota Department of Revenue Use of Confidential Federal Data

The following are specific examples of how MDOR is using confidential federal taxpayer data and for what purpose. In each situation, these records are being used to further Minnesota tax administration objectives, for tax policy, service and compliance with the tax laws.

Research Division

This division uses confidential federal taxpayer data for the creation and use of a biennial homestead parcel database and blurred sample, and for the creation and use of a tax sample for internal production of a biennial study of state and local tax incidence. In addition, federal income return tapes are sometimes used within the Research Division for ad hoc requests to develop information and estimates.

Until recently, the homestead parcel file has been created every other year, using state and local tax and refund information, and federal data on income from federal income tax tapes (IRTF/IMF tapes and the 1099 tape). The most recent database was created for taxes payable 1996, and the most recent blurred sample was created from taxes payable 1994 data. A copy of the blurred sample is provided to the House of Representatives Research Office, under a state mandate, for their use in legislative analysis.

The tax incidence sample is created biennially to support a mandated study of state and local tax incidence in Minnesota. The tax incidence sample uses state income tax return data, and includes property tax information from the homestead parcel file, as well as imputed information on state sales tax and other state taxes. In the case of persons who did not file either a Minnesota income tax return or a property tax refund claim some information is included on social security, dividend, pension, interest, and wage income from federal 1099 tapes. The sample is used only internally within the Research Division of the Department of Revenue.

Homestead parcel database and blurred sample

The homestead parcel database for property taxes payable in 1996 is used internally by the Research Division to analyze property tax burdens and housing consumption, and to estimate property tax refund costs and distribution under current law and for various legislative proposals. The database links information on property tax to Minnesota and federal income tax return data. The complete database includes over 1.2 million records on all homestead parcels in the state. Work is underway currently on a new version of the database for property taxes payable in 2000 (income year 1998), leaving out payable 1998 in the biennial sequence.

The Research Division also has created a blurred sample of the homestead database in response to a state mandate. The most recent blurred sample created was for taxes payable 1994 (income year 1992). The burred sample is provided to the House of Representatives Research Office for use in legislative analysis, primarily of the state property tax refund program for homeowners.

The pay 1994 sample for House Research use was prepared by selecting a stratified random sample of about 45,000 parcels. The confidential data was blurred by removing all geographic or individual identifiers (except for an economic region code for 19 regions statewide), selecting sample ratios in most cases of 1 in 10 or less from each strata of parcel market values, rounding the market values and net property tax of individual parcels, capping high market values and incomes, and visually inspecting and adjusting if necessary the values for individual parcels within cells of a summary table by market value and region. The pay 1994 sample included fields from the federal 1992 return tapes IMF/IRTF, including FAGI, exemptions, tax exempt interest, and state and local deductions (capped at $50,000).

This past summer we were given a copy of an IRS internal memo spelling out new IRS policies for creation of blurred samples containing federal tax return data. In response to that internal memo, we have submitted a "Need and Use Statement" to our local office of the IRS spelling out new procedures for creation and use of a property taxes payable 2000 homestead parcel database and blurred sample. Our need and use statement outlines a new procedure for protecting the confidentiality of federal return data for the blurred sample of the pay 2000 database. We are currently in the process of revising those proposed procedures in response to feedback from IRS staff in the Statistics of Income office in Washington, D.C. and from our legislative staff customers here in Minnesota. The new procedures will provide an even greater level of protection for the privacy and confidentiality of federal taxpayer return data.

There exists no good alternative to use of federal return data in the creation of a blurred sample of income and property tax data for homesteads, to be given to the House Research Office. The legislative staff uses the blurred sample primarily to estimate the tax burden impacts of proposed changes to the property tax refund formula, or to estimate the level of change in the refund in response to legislative changes elsewhere in the property tax system.

A reliable estimate of household income is critical to estimates of the income-based property tax refund for homeowners. It is unrealistic to expect the Research Division of the Department of Revenue to provide all legislative analyses of the property tax refund because of limited staff in the Department, and because legislators work on a confidential basis with legislative staff to develop their proposals. Because the state property tax refund formula uses total household income as a basis, and the state income tax return requests only federal taxable income from taxpayers, state income data alone is incomplete, and needs to be supplemented with federal return information to accurately estimate the state property tax refund.

If we continue to have access to federal return data to create the homeowner database and blurred sample, there will be no added burden on taxpayers because the data is assembled strictly from return information already filed by taxpayers. No taxpayers are contacted for additional information. If our access to federal return data is restricted and it becomes necessary to request income information from taxpayers directly, the burden on taxpayers would increase.

State Tax Incidence Sample

The Research Division also produces a state tax incidence sample for use in a mandated study of state and local tax incidence. The sample is created every other year, most recently using 1996 income year tax information. As indicated in the overview, the tax incidence sample uses state income tax return data, and includes property tax information from the homestead parcel file, as well as imputed information on state sales tax and other state taxes. In the case of persons who did not file either a Minnesota income tax return or a property tax refund claim, some information also is included on social security, dividend, pension, interest and wage income from federal 1099 tapes.

The sample is used only internally within the Research Division of the Department of Revenue, and the published summary report is at the statewide level, using population deciles or income ranges sufficiently broad to prevent identification of confidential federal return data.

Other Research Requests

The Research Division of the Department of Revenue also uses federal tax return tapes and the 1099 tape to develop statewide estimates for ad hoc research requests. The typical product of this work is a statewide estimate of the impact of a proposed law change. The federal return information is used only within the Department, and the resulting estimates are at a high level of aggregation, preventing disclosure of confidential return data.

Non-Research Divisions:

Even though, the Research division is the main consumer of this federal information other areas of the department also use this information for tax administration purposes.

IMF/IRTF Extract Files

IMF/IRTF data elements are entered into the Minnesota Department of Revenue TRIPOD (Tax Return Information Put On Display) system for retrieval to resolve tax administration issues. Federal information is linked to state individual income tax return information for the corresponding year. Delinquent federal years are now also captured from the federal file and matched to the corresponding state year. Information is maintained on the system for six years before the sixth year is purged when the most current year is added.

Data items are displayed on the system within their graphically displayed tax form. They can be accessed by tax form or groups of forms for a defined year or multiple years and can be viewed and/or printed at the option of the user if he/she has been granted those rights beyond read only.

Security controls include a report that defines identity of taxpayer, years/forms accessed and disposition. Beginning access date, ending access date, report sort order, identity of user and access outcomes can be controlled and reported by the system administrator.

The IMF/IRTF is copied to the mainframe computer for audit selection projects. Thresholds are determined for various data fields and identified records are matched to other Social Security Number indexed databases from other agencies such as the Minnesota Departments of Commerce, Economic Security or Revenue databases such as the individual income tax return processing file.

SSNs are used to validity check those contained in the state income tax return comprehensive history file. Returns unmatched after this comparison are used for the validity check with the SSN tickler file.

We also run an annual job to match & select records with non-wage income. This is done by matching the file of licensed medical providers with the latest IMF/IRTF file. The provider file matched by social security no. is coded by type of provider and is furnished by the Minn. Dept. of Health. The resultant file of licensed providers includes Schedule C and Schedule E federal data. It is then matched to the MinnCare Registration file to detect medical providers not registered for MinnCare. These providers with related data are then transferred to a lotus notes database for use by MinnCare staff who contacts them to obtain registration.

Collections staff occasionally access the database for working collection cases.

BMF/BRTF Extract Files
Minnesota corporate franchise tax returns are based on federal taxable income with certain modifications. Both Minnesota and non Minnesota corporations are subject to the Minnesota Corporate Franchise Tax. Federal data is used to verify line items of the return, review nonfiler issues, and verify income amounts for consolidated groups. Also, federal data regarding, balance sheet items, return scoring, 1099/98 payments, etc can provide audit indicators or verification for a Minnesota return.

The Partnership, S-Corporation, Fiduciary Unit uses federal data items to discover nonfiling partnerships, s-corporations and trusts. Federal data items are entered into the data system and used as an audit selection tool which integrates state and federal tax return information. A federal/state small business project team meets periodically to identify various audit projects based on selection criteria developed from fields on the BMF/BRTF.

The Withholding Division uses data items to identify nonfilers and underreporters.

CP 2000
A request for a number of taxpayer records is sent to the programmer with filters for selecting records with discrepancies. Those selected result in tax orders, which are sent to the Tax Order Processing System. This information is processed and made available to auditors and collectors for follow-up. Minnesota generated approximately $5.2 million from this project in FY99.

Levy Extracts
The Collections Div. sends a tape of selected taxpayer filter data to the IRS. The IRS sends back the Levy Extract containing 1099 and W-2 information for the specified taxpayers. Collections then uses this information for levies against income sources to satisfy tax debts.

IRMF
We run a job that attempts to match Minnesota 1099 payees against our tax file. If the payee is not on our file, we place a record in our database and examiners follow up to determine if an assessment should be made.

Another annual job is run to pull off interest payments from banks to locate sources of undeclared income. A paper report of 1099 transactions is sent to the Corporations Division for follow-up.

Federal Audit Reports

A clerk in the Income Tax Compliance Unit enters data from FARs into a temporary FoxPro database. When 400 or 500 are accumulated, the supervisor asks the programmer to run the FAR job which sends the data to a mainframe tape which is input to the Tax Order Processing System from which tax orders are run and sent to taxpayers. After this, the FARs are held for 90 days before being sent to the Information Management Division for imaging and destruction of originals. Minnesota generated approximately $6.8 million from these reports in FY99.

EOMF

Used to detect exempt organizations, which have not filed Unrelated Business Income Tax reports.

Individual File Requests

Weekly requests for paper files on taxpayers are sent through the District IRS Disclosure Office.

Exam/Appeals

Extract contains audit changes made to Minnesota partnerships and s-corps for the year. A programmer runs a match of this tape to our systems and sends a spreadsheet of matches to the Partnership, Small Business Unit and Income Tax Compliance Unit to serve as audit leads.

UNAX Initiatives

Nearly all 1,200 Department of Revenue employees were trained with regard to increased precautions to prevent unauthorized access to federal data and the penalties involved. All new hires are required to attend this training. The training was extended to cleaning staff, the state legislative audit staff and capitol security staff assigned to the building. The department's code of conduct was amended to specifically state that unauthorized browsing is not allowed. Our current systems and limited resources prevent proactive programs to detect unauthorized browsing by individuals who have been granted access. However, when allegations of browsing are made, an investigation is conducted, using the tools currently available which track users access to private information.

Information Sharing with the IRS

The Department of Revenue provides the IRS with more information now than we have in past years due to the passage of third party notification legislation. We fill requests for individual filings from IRS audit staff. The following form copies are some which have been requested and sent from this office: 1120, 1120S, 1040, 1040X, 990, 1065, audit work papers, W-2s, state ST-1, M-1 and M-1X. Sometimes the IRS requests correspondence from the taxpayer. The IRS also receives copies of all Minnesota generated audits if they meet tolerance limits established.

Alternative Solution

There is no good alternative to receiving federal tax data regarding tax filings and financial transactions, unless multiple information submission is required of the public (one to the IRS, and additional submissions to state agencies). Duplicate information submission requires redundant efforts on the part of government to process and maintain this information in a useable format. For instance, a Minnesota resident would need to file a federal income tax return with both the IRS and MDOR, and each would need to process and maintain the same information to be able to perform their tax administration responsibilities. Limited resources and systems currently prevent MDOR and the IRS from capturing all information submitted into a useable format, this additional burden would exacerbate this issue.

In addition, resources would be needed to resolve discrepancies between the two records to address taxpayer issues, regarding which record is accurate.
Our current environment requires substantial data sharing between governmental agencies in regard to child support administration. This involves the IRS, SSA, Human Services and MDOR. Limitations placed on sharing of federal tax data would also require additional redundant efforts on the part of the public in submission of information necessary to administer and enforce these programs.

Minnesota's income tax system is based on the federal, and starts with federal taxable income. We make a conscience attempt to strive for conformity in interpretation of financial events. If receipt of income tax information from the IRS ended, Minnesota would need to completely restructure its income tax system to duplicate the filings, computations and administration necessary to arrive at an income determination which may be different than that of the federal. This would result in citizen confusion and conflicting tax policy determinations as to the impact of financial transactions on a state versus a federal level.

Benefits

In summary, there are many benefits of sharing this information, which reduce the burden placed on the taxpayers and the states. A single point of registration for both state and federal purposes is one example. The elimination of duplicate examinations by the state and the IRS for the same tax periods prevents the taxpayer from being audited twice for the same year by two different agencies for the same purpose. Audit adjustments made by one entity pass through to the other without taxpayer involvement. Education and benefit programs to specific targeted groups are leveraged and made more efficient. Lastly, it minimizes the requirements for submission of redundant information to both agencies.

Ohio
DEPARTMENT OF
TAXATION

October 1, 1999

Ms. Lindy Paull
Chief of Staff
Joint Committee on Taxation
Room 1015 LHOB
Washington, DC 20515

E-mail: lindy.paul@jointtax.house.gov

Re: The Joint Committee on Taxation Study Regarding Privacy and Confidentiality of Taxpayer Data

Dear Ms. Paull:

I understand that the Joint Committee on Taxation is conducting a study regarding privacy and confidentiality of taxpayer data. Having been a tax practitioner for ten years prior to my becoming Ohio's Tax Commissioner earlier this year, I am keenly aware of taxpayers' feelings and sensitivities regarding their privacy and the importance of confidentiality of their taxpayer data. Yet, at the same time, I recognize the extreme importance for state tax agencies to continue to have access to such information in order to administer taxes--especially income-based taxes--in an efficient and expeditious manner.

During the last twelve months, "information sharing" from the Internal Revenue Service has allowed the Ohio Department of Taxation to collect more than $35 million in taxes. Without access to the IRS information, this agency would not have been able to collect any portion of that amount.

Because this agency recognizes the critical need to safeguard IRS-supplied information, each year every employee of the Ohio Department of Taxation who has or might possibly have access to such information must attend a training session during which this agency's disclosure office staff emphasizes the importance of safeguarding such information. Part

P.O. BOX 530
Columbus, Ohio 43216 - 0530

of the training session includes our employees viewing an IRS-produced training video explaining the federal confidentiality laws. Furthermore, this agency's computer service division and related divisions have established "fire walls," as well as other physical security systems, to minimize the possibility of unauthorized access to such IRS-provided information. In fact, since we began receiving such information more than twenty years ago, there has never been any reported breach of security.

In my view, privacy and confidentiality of taxpayer data are not mutually exclusive with regard to IRS-supplied tax sharing information. Rather, privacy and confidentiality of taxpayer data can be maintained--and state tax agencies can have access to this vital information--as long as both the IRS and the state tax agencies continue to recognize the importance of this issue and implement procedures and policies to assure privacy and confidentiality of taxpayer data.

Denying or severely limiting the data the IRS can share with state tax agencies would have a crippling effect upon the states' administration of their taxes. I respectfully urge the Committee consider this fact when the Committee develops its legislative recommendation.

Thank you for your consideration of this very important matter. If you have any further questions, please do not hesitate to contact me at (614) 466-2166.

Sincerely,

Thomas M. Zaino

Thomas M. Zaino
Tax Commissioner

State of South Carolina

Department of Revenue

JIM HODGES
Governor

ELIZABETH CARPENTIER
Director

OFFICE OF THE DIRECTOR
COLUMBIA, SOUTH CAROLINA 29214-0501
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OCT 14 1999

October 6, 1999

Ms. Lindy Paull, Chief of Staff
Joint Committee on Taxation (JCT)
Room 1015 LHOB
Washington, DC 20515

Dear Ms. Paull:

The following is provided to the Joint Committee on Taxation (JCT) regarding the study on the privacy and confidentiality of federal taxpayer data. The SC Department of Revenue (DOR) recognizes the importance of maintaining the trust of the citizens of the State of South Carolina and of the United States of America in government. It is with due diligence that the SC DOR safeguards the confidentiality of the data acquired from the Internal Revenue Service (IRS).

Additionally, we at DOR recognize the frustration and redundant processes imposed on the public by the tax processes administered at the local, state, and federal levels. A recent Wall Street Journal column (Tax Report for September 29, 1999) referenced statements made by AT&T Chairman C. Michael Armstrong. Armstrong's comments were specifically referencing state and local tax filings. Loss of access to federal data will only serve to compound the state and local tax filings on businesses both large and small. An effort currently in place under the Treasury Department and managed through the Internal Revenue Service is predicated on reducing burden on the taxpayers of this country. The project is the Simplified Tax Annual Wage and Reporting System (STAWRS). Single point (one stop service) is one of the concepts being piloted at this time. This concept provides for a taxpayer to file their federal and state reporting forms and payment to a single point of receipt and distribute the information to the correct administering agencies.

Regarding the issues of privacy and confidentiality, the SC DOR's response is set forth as follows:

How Federal Tax Data is Utilized

Federal Tax Data acquired from the IRS is utilized a number of different ways by the SC DOR. Most of the uses can be placed in three general categories.

These three categories are: (1) Customer Service
(2) Compliance and Audit
(3) Research

The SC Department of Revenue receives federal tax data via tape extracts (CP2000, IMF, IRTF, BMF, BRTF, IRMF, and non-itemizer), return and return information furnished upon request, RARs (Revenue Agent Reports), and transcript requests.

From a customer service standpoint, federal data has been acquired and utilized for the following reasons.

- One Stop Service—Taxpayers prefer having to make one trip to one location for assistance or filing their tax returns (individual or business). Taxpayers often request assistance with federal tax returns from state personnel. The SC DOR maintains a Main Office location in Columbia and nine district offices throughout the State of South Carolina. These locations are accessible and visible to the taxpayers.
- Processing of State Tax Returns----Copies of federal returns with the accompanying documents (W-2's, 1099's, etc.) are requested from the IRS to assist taxpayers that come into taxpayer assistance offices or fail to respond to repeated correspondence attempts (by mail or otherwise). This is done for both current and back year returns. Taxpayers do not always practice good record keeping and thus copies of W-2's, 1099's, and federal returns are required to complete their filings with South Carolina. This is increasingly necessary with elderly and disadvantaged taxpayers. In order to expedite service to these taxpayers, the SC DOR will request information from the IRS rather than seeking it from the taxpayer. SC DOR has ceased requirement of 1099 filing with the state return in an effort to reduce the burden on the taxpayer. Loss of access to this data (1099, etc.) will create a further tax burden on both businesses and individuals alike in providing 1099 information to the state.
- Prevent Duplicate Audits---SC DOR utilizes RARs received from the IRS to adjust up or down the audited taxpayer's tax liability. By utilizing federal data (RARs in this case), the state does not need to perform a state audit of an individual or business. This relieves a burden on the taxpayer of having a second audit performed and also allows both the IRS and the SC DOR to cover more ground in the way of audits.
- Fraud Detection—In order to see that the tax laws of the State of South Carolina are fairly enforced across all taxpayers, federal tax data acquired from the IRS can expose fraud. Additionally, federal data acquired assists in identifying an "Innocent Spouse" in potential audit situations.
- Closing Notices/Letters—The SC DOR receives Closing Notices/Letters from the IRS on Estate Tax. This allows SC DOR to close out accounts in our records/system and ceases

to store data/send correspondence to a now non-existent taxpayer. By reducing data/paper storage and mailing of correspondence, the federal data provided by the IRS prevents the SC DOR from unknowingly wasting tax dollars.

- Future Implications—To decrease the taxpayer burden, the SC DOR is investigating the possibility of eliminating the requirement of signature submissions in Fed/State filing of individual income tax returns. Only due to the success of single point filing (IRS Fed/State program) would elimination of signature submissions be possible at the state level. Single point filing is just one of the concepts put forward by STAWRS. STAWRS is also moving forward programs in the area of streamlined customer service and simplified requirements. These initiatives would be short circuited by the unavailability of federal tax data.

In relation to Compliance and Audit, the tape extracts provided by the IRS are critical tools for the SC DOR. Below is a brief description of what the various tape extracts are used for by the agency.

- IMF & IRTF—Tolerance matches on federal taxable income (FTI) and verification of alimony payments. Additionally, these tape extracts are instrumental in Schedule A, C, and E audits. The SC individual income tax return is based on federal taxable income (FTI). Additionally, a new thrust for the IMF is the IMF Preparers Inventory Listing. The IMF Preparers Inventory Listing is used by the SC DOR to identify taxpayers that had their returns prepared by tax preparers suspected of filing "dubious" returns.
- BMF & BRTF—With regards to compliance and audit, these tapes are utilized to verify corporate information like Federal Employer Identification Numbers (FEI or EIN).
- CP2000—Assists in automated audit selection by the agency.

Not only does the federal tax data obtained enable the SC DOR to verify certain information provided, the agency receives "tips" from taxpayers as to potential non-filers. In an indirect manner, federal tax data provided allows the SC DOR to respond to taxpayer's concerns of possible non-filers among our state population. By locating these non-filers, the IRS and SC DOR are lessening the tax burden on the overall taxpaying populace.

While the utilization of RARs was touched on earlier as being a customer service related function, use of federal RAR information also allows the SC DOR to assess additional state tax (or reduce). As a result of sharing RAR data with the SC DOR, the IRS and SC DOR realize greater "coverage" of the taxpayer population with respect to compliance and audit capabilities.
Due to federal tax data from CP2000 and RAR, the SC Department of Revenue collected

$10,019,047 in fiscal year 1998-1999. An exact breakdown of the number of assessments generated and money collected is provided below.

Fiscal Year 1998-99	Assessments	Amount
RAR	2,704	$3,776,036
CP2000	16,923	$6,243,011

Federal data is utilized by various research arms of the SC Department of Revenue. Data acquired from the IRS is the ONLY source available for the agency to estimate the revenue impact/cost to the State of South Carolina of deductions and exclusions in the individual and corporate income tax code.

Additionally, the BMF and BRTF extract tapes are employed to produce a Tax Expenditure Report and to determine the fiscal impact of current and proposed legislation thru statistical analysis. The SC DOR provides the fiscal impact of legislative tax initiatives to the SC General Assembly and SC Board of Economic Advisors to assist these bodies decision making processes.

State Data Provided to IRS

The sharing of data between the IRS and the SC DOR is not a one way street. The SC DOR reciprocates with the IRS by sharing:

1. SC DOR completed RARs
2. Copies of returns (sales, withholding, and corporate)
3. Provides 1099G information

SC DOR completed RARs are utilized by the IRS just as the state uses IRS generated RARs. The IRS takes the SC generated information and assesses taxpayers based on this information. Not only is this a revenue generating/time saving benefit, it prevents duplicate audits from being performed by the IRS and relieves the burden from the taxpayer of facing multiple audits. So, an enforcement action ends up resulting in a customer service benefit. Due to this benefit of cooperation, both agencies realize further taxpayer coverage.

Copies of returns provided by SC DOR to the IRS are naturally beneficial to the IRS auditors in the field. Returns provide leads as well as completing the picture of the taxpayer's filing history on a federal and state level.

Alternatives to Federal Tax Data Acquirement

The only real alternative for the SC Department of Revenue to NOT receiving federal tax data is to require the taxpayer to provide to the state copies of ALL returns and information supplied to the IRS. Given our experience with taxpayer's desire for "one stop shop" assistance and filing and the problems with record keeping by taxpayers (see Customer Service under How Federal Tax Data is Utilized), requiring "dual" filing of federal tax forms and data would place a heavy burden on the taxpayer. Further, the burden on the SC DOR would increase significantly as the electronic and physical storage of additional returns would add significant operational expense.

UNAX (Unauthorized Access)

SC DOR educates new employees and provides annual training for current employees throughout the agency on the browsing/UNAX (unauthorized access) laws put in place as a result of the Taxpayer Browsing Protection Act of 1997. New employees are shown the IRS produced video and are briefed on the anti-browsing legislation, whether they have access to federal data or not. Signing of a disclosure statement is required for ALL new employees. For current employees, an annual briefing of all employees is conducted. Furthermore, more intense and specific training/briefings are held with employees that have access to federal data.

Hopefully, the information provided will enhance the JCT's understanding of the importance of the IRS providing federal tax data to the SC DOR. As has been pointed out, the sharing of information is not a one way street and the IRS in conjunction with the SC DOR are in a mutually beneficial partnership. A mutually beneficial partnership in assisting each other in carrying out our respective functions, but also and more importantly more effectively serving the taxpayers of the State of South Carolina and of the United States.

Sincerely yours,

E Carpentier

Elizabeth Carpentier
Director

EC/afw

OCT 0 7 1999

STATE OF TENNESSEE
DEPARTMENT OF REVENUE
ANDREW JACKSON STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37242

DON SUNDQUIST
Governor

RUTH E. JOHNSON
Commissioner

September 30, 1999

Ms. Lindy Paull
Chief of Staff
Joint Committee on Taxation
Room 1015 LHOB
Washington, DC 20515

Dear Ms. Paull:

Regular exchanges of taxpayer information occur between the Tennessee Department of Revenue and the Internal Revenue Service pursuant to the Federal-State Exchange Program. Such reciprocal exchanges have occurred in varying forms for more than fifty years. The initial exchanges were authorized by means of specific requests. The regulation and control of subsequent exchanges has progressed and evolved into a formal agreement that was effective on February 2, 1982.

The exchange of information between the Tennessee Department of Revenue and the Internal Revenue Service provides the following benefits:

- the means of discussing and resolving a large volume of specific cases,
- assistance in obtaining information from other federal/state agencies,
- coordination of audit efforts and results,
- development of criminal investigation cases,
- increased familiarity with IRS procedures which lead to new awareness of opportunities for cooperation,
- development of new programs based on existing IRS models,
- reduction of duplicate audits conducted by the IRS and this agency,
- consistency and compliance by taxpayers in reporting to each agency,
- minimization of audit resources and maximization of each agencies audit results.

During the course of exchanging taxpayer information and audit results, with the Internal Revenue Service, the Tennessee Department of Revenue has fostered increased reporting compliance and generated millions of dollars in additional revenue. In the event the exchange of information program between our agencies is reduced or eliminated our agency would be limited in enforcing its revenue enhancing and reporting compliance statutes. Additionally, the IRS would not benefit from the substantial source of taxpayer information that is provided by this state. The effect of the reduction or loss of such benefits would be reflected in diminished revenues and decreased reporting compliance.

One of the primary benefits involved in the exchange program is the consistency and predictability that is realized by the taxpayer during the course of the audit. The audit efforts accomplished by each agency are realized by the receiving agency and as a result provide predictability and consistency for the taxpayer. The taxpayer reporting and compliance requirements are enforced by each agency but only one agency coordinates and negotiates the audit with the taxpayer.

Our mutual exchange program has worked well for more than fifty years and has provided improved taxpayer service and increased revenues to each agency. While Tennessee is one of the few remaining states that does not administer a state income tax the audit data and taxpayer information exchanged between our agencies has resulted in substantial increases in revenue and has provided important taxpayer data that enables our agency to maintain accurate files and more efficiently serve the taxpaying public.

It should be noted that while this state does not administer an income tax on wages, a Hall income tax has been administered since 1929. The limited income tax is levied on interest derived from long term notes, bonds, certain stock dividends, income realized from mutual funds, distributions from Sub Chapter S Corporations and taxable income from trusts and estates.
The Tennessee Department of Revenue has utilized the IMF and IRTF extract tapes for many years in order to compare sources of income received by the taxpayer and the amounts actually reported on the Tennessee income tax return. The utilization of the IRS extract tapes and the resulting

adjustments to state tax returns has enabled the state of Tennessee to generate millions of dollars in additional tax revenue.

In view of Tennessee's existing tax structure and a perceived lack of revenue relative to the current level of government services and to fiscal situations in other states, practically every year legislation is proposed regarding an individual income tax or some variant form of taxation on earnings. Numerous bills have proposed altering the current existing tax on dividends and interest to include or exclude certain variables. Further, the Department of Revenue frequently completes fiscal notes or analyzes policy proposals that target other specific income factors for both narrow and broad groups of taxpayers. In the absence of using the IMF/IRTF extracts and other IRS data the Tennessee Department of Revenue has no accurate data sources from which to measure an individual's adjusted gross income or the inherent earnings components that are frequently used as part of the starting tax base in most proposed legislation.

I respectfully submit, to the Joint Committee on Taxation, that our exchange of information program with the Internal Revenue Service has been and is working well. The benefits to our citizens, the IRS, and to this state are incalculable. In the absence of participation in the exchange of information program, this state will not be properly equipped to efficiently administer its taxing statutes. Loss of participation or diminution of this long standing program will have a detrimental effect on the IRS, the state of Tennessee, and our citizens.

Thank you for giving consideration to the tax implications and administrative concerns which will be realized by the state of Tennessee in the event of a reduction or elimination of the exchange of information data that has served our mutual agencies so well.

Sincerely,

Ruth E. Johnson

Ruth E. Johnson

REJ:rc

OFFICE OF THE COMPTROLLER TEXAS

COMPTROLLER OF PUBLIC ACCOUNTS

P.O. BOX 13528
AUSTIN, TX 78711-3528

CAROLE KEETON RYLANDER
Comptroller

OCT 07 1999

September 29, 1999

Ms. Lindy Paull
Chief of Staff
Joint Committee on Taxation
Room 1015 LHOB
Washington, D.C. 20515

Re: Texas' Use of Federal Data

Dear Ms. Paull:

As a state that does not have a personal income tax, I think it important that we express our use of confidential federal taxpayer data to the Committee.

The confidential federal taxpayer data is an essential tool to us when dealing with taxpayers whose records have been destroyed or those who refuse to cooperate with us by providing their records to us. While it may be possible to utilize other data such as Dunn & Bradstreet, the reliability of the data cannot be compared to that of the federal data.

Our franchise tax statute is tied, in part, to the federal tax data. Proper utilization of the federal data can virtually eliminate our need to contact taxpayers that will not require an adjustment to their reported tax. Our ability to identify such compliant taxpayers would not be possible by utilizing any other data.

We have utilized the data for revenue estimating purposes. Specifically, we sort and group tax return information relevant for revenue estimating purposes and make appropriate calculations and summarization on a statewide basis. The statewide summary of manipulated information generally becomes the basis for an estimate of state fiscal impact surrounding a legislative proposal.

All of our personnel having any access to the confidential federal taxpayer data receive annual training on the safeguard and use of the data. Limited and very controlled access to the data is maintained throughout our agency at all times. We do not maintain any of the confidential federal data on computers that are accessible for browsing, thus our protection from Unauthorized Access (UNAX). Furthermore, our previous *Safeguard Reviews* have confirmed our continued protection of the federal data.

We have worked very closely with the three district offices of the Internal Revenue Service here in Texas. We've been able to provide them with our confidential tax data of our sales taxes, franchise taxes, motor fuels, and customized reports to assist them in identifying non-U.S. companies doing business in the United States that should be reporting income taxes.

It appears that more and more data on persons and companies is on the worldwide web and we, as government entities, must utilize our resources in an effort to stay informed and ahead. A close working relationship among the states and federal is imperative.

I appreciate the opportunity to share our views on this subject. If you have any questions, please give me a call.

Sincerely,

Otis Fields

Otis Fields
Manager, Audit Division

Cc: Mr. Harley Duncan, Federation of Tax Administrators

Tommy G. Thompson
Governor

Linda Stewart
Secretary

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State of Wisconsin
Department of Workforce Development

October 1, 1999

OCT 12 1999

Joint Committee on Taxation
Lindy L. Paull, Chief of Staff
United States Congress
1015 Longworth House Office Building
Washington, D.C. 20515

Fax: (202) 225-0832

Dear Sirs:

I am writing in response to your announcement (199 TNT 159-13), dated August 18, 1999, inviting comments on Taxpayer Confidentiality. I am writing to ask that Section 6103 of the Internal Revenue Code be clarified so that states like Wisconsin can continue to implement the provisions of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA). Specifically, I request that the term "local agency" which is used in Section 6103 (*l*)(7) be defined to mean an agency that is the local administrator of a program identified in Section 6103 (*l*)(7).

In passing PRWORA, Congress declared a national crisis in terms of family functioning and welfare dependence. It gave states a broad invitation to experiment with public assistance—the Temporary Assistance to Needy Families (TANF) Block Grant--in order to address this crisis. One of the ways in which PWORA invites states to experiment is in the type of organization that administers TANF. The law specifically gives states the option of administering TANF through contracts with "charitable, religious, or private organizations." (Section 104)

Wisconsin has used that option since 1997 to create and administer its Wisconsin Works TANF program. A variety of organizations administer the program locally—county governments, private not-for profit entities, and private for-profit entities. Each local agency is responsible for operating the programs and designing its services. Each local agency has a fixed budget for benefits, services and administration and has incentives for success. It has been fascinating to see the creativity that has emerged under this process.

In order for this mix of agencies to administer Wisconsin's TANF program, this same mix of agencies must have access to the data tools developed to manage the program, including the database and network that assists in determining and verifying eligibility. This includes access to numerous data sources, including tax return data. Under the Social Security Act, agencies administering TANF programs must request and use tax return information from the Internal Revenue Service for income and eligibility verification.

SEC-7792-E (R. 07/97)

Federal returns. In some cases we are able to alert taxpayers to overpayments of state tax from examining federal returns.

We also use the data to identify capital asset acquisitions and dispositions in order to address potential sales or use tax obligations.

Tax Discovery and Compliance

Washington also engages in tax discovery efforts to discover unregistered taxpayers. Generally, taxpayers fail to register their businesses because they do not understand their tax obligations, although there are some who intend to avoid the tax. We use Form 1099 information extracted from Federal computer tapes to identify unregistered taxpayers; we then contract them to determine whether they are required to register and pay taxes. We also use that information to target taxpayer education efforts to industries with significant numbers of non-reporters or under-reporters.

Estate Tax Administration

Washington receives information from the IRS on estate filings for Washington residents. That information is then cross-referenced to estate tax returns filed with Washington. If an estate has filed with the IRS but not with the state, we contact the personal representative for the estate and request filing with Washington.

Research

Washington's Department of Revenue is responsible for producing fiscal notes for legislative proposals, completing economic studies requested by the Legislature or the Governor, providing general information regarding tax collections to the public, and producing forecasts for specific state funds. The Department uses Federal taxpayer data extracted from computer tapes primarily for analyzing proposed legislation and funding possibilities. Taxpayer specific information is not used for this purpose. Some recent research projects using federal taxpayer data include personal income modeling, estimating the number of Washington residents who received federal earned income credits; estimating poverty level residents by zip code and household size, and apportionment modeling for specific industries.

Alternatives To Using Federal Tax Data

We are aware of no alternatives to using federal tax data that would provide us with the information we currently use, nor are we aware of any reasonable substitutes.

Impact on Taxpayer Burden

Washington has been able to use Federal tax data to reconstruct return information for taxpayers who have lost all accounting records, including their federal tax returns, due to fire, flood, or other catastrophic events. Federal tax data can sometimes also be used in lieu of other records to minimize the burden on taxpayers.

Safeguarding Federal Tax Data

Federal tax data is safeguarded by the agency in accordance with the Internal Revenue Service's guidelines. The data is physically secured and access is restricted. Various education efforts are carried out with the Department's employees to increase awareness of the safeguarding requirements. Internal inspections are performed to ensure compliance with safeguard procedures. We are not aware of any unauthorized access of the federal tax data.

In addition, Washington has its own tax confidentiality clause, RCW 82.32.330 (Secrecy Clause) which was modeled, in part, on Section 6103. All Department employees are required to read and sign an affidavit which explains the secrecy clause and the penalties for violating it. Tax information, which includes information the Department of Revenue receives from the Internal Revenue Service, is prohibited from disclosure except as authorized. Violations of the secrecy clause can lead to fines and/or criminal punishment. State employees may also be liable for forfeiture of state employment for two years, as well as disciplinary action in accordance with the Merit System Rules.

Information Provided to the Internal Revenue Service

The Internal Revenue Service has direct online access to Washington's tax information. We provided this access in 1991 after the number of IRS requests for information exceeded 120 in one week. The IRS has a terminal in every Washington State field office, with over 100 logon ids, and full inquiry access to all Washington tax information, including gross receipts reported by each business, retail sales taxes collected, use tax paid, deductions and credits taken, as well as the status of each account.

The State of Washington makes extensive use of the federal tax data and would experience significant negative impacts on its tax administration and research capabilities if it were no longer available. We have stringent confidentiality requirements on all taxpayer data to ensure the privacy of our taxpayers. The exchange of information is beneficial to taxpayers, the federal government and to Washington State.

If you have any questions or need any further information, please do not hesitate to call me at 360.753.3446.

Sincerely,

Claire Hesselholt

Claire Hesselholt
Policy Counsel

cc: Harley Duncan, Federation of Tax Administrators
Frederick C. Kiga, Director, Department of Revenue
William N. Rice, Deputy Director, Department of Revenue
Ken Capek, Assistant Director, Audit
Sharon M. Brown, Assistant Director, Taxpayer Account Administration
Mary Welsh, Assistant Director, Research

Tommy G. Thompson
Governor

Linda Stewart
Secretary

State of Wisconsin
Department of Workforce Development

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October 1, 1999

OCT 12 1999

Joint Committee on Taxation
Lindy L. Paull, Chief of Staff
United States Congress
1015 Longworth House Office Building
Washington, D.C. 20515

Fax: (202) 225-0832

Dear Sirs:

I am writing in response to your announcement (199 TNT 159-13), dated August 18, 1999, inviting comments on Taxpayer Confidentiality. I am writing to ask that Section 6103 of the Internal Revenue Code be clarified so that states like Wisconsin can continue to implement the provisions of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA). Specifically, I request that the term "local agency" which is used in Section 6103 (*l*)(7) be defined to mean an agency that is the local administrator of a program identified in Section 6103 (*l*)(7).

In passing PRWORA, Congress declared a national crisis in terms of family functioning and welfare dependence. It gave states a broad invitation to experiment with public assistance—the Temporary Assistance to Needy Families (TANF) Block Grant--in order to address this crisis. One of the ways in which PWORA invites states to experiment is in the type of organization that administers TANF. The law specifically gives states the option of administering TANF through contracts with "charitable, religious, or private organizations." (Section 104)

Wisconsin has used that option since 1997 to create and administer its Wisconsin Works TANF program. A variety of organizations administer the program locally—county governments, private not-for profit entities, and private for-profit entities. Each local agency is responsible for operating the programs and designing its services. Each local agency has a fixed budget for benefits, services and administration and has incentives for success. It has been fascinating to see the creativity that has emerged under this process.

In order for this mix of agencies to administer Wisconsin's TANF program, this same mix of agencies must have access to the data tools developed to manage the program, including the database and network that assists in determining and verifying eligibility. This includes access to numerous data sources, including tax return data. Under the Social Security Act, agencies administering TANF programs must request and use tax return information from the Internal Revenue Service for income and eligibility verification.

SEC-7792-E (R. 07/97)

Wisconsin has taken this collection of laws to mean that the local agencies administering Wisconsin Works may access and use tax information in administration of the program. All of these agencies are doing the work described in Section 6103 (*l*)(7). Our difficulty comes with the opinion held by representatives of the Internal Revenue Service that only governmental agencies may view and use Internal Revenue Service data. We have asked them to show us this definition in the U.S. Code. They have been unable to do so. Absent such a definition, we continue to believe that we correctly identify a local agency by its function (administering a TANF program), and by the clear intent in PRWORA.

We would find it helpful if Congress would codify this functional definition of "local agency" in the Internal Revenue Code to resolve our issue with the Internal Revenue Service. We could then return our attention to the business of helping poor families achieve self-sufficiency.

Sincerely,

Howard I. Bernstein
Legal Counsel

cc: Linda Stewart, Secretary, DWD

THE STATE OF WYOMING

DEPARTMENT OF REVENUE

JIM GERINGER, *GOVERNOR*
R.M. "JOHNNIE" BURTON, *DIRECTOR*

Herschler Building ❑ 2nd Floor West
122 W. 25TH STREET ❑ CHEYENNE, WYOMING 82002-0110
TELEPHONE (307) 777-7961 ❑ E-MAIL: dor@missc.state.wy.us
WEB SITE http://revenue.state.wy.us

October 25, 1999

OCT 26 1999

Elizabeth P. Askey
Office of Tax Legislative Council
Treasury Department
1500 Pennsylvania Avenue NW, Room 1321A
Washington, D.C. 20220

Dear Ms. Askey:

This letter is in response to a Federation of Tax Administrators Bulletin dated September 9, 1999 entitled "Congress Studying States' Use of Federal Data." While this letter is untimely for the deadline in the bulletin for the Joint Committee on Taxation (JCT), it is our understanding that this letter is timely for the comment period for the Treasury Department. Nevertheless, we have also copied Ms. Lindy Paull the designated contact for JCT comments.

In Wyoming, the Departments of Revenue and Audit are separate state agencies. We do, however, work together closely as the Department of Revenue issues assessments based on Department of Audit findings. In several cases in the past eighteen months we have made requests for federal data from the Internal Revenue Service (IRS) connected to state audit activity. One case alone, involved an assessment in excess of $900,000.00. In this particular case there is a significant discrepancy between a business's gross receipts reported to the IRS and to the state of Wyoming. Our access to federal data has been crucial in developing evidence for this case.

It is also noteworthy that some of our requests for federal data have not yielded discrepancies with our state tax data. These findings are also significant and point us in a different direction in those instances. We are of the opinion that the IRS information is an important source of data for analysis on a case by case basis. We would not want to lose the opportunity to receive such data.

As a sparsely populated non-income tax state we make a limited number of requests for federal data. But when we do, the information we receive is crucial to analysis and decisonmaking. We are currently on a paper exchange with the IRS. We are not engaged in any electronic merging of federal tax data. As a result, our safeguarding activities are tied to physical security and destruction of federal tax data. Our security procedures are in compliance with the requirements established by Department of Treasury Publication 1075 (Rev. 3-99) and the Disclosure Officer of the Rocky Mountain District.

Fax Numbers
DOR Main (307)777-7722 ❑ Ad Valorem (307)777-7722 ❑ Excise Tax Division (307)777-3632 ❑ Mineral Tax Division (307)777-7849 ❑ Liquor Division (307)777-6255

In the past eighteen months we have also provided the IRS state tax information for their tax administration purposes. Most of the requests from the IRS have been for businesses sales tax remittances. Some have involved requests for information connected to matters of criminal investigation.

We appreciate the opportunity to provide comments in this process. Please note our support for the continued use of IRS information.

Sincerely,

Robert C. Tompkins
Taxpayer Services Manager
Excise Tax Division

J. Keith Wilson
Administrator
Excise Tax Division

pc:

Ms. Lindy Paull
Chief of Staff
Room 1015 LHOB
Washington, D.C. 20515

FTA
Suite 348
444 N. Capitol St. NW
Washington, D.C. 20001
Attn: Harley Duncan, Executive Director

Tax Executives Institute, Inc.

1200 G Street, N.W., Suite 300
Washington, D.C. 20005-3814
Telephone: 202/638-5601
Fax: 202/638-5607

OCT 21 1999

October 21, 1999

Lindy Paull
Chief of Staff
Joint Committee on Taxation
1015 Longworth House Office Building
Washington, D.C. 20515

Re: ***Confidentiality Study***

Dear Ms. Paull:

In response to your August 17, 1999, request, I am pleased to enclose the Institute's comments in respect of the Joint Committee's impending study on taxpayer confidentiality. I am also enclosing a diskette in a Wordperfect 8.0 format.

If you have any questions or need additional copies, please do not hesitate to call Mary L. Fahey of the Institute's professional staff at (202) 638-5601, ext. 308.

Respectfully submitted,

TAX EXECUTIVES INSTITUTE, INC.

C.W. Shewbridge III

Charles W. Shewbridge, III
International President

Enclosures

Comments

of

TAX EXECUTIVES INSTITUTE, INC.

on

Study of Taxpayer Confidentiality

submitted to

The Staff of the Joint Committee On Taxation and U.S. Department of Treasury

October 21, 1999

The Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 STAT. 782, instructs the staff of the Joint Committee on Taxation and the U.S. Department of Treasury to prepare studies pertaining to the confidentiality of tax returns and tax return information. On August 17, 1999, the Joint Committee staff invited comments with respect to this subject, and on October 8, 1999, the Treasury Department issued a similar request. The reports are due to be submitted to Congress by January 22, 2000.

I. BACKGROUND

Tax Executives Institute is the preeminent association of business tax executives in North America. Our approximately 5,000 members represent 2,800 of the leading corporations through 52 chapters in the United States, Canada, and Europe. TEI represents a cross-section of the business community, and is dedicated to the development and effective implementation of sound tax policy, to promoting the uniform and equitable enforcement of the tax laws, and to reducing the cost and burden of administration and compliance to the benefit of taxpayers and government alike. As a professional association, TEI is firmly committed to maintaining a tax system that works — one that is administrable and that taxpayers can comply with in a cost-efficient manner.

Members of TEI are responsible for managing the tax affairs of their companies and must contend daily with the Internal Revenue Service and provisions of the tax law relating to the operation of business enterprises. We believe that the diversity and professional training of our members enable us to bring an important, balanced, and practical perspective to the issues raised by the taxpayer confidentiality provisions of the Internal Revenue Code.

The Joint Committee staff and Treasury Department have requested comments on issues relating to the confidentiality of tax returns, including —

- The adequacy of present-law protections governing taxpayer privacy;
- The interrelationship of the taxpayer confidentiality provisions in the Internal Revenue Code (primarily section 6103) with the Freedom of Information Act, the Privacy Act, and section 6110 of the Code;

- The need, if any, for third parties, including those presently authorized under the Code, to use tax return information; and
- Whether greater levels of voluntary compliance can be achieved by allowing the public to know who is legally required to file tax returns but does not do so.

TEI is pleased to respond to these requests.

II. ADEQUACY OF PRESENT LAW

For all its flaws, the U.S. tax system generally works well. Each year, millions of individuals and businesses voluntarily self-assess and pay the billions of dollars necessary to fund the military, the Social Security and Medicare programs, and other government programs. In the tax returns they file annually with the Internal Revenue Service, U.S. taxpayers lay bare not only their souls but also their personal and business lives. The level of detailed information required by the Internal Revenue Code is at once daunting and extraordinarily sensitive, and the willingness of taxpayers to disclose confidential information is largely attributable to assurances that their privacy interests will be safeguarded by the government.

Before 1977, tax returns were "public records" subject to disclosure under Treasury Department regulations approved by the President or by presidential order. In the aftermath of the Watergate scandals, however, Congress acted to strengthen taxpayers' privacy rights, reflecting public reaction to a wide range of governmental intrusions into private life well beyond the tax area. Consider, for example, the comments of the U.S. Privacy Protection Study Commission:

> 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.
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> 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.

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Thus, in 1976, Congress provided that tax returns and tax return information are confidential and not subject to disclosure, except in 13 limited circumstances. In these areas of allowable disclosure, Congress attempted "to balance the particular office or agency's need for the information involved with the citizen's right to privacy, as well as the impact of the disclosure upon the continuation of compliance with our country's voluntary tax assessment system." Staff of the Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1976,* 94th Cong., 2d Sess. 315 (1976). Embodied in section 6103 of the Code, these rules define the protected area ("returns" and "return information") in detail, establish a basic rule of confidentiality, and prescribe different rules for disclosure to each of three groups — private persons, government taxing authorities, and

other government agencies.

In enacting section 6103(a), Congress made confidentiality the general rule: "Returns and return information shall be confidential, and except as authorized by this title [federal officers, employees, and certain other persons shall not] disclose any return or return information." "Return information" is defined, in part, under section 6103(b)(2)(A), as follows:

> [A] taxpayer's identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments, whether the taxpayer's return was, is being, or will be examined or subject to other investigation or processing, or any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense.

Courts repeatedly have confirmed the broad scope of this statutory language. *E.g., Branch Ministries, Inc. v. Richardson*, 970 F. Supp. 11, 18 (D.D.C. 1997) ("[t]his language is extremely broad. . . ."); *Lehrfeld v. Richardson,* 954 F. Supp. 9, 13 (D.D.C. 1996), *aff'd*, 132 F.3d 1463 (D.C. Cir. 1998) ("'return information' is defined broadly to include almost any information compiled by the IRS in connection with its determination of a taxpayer's liability"). Section 6103 is the type of statute that exempts information from disclosure under the Freedom of Information Act (FOIA) because it is nondiscretionary or establishes "particular criteria" for withholding information within the meaning of FOIA Exemption 3. *Church of Scientology of California v. IRS*, 792 F. 2^{d} 146, 150

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So important is protecting taxpayer confidentiality and maintaining taxpayer confidence in the integrity of the tax system that the Internal Revenue Code contains a three-tier system of sanctions for those who violate section 6103. First, section 7431(a) accords aggrieved taxpayers a civil cause of action and provides for damages in the case of unauthorized disclosures. Second, section 7213(a)(1) makes the unauthorized disclosure of taxpayer returns and return information a felony. Finally, the law mandates the firing of any federal employee convicted of unauthorized disclosure. I.R.C. § 7213(a)(1). The enactment of civil and criminal penalties demonstrates the importance of the taxpayer confidentiality provisions.

Section 6103's ban on disclosure is not, however, absolute. In addition to the 13 limited exceptions, Congress has provided under section 6110 for the disclosure of "written determinations," which are defined as "a ruling, determination letter, technical advice memorandum, or Chief Counsel advice." Background file documents relating to written determinations — defined as any written material submitted in support of the request — are also subject to disclosure. These documents

[1] FOIA lists categories of information that a federal agency must make available for public inspection. 5 U.S.C. § 552(a). Although the statute sets forth a general presumption that agency records are publicly accessible, there are nine exemptions from public disclosure. For example, Exemption 3 of FOIA provides that an agency is not required to disclose matters that are specifically exempted from disclosure by statute "provided that such statute (A) requires that the matters be withheld from the public in such a manner as to leave no discretion on the issue, or (B) establishes particular criteria for withholding or refers to particular types of matters to be withheld . . . ." 5 U.S.C. § 552(b)(3).

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Over the years, disputes have arisen concerning what constitutes a "written determination" under section 6110. *See, e.g., Tax Analysts v. IRS*, 117 F. 3d 607 (D.C. Cir. 1997) (relating to the application of FOIA Exemption 3 and section 6110 to field service advice memoranda). Thus, a tension exists between section 6103's general rule of confidentiality and section 6110's policy of public access.

We have described the current taxpayer confidentiality regime in some detail because we believe that, in general, taxpayers and the public have been well served during the 23 years since the enactment of sections 6103 and 6110. We recognize that at times the IRS may have invoked section 6103 to prevent information from becoming disclosed, as, for example, a litigating tactic or perhaps in an attempt to save itself from embarrassment. TEI believes, however, that on the whole taxpayer confidentiality must remain paramount and, therefore, that no fundamental changes should be effected. We suggest, however, that the law should be updated to take into account IRS programs

that have developed since section 6103 was enacted. (Specifically, as discussed in the next section, advance pricing agreements should be considered "tax return information" and excluded from disclosure under section 6103.) In addition, the limited exceptions to section 6103 should be clarified in respect of third-party access to tax returns and return information to ensure that unrelated parties do not have access to confidential information.

III. INTERACTION WITH FOIA

In general, section 6103 and FOIA have operated in tandem to reasonably balance the public's interest in protecting taxpayer privacy against the public's right to have access to certain information. Thus, FOIA (and, later, section 6110) has resulted in the publication of private letter rulings (PLRs), technical advice memoranda (TAMs), general counsel memoranda (GCMs), IRS actions on decision (AODs), and, most recently, field service advice (FSAs). The release of these documents — subject to appropriate redaction — has served to keep the public abreast of IRS positions on issues, often well before official "published" guidance is released. Thus, written determinations, such as PLRs and TAMs, have provided much needed guidance in transition periods while more formal guidance is being prepared. This is not to say, however, that there have not been some hiccups. One of the problem areas involves the IRS's advance pricing agreement (APA) program.[2]

[2] Under section 6110, the IRS is to redact taxpayer information before releasing so-called written determinations — a process in which the affected taxpayers participate. Although TEI is concerned about the potential for inadvertent disclosure — especially where voluminous background information is involved — the safeguards utilized by the IRS work remarkably well.

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As a professional association dedicated to the development and implementation of sound tax policy, TEI is fully aware of the policy concerns underlying the Freedom of Information Act. Unless the proper balance is struck between the public's interest in safeguarding taxpayer privacy and the principles underlying "government in the sunshine," however, irreparable harm may be done to the tax system and, more particularly, the APA program. TEI is concerned that the release of APAs and supporting materials, even in redacted form, will adversely affect the program. Taxpayers submitted the pricing information to the IRS with the understanding that the information would be subject to the same confidentiality restrictions as tax returns. Companies' legitimate privacy interests would be compromised by the release of the APA background files and their ability to compete effectively in the marketplace could be harmed. In addition, releasing APAs and their background files could well diminish the willingness of taxpayers — and our treaty partners — to participate in the program.

TEI is not alone in recognizing the dangers of releasing APAs. Earlier this year, several members of Congress introduced H.R. 2378 to safeguard taxpayers' rights by ensuring that the submitted information remains confidential. The bill would also require the Treasury Department to issue an annual report on the APA program. This report, which would include information such

as a summary of the methodology used in each agreement, would provide taxpayers with valuable insight concerning how the IRS administers the transfer pricing provisions of the Code, as well as the administration of the APA program itself. Consistent with the overall concern for confidentiality, the bill provides that the Secretary's primary concern in preparing the reports shall be to protect the identity and privacy rights of the taxpayer. This provision should balance taxpayers' privacy concerns with the policies underlying the Freedom of Information Act. The annual report should also help promote the APA program by making available information about the scope and benefits of the program. Thus, it would encourage more taxpayers to participate in the APA program without sacrificing taxpayers' legitimate privacy interests. A version of the APA provision was included in H.R. 2488, the Financial Freedom Act of 1999, which was vetoed by President Clinton for reasons unrelated to APAs, and is included in H.R. 2923, the so-called extenders bill awaiting action on the House floor.

TEI believes that the APA program represents the best way for companies to resolve transfer pricing controversies and avoid costly and time-consuming audits and litigation. At a time when the IRS is seeking more efficient, taxpayer-friendly ways of doing business, initiatives such as the APA program should actively be encouraged. Thus, the Institute strongly believes that section 6103 should be amended to protect the confidentiality of APAs and their background files. The Joint Committee's and Treasury Department's studies should address taxpayers' concerns about the APA

program and recommend legislation to protect APAs from disclosure.[3]

IV. THIRD-PARTY ACCESS TO TAX RETURN INFORMATION

Section 6103 contains certain limited exceptions to its bar on the disclosure of confidential information. For example, sections 6103(h)(4)(B) and 6103(h)(4)(C) provide that third-party taxpayer information can be provided in situations where the treatment of an item reflected on the taxpayer's return is *directly related* to the resolution of an issue in the proceeding in which the information is sought or where there is a *direct transactional relationship* between the party seeking the information and the taxpayer and that relationship *directly affects* the resolution of the issue. In light of the important privacy interests underlying section 6103, TEI strongly believes that these exceptions should be narrowly construed.

A recent decision by the United States District Court for the District of Puerto Rico undercuts the privacy protections accorded by section 6103. In *Bristol-Myers Barceloneta, Inc., Bristol Caribbean, Inc., and Bristol Laboratories Corp. v. United States*, Civil 97-2567CCC, the court ordered that the IRS produce tax return information in respect of unrelated parties. The order grew out of the plaintiffs' efforts to secure information relating to their claim that the IRS had improperly

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[3] Contrary to recent criticism of the need for APA confidentiality, the APA program does *not* permit taxpayers to set their own effective tax rates. The APA program focuses on *methodology* and acts as a replacement for an audit of a taxpayer's return. Information gathered in the conduct of an audit is considered tax return information and subject to section 6103's confidentiality provisions. APAs should likewise be considered tax return information.

denied them the favorable treatment accorded other taxpayers, and it was resisted by the IRS on section 6103 grounds.[4] The efforts of some affected taxpayers to voice their objections to the disclosure of confidential tax return information — and to recommend alternative, less-drastic solutions — proved unsuccessful.[5]

TEI believes that the district court misinterpreted the exceptions under sections 6103(h)(4)(B) and (C), which have generally been limited to situations where there is some relationship between the taxpayers and the third party. Thus, for example, in *Davidson v. Brady*, 559 F. Supp. 456 (W.D. Mich. 1983), *aff'd on other grounds*, 732 F. 2[d] 552 (6[th] Cir. 1984), the court found that the disclosure of a third party's financial statement submitted to the IRS during a criminal investigation was proper under section 6103(h)(5)(C) because of the debtor-creditor relationship between the two parties. *See also Mindell v. United States*, 693 F. Supp. 847 (D. Cal. 1988) (IRS permitted under section 6103(h)(5)(B) to disclose taxpayer's return to tax preparer to permit defense against preparer penalty).

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[4] The plaintiffs had sought to change their taxable year to maximize the tax benefits accorded by section 936 of the Code, following Congress's 1993 amendment of that provision. Plaintiffs argued that several similarly situated corporations were successful in their efforts to change their taxable years, and that the disparate treatment accorded them was improper, citing *IBM Corp. v. United States*, 343 F.2d 914 (Ct. Cl. 1965). It is the return information of taxpayers filing for a change in taxable year that was the subject of the district court's order. Although the return information was produced in July under conditions of confidentiality, TEI is seriously concerned about the long-term effect of the court's order on taxpayer confidentiality.

[5] Following the district court's initial February 5, 1999, order requiring the IRS to produce the confidential third-party information, the IRS's Chief Counsel notified the affected taxpayers. Several of those taxpayers sought to participate in the case as *amici curiae*, but their motion — along with the government's motion for reconsideration — was denied on May 14, 1999.

Quite simply, tax returns of unrelated parties should not be released to litigants in a pending case.[6] As noted by a federal appellate court in quashing a subpoena from the Commodities Futures Trading Commission for copies of individual traders' tax returns, "Income tax returns are highly sensitive documents." *Commodities Futures Trading Comm'n v. Collins*, 997 F. 2d 1230 (7th Cir. 1993).[7] The exceptions should be clarified to require a direct relationship between the taxpayer and the third party. The IRS might also be directed to develop alternative means of allowing taxpayers to pursue claims of "disparate treatment" based on the IRS's actions in respect of unrelated parties.

V. DISCLOSURE OF NON-FILERS

One issue to be addressed in the study is whether the publication of the names of taxpayers who do not file returns would encourage voluntary compliance. The Institute believes that, as a matter of tax policy and administration, such a program would be ill advised.

As the Privacy Commission found in 1977, "extraordinary precautions must be taken against misuse of the information the Service collects from and about taxpayers." In enacting section 6103, Congress was also concerned about the "impact of disclosure upon the continuation of compliance

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[6] Let there be no mistake: TEI believes that the plaintiffs' "disparate treatment" claim is worthy of adjudication. Nevertheless, even a wholly meritorious claim is insufficient reason to vitiate the protections of the Code's privacy provisions.

[7] The court also noted, "The self-reporting, self-assessing character of the income tax system would be compromised were they promiscuously disclosed to agencies enforcing regulatory programs unrelated to tax collection itself."

with our country's voluntary tax assessment system." TEI believes that the concerns leading to the enactment of section 6103 IRS are still valid today.

Assuming that the information published is accurate, revealing the names of non-filers will undoubtedly erode taxpayers' privacy rights. Moreover, should mistakes occur — as seems highly likely in today's mobile society — taxpayers will soon lose confidence in the accuracy of the information, thereby defeating the purpose of the provision. In such circumstances, the provision could well hinder, rather than help voluntary compliance.

Finally, the suggestion raises significant administrative questions. How will the provision be implemented? Will the IRS develop a list of who filed a return in one year, compare it with a list of those who filed a return in prior years, and publish a list of names on one list, but not the other? When will the decision be made? Who will be responsible for keeping the list up-to-date? How will changes in names or mergers of companies be handled? How will errors be rectified? Will supposed non-filers have the opportunity to object to their inclusion on the list (before the fact)? What are the consequences of listing the name of a taxpayer who has, in fact, filed a return? TEI believes that the publication could cause more harm than good.

VI. CONCLUSION

Tax Executives Institute appreciates this opportunity to present our views on issues relating to taxpayer confidentiality. If you have any questions, please do not hesitate to call Robert J. McDonough, Jr., chair of TEI's IRS Administrative Affairs Committee, at (978) 625-6210 or Mary L. Fahey of the Institute's professional staff at (202) 638-5601.

Respectfully submitted,

TAX EXECUTIVES INSTITUTE, INC.

C.W. Shewbridge III

Charles W. Shewbridge, III
International President

Comments

of

TAX EXECUTIVES INSTITUTE, INC.

on

Study of
Taxpayer Confidentiality

submitted to

The Staff of the Joint Committee
On Taxation
and
U.S. Department of Treasury

October 21, 1999

The Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 STAT. 782, instructs the staff of the Joint Committee on Taxation and the U.S. Department of Treasury to prepare studies pertaining to the confidentiality of tax returns and tax return information. On August 17, 1999, the Joint Committee staff invited comments with respect to this subject, and on October 8, 1999, the Treasury Department issued a similar request. The reports are due to be submitted to Congress by January 22, 2000.

I. BACKGROUND

Tax Executives Institute is the preeminent association of business tax executives in North America. Our approximately 5,000 members represent 2,800 of the leading corporations through 52 chapters in the United States, Canada, and Europe. TEI represents a cross-section of the business community, and is dedicated to the development and effective implementation of sound tax policy, to promoting the uniform and equitable enforcement of the tax laws, and to reducing the cost and burden of administration and compliance to the benefit of taxpayers and government alike. As a professional association, TEI is firmly committed to maintaining a tax system that works — one that is administrable and that taxpayers can comply with in a cost-efficient manner.

Members of TEI are responsible for managing the tax affairs of their companies and must contend daily with the Internal Revenue Service and provisions of the tax law relating to the operation of business enterprises. We believe that the diversity and professional training of our members enable us to bring an important, balanced, and practical perspective to the issues raised by the taxpayer confidentiality provisions of the Internal Revenue Code.

The Joint Committee staff and Treasury Department have requested comments on issues relating to the confidentiality of tax returns, including —

- The adequacy of present-law protections governing taxpayer privacy;
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As a professional association dedicated to the development and implementation of sound tax policy, TEI is fully aware of the policy concerns underlying the Freedom of Information Act. Unless the proper balance is struck between the public's interest in safeguarding taxpayer privacy and the principles underlying "government in the sunshine," however, irreparable harm may be done to the tax system and, more particularly, the APA program. TEI is concerned that the release of APAs and supporting materials, even in redacted form, will adversely affect the program. Taxpayers submitted the pricing information to the IRS with the understanding that the information would be subject to the same confidentiality restrictions as tax returns. Companies' legitimate privacy interests would be compromised by the release of the APA background files and their ability to compete effectively in the marketplace could be harmed. In addition, releasing APAs and their background files could well diminish the willingness of taxpayers — and our treaty partners — to participate in the program.

TEI is not alone in recognizing the dangers of releasing APAs. Earlier this year, several members of Congress introduced H.R. 2378 to safeguard taxpayers' rights by ensuring that the submitted information remains confidential. The bill would also require the Treasury Department to issue an annual report on the APA program. This report, which would include information such

as a summary of the methodology used in each agreement, would provide taxpayers with valuable insight concerning how the IRS administers the transfer pricing provisions of the Code, as well as the administration of the APA program itself. Consistent with the overall concern for confidentiality, the bill provides that the Secretary's primary concern in preparing the reports shall be to protect the identity and privacy rights of the taxpayer. This provision should balance taxpayers' privacy concerns with the policies underlying the Freedom of Information Act. The annual report should also help promote the APA program by making available information about the scope and benefits of the program. Thus, it would encourage more taxpayers to participate in the APA program without sacrificing taxpayers' legitimate privacy interests. A version of the APA provision was included in H.R. 2488, the Financial Freedom Act of 1999, which was vetoed by President Clinton for reasons unrelated to APAs, and is included in H.R. 2923, the so-called extenders bill awaiting action on the House floor.

TEI believes that the APA program represents the best way for companies to resolve transfer pricing controversies and avoid costly and time-consuming audits and litigation. At a time when the IRS is seeking more efficient, taxpayer-friendly ways of doing business, initiatives such as the APA program should actively be encouraged. Thus, the Institute strongly believes that section 6103 should be amended to protect the confidentiality of APAs and their background files. The Joint Committee's and Treasury Department's studies should address taxpayers' concerns about the APA

program and recommend legislation to protect APAs from disclosure.[3]

IV. THIRD-PARTY ACCESS TO TAX RETURN INFORMATION

Section 6103 contains certain limited exceptions to its bar on the disclosure of confidential information. For example, sections 6103(h)(4)(B) and 6103(h)(4)(C) provide that third-party taxpayer information can be provided in situations where the treatment of an item reflected on the taxpayer's return is *directly related* to the resolution of an issue in the proceeding in which the information is sought or where there is a *direct transactional relationship* between the party seeking the information and the taxpayer and that relationship *directly affects* the resolution of the issue. In light of the important privacy interests underlying section 6103, TEI strongly believes that these exceptions should be narrowly construed.

A recent decision by the United States District Court for the District of Puerto Rico undercuts the privacy protections accorded by section 6103. In *Bristol-Myers Barceloneta, Inc., Bristol Caribbean, Inc., and Bristol Laboratories Corp. v. United States*, Civil 97-2567CCC, the court ordered that the IRS produce tax return information in respect of unrelated parties. The order grew out of the plaintiffs' efforts to secure information relating to their claim that the IRS had improperly

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denied them the favorable treatment accorded other taxpayers, and it was resisted by the IRS on section 6103 grounds.[4] The efforts of some affected taxpayers to voice their objections to the disclosure of confidential tax return information — and to recommend alternative, less-drastic solutions — proved unsuccessful.[5]

TEI believes that the district court misinterpreted the exceptions under sections 6103(h)(4)(B) and (C), which have generally been limited to situations where there is some relationship between the taxpayers and the third party. Thus, for example, in *Davidson v. Brady*, 559 F. Supp. 456 (W.D. Mich. 1983), *aff'd on other grounds*, 732 F. 2[d] 552 (6[th] Cir. 1984), the court found that the disclosure of a third party's financial statement submitted to the IRS during a criminal investigation was proper under section 6103(h)(5)(C) because of the debtor-creditor relationship between the two parties. *See also Mindell v. United States*, 693 F. Supp. 847 (D. Cal. 1988) (IRS permitted under section 6103(h)(5)(B) to disclose taxpayer's return to tax preparer to permit defense against preparer penalty).

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[5] Following the district court's initial February 5, 1999, order requiring the IRS to produce the confidential third-party information, the IRS's Chief Counsel notified the affected taxpayers. Several of those taxpayers sought to participate in the case as *amici curiae*, but their motion — along with the government's motion for reconsideration — was denied on May 14, 1999.

Quite simply, tax returns of unrelated parties should not be released to litigants in a pending case.[6] As noted by a federal appellate court in quashing a subpoena from the Commodities Futures Trading Commission for copies of individual traders' tax returns, "Income tax returns are highly sensitive documents." *Commodities Futures Trading Comm'n v. Collins*, 997 F. 2[d] 1230 (7[th] Cir. 1993).[7] The exceptions should be clarified to require a direct relationship between the taxpayer and the third party. The IRS might also be directed to develop alternative means of allowing taxpayers to pursue claims of "disparate treatment" based on the IRS's actions in respect of unrelated parties.

V. DISCLOSURE OF NON-FILERS

One issue to be addressed in the study is whether the publication of the names of taxpayers who do not file returns would encourage voluntary compliance. The Institute believes that, as a matter of tax policy and administration, such a program would be ill advised.

As the Privacy Commission found in 1977, "extraordinary precautions must be taken against misuse of the information the Service collects from and about taxpayers." In enacting section 6103, Congress was also concerned about the "impact of disclosure upon the continuation of compliance

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[6] Let there be no mistake: TEI believes that the plaintiffs' "disparate treatment" claim is worthy of adjudication. Nevertheless, even a wholly meritorious claim is insufficient reason to vitiate the protections of the Code's privacy provisions.

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with our country's voluntary tax assessment system." TEI believes that the concerns leading to the enactment of section 6103 IRS are still valid today.

Assuming that the information published is accurate, revealing the names of non-filers will undoubtedly erode taxpayers' privacy rights. Moreover, should mistakes occur — as seems highly likely in today's mobile society — taxpayers will soon lose confidence in the accuracy of the information, thereby defeating the purpose of the provision. In such circumstances, the provision could well hinder, rather than help voluntary compliance.

Finally, the suggestion raises significant administrative questions. How will the provision be implemented? Will the IRS develop a list of who filed a return in one year, compare it with a list of those who filed a return in prior years, and publish a list of names on one list, but not the other? When will the decision be made? Who will be responsible for keeping the list up-to-date? How will changes in names or mergers of companies be handled? How will errors be rectified? Will supposed non-filers have the opportunity to object to their inclusion on the list (before the fact)? What are the consequences of listing the name of a taxpayer who has, in fact, filed a return? TEI believes that the publication could cause more harm than good.

VI. CONCLUSION

Tax Executives Institute appreciates this opportunity to present our views on issues relating to taxpayer confidentiality. If you have any questions, please do not hesitate to call Robert J. McDonough, Jr., chair of TEI's IRS Administrative Affairs Committee, at (978) 625-6210 or Mary L. Fahey of the Institute's professional staff at (202) 638-5601.

Respectfully submitted,

TAX EXECUTIVES INSTITUTE, INC.

C.W. Shewbridge III

Charles W. Shewbridge, III
International President

Comments

of

TAX EXECUTIVES INSTITUTE, INC.

on

Study of
Taxpayer Confidentiality

submitted to

The Staff of the Joint Committee On Taxation and U.S. Department of Treasury

October 21, 1999

The Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 STAT. 782, instructs the staff of the Joint Committee on Taxation and the U.S. Department of Treasury to prepare studies pertaining to the confidentiality of tax returns and tax return information. On August 17, 1999, the Joint Committee staff invited comments with respect to this subject, and on October 8, 1999, the Treasury Department issued a similar request. The reports are due to be submitted to Congress by January 22, 2000.

I. Background

Tax Executives Institute is the preeminent association of business tax executives in North America. Our approximately 5,000 members represent 2,800 of the leading corporations through 52 chapters in the United States, Canada, and Europe. TEI represents a cross-section of the business community, and is dedicated to the development and effective implementation of sound tax policy, to promoting the uniform and equitable enforcement of the tax laws, and to reducing the cost and burden of administration and compliance to the benefit of taxpayers and government alike. As a professional association, TEI is firmly committed to maintaining a tax system that works — one that is administrable and that taxpayers can comply with in a cost-efficient manner.

Members of TEI are responsible for managing the tax affairs of their companies and must contend daily with the Internal Revenue Service and provisions of the tax law relating to the operation of business enterprises. We believe that the diversity and professional training of our members enable us to bring an important, balanced, and practical perspective to the issues raised by the taxpayer confidentiality provisions of the Internal Revenue Code.

The Joint Committee staff and Treasury Department have requested comments on issues relating to the confidentiality of tax returns, including —

- The adequacy of present-law protections governing taxpayer privacy;
- The interrelationship of the taxpayer confidentiality provisions in the Internal Revenue Code (primarily section 6103) with the Freedom of Information Act, the Privacy Act, and section 6110 of the Code;

- The need, if any, for third parties, including those presently authorized under the Code, to use tax return information; and
- Whether greater levels of voluntary compliance can be achieved by allowing the public to know who is legally required to file tax returns but does not do so.

TEI is pleased to respond to these requests.

II. ADEQUACY OF PRESENT LAW

For all its flaws, the U.S. tax system generally works well. Each year, millions of individuals and businesses voluntarily self-assess and pay the billions of dollars necessary to fund the military, the Social Security and Medicare programs, and other government programs. In the tax returns they file annually with the Internal Revenue Service, U.S. taxpayers lay bare not only their souls but also their personal and business lives. The level of detailed information required by the Internal Revenue Code is at once daunting and extraordinarily sensitive, and the willingness of taxpayers to disclose confidential information is largely attributable to assurances that their privacy interests will be safeguarded by the government.

Before 1977, tax returns were "public records" subject to disclosure under Treasury Department regulations approved by the President or by presidential order. In the aftermath of the Watergate scandals, however, Congress acted to strengthen taxpayers' privacy rights, reflecting public reaction to a wide range of governmental intrusions into private life well beyond the tax area. Consider, for example, the comments of the U.S. Privacy Protection Study Commission:

> 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.

U.S. Privacy Protection Study Commission, *Personal Privacy in an Information Society* 537 (1977).

Thus, in 1976, Congress provided that tax returns and tax return information are confidential and not subject to disclosure, except in 13 limited circumstances. In these areas of allowable disclosure, Congress attempted "to balance the particular office or agency's need for the information involved with the citizen's right to privacy, as well as the impact of the disclosure upon the continuation of compliance with our country's voluntary tax assessment system." Staff of the Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1976,* 94th Cong., 2d Sess. 315 (1976). Embodied in section 6103 of the Code, these rules define the protected area ("returns" and "return information") in detail, establish a basic rule of confidentiality, and prescribe different rules for disclosure to each of three groups — private persons, government taxing authorities, and

other government agencies.

In enacting section 6103(a), Congress made confidentiality the general rule: "Returns and return information shall be confidential, and except as authorized by this title [federal officers, employees, and certain other persons shall not] disclose any return or return information." "Return information" is defined, in part, under section 6103(b)(2)(A), as follows:

> [A] taxpayer's identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments, whether the taxpayer's return was, is being, or will be examined or subject to other investigation or processing, or any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense.

Courts repeatedly have confirmed the broad scope of this statutory language. *E.g., Branch Ministries, Inc. v. Richardson*, 970 F. Supp. 11, 18 (D.D.C. 1997) ("[t]his language is extremely broad. . . ."); *Lehrfeld v. Richardson,* 954 F. Supp. 9, 13 (D.D.C. 1996), *aff'd*, 132 F.3d 1463 (D.C. Cir. 1998) ("'return information' is defined broadly to include almost any information compiled by the IRS in connection with its determination of a taxpayer's liability"). Section 6103 is the type of statute that exempts information from disclosure under the Freedom of Information Act (FOIA) because it is nondiscretionary or establishes "particular criteria" for withholding information within the meaning of FOIA Exemption 3. *Church of Scientology of California v. IRS*, 792 F. 2d 146, 150

(D.C. Cir. 1986), *aff'd en banc*, 792 F. 2nd 153 (1986), *aff'd*, 484 U.S. 9 (1987).[1]

So important is protecting taxpayer confidentiality and maintaining taxpayer confidence in the integrity of the tax system that the Internal Revenue Code contains a three-tier system of sanctions for those who violate section 6103. First, section 7431(a) accords aggrieved taxpayers a civil cause of action and provides for damages in the case of unauthorized disclosures. Second, section 7213(a)(1) makes the unauthorized disclosure of taxpayer returns and return information a felony. Finally, the law mandates the firing of any federal employee convicted of unauthorized disclosure. I.R.C. § 7213(a)(1). The enactment of civil and criminal penalties demonstrates the importance of the taxpayer confidentiality provisions.

Section 6103's ban on disclosure is not, however, absolute. In addition to the 13 limited exceptions, Congress has provided under section 6110 for the disclosure of "written determinations," which are defined as "a ruling, determination letter, technical advice memorandum, or Chief Counsel advice." Background file documents relating to written determinations — defined as any written material submitted in support of the request — are also subject to disclosure. These documents

[1] FOIA lists categories of information that a federal agency must make available for public inspection. 5 U.S.C. § 552(a). Although the statute sets forth a general presumption that agency records are publicly accessible, there are nine exemptions from public disclosure. For example, Exemption 3 of FOIA provides that an agency is not required to disclose matters that are specifically exempted from disclosure by statute "provided that such statute (A) requires that the matters be withheld from the public in such a manner as to leave no discretion on the issue, or (B) establishes particular criteria for withholding or refers to particular types of matters to be withheld . . . ." 5 U.S.C. § 552(b)(3).

include any communications between the IRS and persons outside the IRS concerning such written determination that occur before the IRS issues the determination. Thus, at the same time it enacted section 6103, Congress enacted section 6110 to require the disclosure of private letter rulings and technical advice memoranda because the "secrecy surrounding" those written determinations "has generated suspicion that the tax laws are not being applied on an evenhanded basis." S. Rep. No. 94-938 (Part 1), 94th Cong., 2d Sess. 305 (1976).

Over the years, disputes have arisen concerning what constitutes a "written determination" under section 6110. *See, e.g., Tax Analysts v. IRS*, 117 F. 3d 607 (D.C. Cir. 1997) (relating to the application of FOIA Exemption 3 and section 6110 to field service advice memoranda). Thus, a tension exists between section 6103's general rule of confidentiality and section 6110's policy of public access.

We have described the current taxpayer confidentiality regime in some detail because we believe that, in general, taxpayers and the public have been well served during the 23 years since the enactment of sections 6103 and 6110. We recognize that at times the IRS may have invoked section 6103 to prevent information from becoming disclosed, as, for example, a litigating tactic or perhaps in an attempt to save itself from embarrassment. TEI believes, however, that on the whole taxpayer confidentiality must remain paramount and, therefore, that no fundamental changes should be effected. We suggest, however, that the law should be updated to take into account IRS programs

that have developed since section 6103 was enacted. (Specifically, as discussed in the next section, advance pricing agreements should be considered "tax return information" and excluded from disclosure under section 6103.) In addition, the limited exceptions to section 6103 should be clarified in respect of third-party access to tax returns and return information to ensure that unrelated parties do not have access to confidential information.

III. Interaction with FOIA

In general, section 6103 and FOIA have operated in tandem to reasonably balance the public's interest in protecting taxpayer privacy against the public's right to have access to certain information. Thus, FOIA (and, later, section 6110) has resulted in the publication of private letter rulings (PLRs), technical advice memoranda (TAMs), general counsel memoranda (GCMs), IRS actions on decision (AODs), and, most recently, field service advice (FSAs). The release of these documents — subject to appropriate redaction — has served to keep the public abreast of IRS positions on issues, often well before official "published" guidance is released. Thus, written determinations, such as PLRs and TAMs, have provided much needed guidance in transition periods while more formal guidance is being prepared. This is not to say, however, that there have not been some hiccups. One of the problem areas involves the IRS's advance pricing agreement (APA) program.[2]

[2] Under section 6110, the IRS is to redact taxpayer information before releasing so-called written determinations — a process in which the affected taxpayers participate. Although TEI is concerned about the potential for inadvertent disclosure — especially where voluminous background information is involved — the safeguards utilized by the IRS work remarkably well.

The APA program is designed to forestall contentious and expensive transfer pricing disputes between taxpayers and the IRS. A voluntary venture, the APA program represents one of the IRS's success stories of the 1990s, for it furthers the goals of reducing taxpayer burdens and minimizing disputes between the IRS and taxpayers. Under the program, the taxpayer submits detailed and confidential financial information, business plans, and projections to the IRS for consideration. Resolution involves an extensive analysis of the taxpayer's functions and risks. Since its inception in 1991, the APA program has produced more than 180 APAs, and approximately 195 APA requests are pending.

An APA effectively resolves transfer pricing disputes before they arise. Each APA specifies a methodology negotiated between the specific taxpayer and the IRS (and, at times, one or more foreign countries) for the taxpayer to use in determining its intercompany pricing and thereby ensure compliance with section 482 of the Internal Revenue Code. The information set forth in an APA is highly fact specific and involves sensitive financial and commercial information. By reducing taxpayer burdens and enhancing taxpayer certainty, the APA program strengthens the competitiveness of participating U.S. businesses and facilitates the more efficient use of IRS resources.

Although the IRS had treated APAs as subject to section 6103 from the inception of the program, earlier this year it stipulated that APAs were "rulings" and therefore "written

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VI. Conclusion

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Respectfully submitted,

TAX EXECUTIVES INSTITUTE, INC.

Charles W. Shewbridge, III
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WASHINGTON COUNSEL, P.C.
ATTORNEYS AT LAW

GARY J. GASPER

January 12, 2000

JAN 13 2000

Ms. Lindy L. Paull
Chief of Staff
Joint Committee on Taxation
1015 Longworth House Office Building
Washington, D.C. 20515

Re: Comments on Taxpayer Confidentiality and Tax Return Information – JCT Press Release: 99-03

Dear Ms. Paull:

On behalf of Piercy, Bowler, Taylor & Kern (CPAs), Mr. Gil Hyatt, and others, we respectfully submit the enclosed comments on issues relevant to the confidentiality of Federal tax returns and return information in response to JCT Press Release: 99-03.

These comments include specific examples of misuse of confidential tax return information by the California Franchise Tax Board ("FTB"), as well as administrative and legislative recommendations. As a guiding principle, we believe that any state or local tax agency, like the FTB, that does not have proper safeguards in place or that recklessly disregards safeguards designed to protect taxpayer information should be prohibited from receiving Federal tax returns and return information from the IRS.

To implement this sound tax policy, the JCT in its study should consider making the following administrative and legislative recommendations to Congress:

(1) Grant authority and provide direction to the IRS to immediately cease sharing Federal tax returns and return information with any state or local tax agency, such as the FTB, that does not have proper safeguards in place or that recklessly disregards safeguards designed to protect taxpayer information, until identified abuses have been rectified and the agencies have taken appropriate measures to prevent future abuses;

(2) Pass legislation requiring that all state or local tax agencies that receive Federal tax returns and return information, including the FTB, should adopt and fully comply with the same reforms and taxpayer rights protections imposed on the Internal Revenue Service by the Internal Revenue Service Restructuring and Reform Act of 1998 as a prerequisite for obtaining Federal tax returns and return information from the IRS; and

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(3) Direct the Taxpayer Advocate to establish a function within his/her office to specifically address taxpayer complaints regarding breaches of confidentiality relating to Federal tax returns and return information by state and local tax agencies as well as provide authority to the Taxpayer Advocate to request that the IRS cease sharing Federal tax returns and return information with any state or local tax agency, such as the FTB, that does not have proper safeguards in place or that recklessly disregards safeguards designed to protect taxpayer information.

Thank you for the opportunity to submit these comments and please do not hesitate to contact us if we can be of any further assistance.

Sincerely,

Gary

Gary J. Gasper

cc: Richard A. Grafmeyer, Deputy Chief of Staff, Joint Committee on Taxation
Barry L. Wold, Legislation Counsel, Joint Committee on Taxation
Timothy L. Hanford, Tax Counsel, Ways and Means Committee
Janice Mays, Democratic Chief Counsel, Ways and Means Committee
Tom Roesser, Tax Counsel, Senate Finance Committee
Russell Sullivan, Minority Chief Tax Counsel, Senate Finance Committee
Jonathan Talisman, Acting Assistant Secretary (Tax Policy), Department of the Treasury

COMMENTS ON TAX RETURN AND RETURN INFORMATION CONFIDENTIALITY IN RESPONSE TO JCT PRESS RELEASE: 99-03

RECOMMENDATIONS

Any state or local tax agency that does not have proper safeguards in place or that recklessly disregards safeguards designed to protect tax payer information should be prohibited from receiving Federal tax returns and return information from the IRS.

To implement this sound tax policy, the Joint Committee on Taxation ("JCT") in its study should consider making the following administrative and legislative recommendations to Congress:

(1) Grant authority and provide direction to the IRS to immediately cease sharing Federal tax returns and return information with any state or local tax agency that does not have proper safeguards in place or that recklessly disregards safeguards designed to protect taxpayer information, until identified abuses have been rectified and the agencies have taken appropriate measures to prevent future abuses;

(2) Pass legislation requiring that all state or local tax agencies that receive Federal tax returns and return information should adopt and fully comply with the same reforms and taxpayer rights protections imposed on the Internal Revenue Service by the Internal Revenue Service Restructuring and Reform Act of 1998 as a prerequisite for obtaining Federal tax returns and return information from the IRS; and

(3) Direct the Taxpayer Advocate to establish a function within his/her office to specifically address taxpayer complaints regarding breaches of confidentiality relating to Federal tax returns and return information by state and local tax agencies, as well as provide authority to the Taxpayer Advocate to request that the IRS cease sharing Federal tax returns and return information with any state or local tax agency that does not have proper safeguards in place or that recklessly disregards safeguards designed to protect taxpayer information.

I. INTRODUCTION

In preparation for a study on taxpayer confidentiality required by the Internal Revenue Service Reform and Restructuring Act of 1998 ("the Act"), the Joint Committee on Taxation ("JCT") has requested public comments on various issues of taxpayer privacy and the use of tax return information, including the impact on taxpayer privacy of sharing tax information for the purposes of enforcing State and local laws.

II. BACKGROUND

Congress has taken great steps to prevent abuses against taxpayers, in particular, violations of confidentiality with regards to Federal tax returns and return information. Federal tax returns and return information are shared with state tax agencies so long as those agencies abide by certain rules that protect confidential taxpayer information.

State and local tax agencies must maintain safeguards that protect taxpayer privacy and confidentiality with respect to tax returns and tax return information. Agencies that do not maintain adequate safeguards or recklessly disregard such safeguards should be prohibited from receiving Federal tax return information.

Congress has a strong interest in the policies and procedures of the state tax agencies that receive Federal tax returns and return information. Internal Revenue Code § 6103 makes it clear that state employees with access to Federal tax return information shall keep such information confidential and may not disclose it to anyone except for those properly authorized to view such information. Because Federal tax information is what is being shared, Congress **must** insure that tax information shared with State and local agencies is protected to the same degree called for by Federal law and that such agencies must be held to the same standard to which the IRS is held regarding Federal tax information, including full compliance with recent IRS reform and "taxpayer rights" legislation.

Congress should also insure that recent IRS reforms are not undermined by abusive state tax agencies misusing Federal tax information. Furthermore, Congress should also insure that the IRS is not a partner with abusive state tax agencies using Federal tax information improperly to coerce, threaten or abuse taxpayer's rights, including during state examinations or audits.

III. VIOLATIONS OF CONFIDENTIALITY BY STATE AGENCIES

A. Overview

Unfortunately, some state tax agencies do not have proper confidentiality safeguards for taxpayer information and many states that do recklessly disregard such safeguards in their zeal to collect as much tax revenue as possible, many in violation of taxpayer privacy and confidentiality of Federal tax returns and return information.

While Congress addressed the issues of taxpayer privacy and abuse at the federal level in the Act, there may be just as many oppressive actions currently occurring throughout the country at the State level. Attached in a package of news article as "Attachment A," is an article from *Forbes*

Magazine entitled *"Tax torture, local style"* (July 6, 1998). This article highlights the fact that "[T]here are at least half as many revenue agents working for the states as the federal government" and "[C]ollectively, they are just as oppressive as the feds." Moreover, many of these abuses and violations derive from information states receive from federal agencies under their information sharing arrangements.

The *Forbes* article lists a number of state tax department problems including: (1) privacy violations by California, Connecticut, and Kentucky; (2) criminal or dubious activities by Connecticut, Indiana, Kentucky, New Mexico, North Carolina, Oklahoma, and Wisconsin; and (3) mass erroneous tax-due bills by Arizona, California, Indiana, Michigan, and Ohio.

In another recent article, the *Los Angeles Times* reported that the state taxing authority, the California Franchise Tax Board, "is second in size and scope only to the Internal Revenue Service – and by all accounts the state agency is the more efficient, more aggressive and more relentless of the two" and that "there is little to stop the agency from becoming more aggressive." See also, "Attachment A," article titled "*State Agency Rivals IRS in Toughness," Los Angeles Times* (August 2, 1999, page 1).

The state tax agencies are also applying inconsistent rules resulting in inequitable treatment and unfair burdens on nonresident taxpayers. A recent article entitled *"State Taxation of Professional Athletes: Congress Must Step In"* (Paul Barger, Tax Notes, October 11, 1999, p. 243) detailed the type of inconsistent and disparate treatment that some nonresident taxpayers face from state taxing agencies. See also, "Attachment A."

Overall, serious violations of taxpayer confidentiality and taxpayer rights in the examination and audit process are presently occurring at an alarming rate at the State and local levels. In many cases these abuses involve the misuse of confidential Federal tax returns and return information.

B. Examples of Taxpayer Abuse and Misuse of Confidential Information at the State Level in California

Recent cases evidence a total disregard of taxpayer protections and safeguards of confidential tax return and return information by the California Franchise Tax Board ("FTB"), the state's income tax collection agency, particularly with respect to residency audits.

In a case involving Mr. Gil Hyatt, the FTB practiced indiscriminate breaches of taxpayers' confidentiality and improperly used the threat of disclosing taxpayer confidential information to exact additional taxes. The FTB blatantly disregarded the requirements for proper treatment of confidential information and then used the disclosure of confidential information to coerce settlement of an unreasonable tax assessment from a taxpayer. Among the FTB's more reprehensible actions was the public disclosure to newspapers and other public entities of Mr. Hyatt's name, social security number, and non-public address through quasi-subpoenas during the state examination and audit process.

The accounting firm of Piercy, Bowler, Taylor & Kern has represented a number of other clients in similar circumstances – all involving a total disregard of taxpayer protections and safeguards of confidential tax return and return information by the FTB. Other cases of abusive tactics and misuse of taxpayer information by the FTB are described in memorandums attached hereto. These memos by Mr. Gil Hyatt include descriptions of his case, the case of Mr. George Archer (a professional golfer), and the case of Mr. Joseph and Emily Gilbert. See, Attachment C (Memo by Mr. Gil Hyatt); Attachment D (Memo by Mr. Gil Hyatt); and Attachment E (Memo by Mr. Gil Hyatt).

C. Facts in the Case of Mr. Gil Hyatt

Mr. Gil Hyatt is a Nevada resident who is well-known throughout the world for his innovations in computer technology. He is justly protective of the location of his office and research lab in view of the industrial espionage that is rampant in the industry marketplace in which he works and in view of established dangers from stalkers and other predators. He has taken great care to keep the address of his home, office, and research lab secret to protect against industrial espionage and stalking, including purchasing the property through a trust and taking other precautions so that his name was not connected with the property.

Mr. Hyatt moved from California to Nevada in September 1991 and still resides in Nevada to this present day with no intention of changing his Nevada residency. Even though Mr. Hyatt has physically moved away from California and intends to stay in Nevada indefinitely, the FTB refused to acknowledge the move for tax purposes, began an extensive tax examination and assessed him with what is tantamount to an "exit tax" of millions of dollars. Because of his particular need for confidentiality and privacy, the FTB with blatant disregard for both Federal and state laws, proceeded on a calculated program to intimidate and harass him by public disclosure of confidential information (including shared Federal tax information) and by making threats of further public disclosure if he did not settle with the FTB over the amount of taxes owed.

Because of the tortious conduct by the FTB, Mr. Hyatt filed a complaint in Nevada state court claiming violations of his right to privacy, fraud, and abuse of process. This case is set for trial in Nevada in November 2000. In spite of the claims in this case and the pending state court action, the FTB continues its tortious conduct, including continuing to disclose Mr. Hyatt's confidential information.

In general, the facts in Mr. Hyatt's case involve an assessment by the FTB of millions of dollars in false penalties and intentional errors in income calculations, done in a manner consistent with the FTB's established practice of significantly increasing assessments in preparation for settlement negotiations. When Mr. Hyatt argued against the assessment, the FTB threatened that his confidential personal information would become public if he didn't settle his case. In other similar examples, taxpayers have been known to settle at the protest stage to keep their private information from becoming public.

During the course of this "residency" examination, Mr. Hyatt was cajoled into giving his private address to the FTB only after the FTB provided assurances that it would keep it strictly confidential and that California law made it a crime for the FTB to disclose this information. As the examination proceeded, without notice to Mr. Hyatt and with total disregard for his privacy, safety, and confidentiality, the FTB, within weeks of receiving the information, began indiscriminately broadcasting the private address to the very entities from whom Mr. Hyatt sought to keep the private address confidential. The FTB sent out formal Demands for Information (quasi-subpoenas) to newspapers and to other public entities that keep large databases of information on citizens. A copy of this quasi-subpoena ("Demand for Information") is attached hereto as "Attachment B."

These quasi-subpoenas disclosed Mr. Hyatt's name, social security number, and his non-public residence address to the very entities from which he sought to be protected. This without even noticing, servicing, or informing Mr. Hyatt or his attorney that such quasi-subpoenas were being sent out, thereby depriving him of his legal right to take legal action to quash these fraudulent quasi-subpoenas. When challenged about this disclosure of confidential information, the FTB argued that the private address need not be kept confidential because it was public — in spite of the fact that Mr. Hyatt was never publicly linked to this address.

The FTB did not just disclose this confidential information accidentally or discretely. In fact, the FTB was very direct in using the Demands for Information form to indiscriminately disclose Mr. Hyatt's confidential information and cast him in a bad light, while at the same time getting the recipient's attention due to its formal, criminal-investigation type format. See, Attachment B. While the FTB asserts that these quasi-subpoenas are intended only to demand information from uncooperative third parties, the FTB has adopted another use for them — as tools for embarrassing and intimidating taxpayers during the examination and audit process and disclosing the taxpayer's confidential information by indiscriminately sending them out in mass mailings.

Another abuse in the Hyatt case occurred when the FTB located a check made out to a Dr. Shapiro. Instead of asking Mr. Hyatt for information on this Dr. Shapiro, the FTB located six Dr. Shapiros in the telephone book and sent out quasi-subpoenas containing confidential information to all of them, thereby informing a group of professionals that Mr. Hyatt was under investigation, focusing more attention on him, and causing him even greater exposure and embarrassment. The FTB also sent quasi-subpoenas containing confidential information to several newspapers on a "fishing expedition" calculated to cause Mr. Hyatt even more exposure and embarrassment. These examples are strong indications that the FTB uses confidential taxpayer information to intimidate taxpayers in order to exact improper tax assessments and recklessly disregards safeguards with respect to tax information.

D. Other Generic Violations of Confidentiality By the FTB and the State of California

A state tax agency that receives federal tax information should maintain a secure area for such information. The FTB, however, allows its auditors to carry such information in unsecured briefcases to locations outside of the FTB (e.g., an auditor's residence). Furthermore, all federal tax information should be provided only on a need-to-know basis and should not be commingled with other information or indiscriminately disseminated even within the recipient agency. At the FTB, in contrast, Federal and state tax information is commingled into a single audit file, which is then indiscriminately disseminated throughout the agency without proper protection for the federal tax information within. The FTB does not properly safeguard confidential federal taxpayer information, but instead often keeps such information in the offices, car trunks, and homes of FTB agents and even regularly misplaces or loses such information.

In Mr. Hyatt's case, the FTB, without any indication of satisfying the special requirements of Federal law, intermingled Federal income tax returns with extensive state audit information in audit files, shipped those files to an unsecured agent's home in Arizona, and maintained the audit files (including the Federal tax return information) in this unsecured and illegal environment. The

Federal tax returns and return information remains intermingled to this day with no indication that the FTB will ever provide safeguards for the Federal tax returns and return information.

In addition, recent Federal tax reforms of seek to prevent individual's within agencies from inspecting a taxpayer's federal tax information without authorization ("illegal browsing") have not been enforced at the state level in California. For instance, the FTB in some cases appears to practice a "fishing" tactic of browsing taxpayers' confidential tax information in order to determine which taxpayers would make good candidates for a state "residency" tax audit. These techniques fly in the face of recent Congressional legislation restricting such illegal browsing.

Because the FTB does not distinguish between Federal confidential information and state confidential information, the FTB is no more likely to be careful with Federal tax information than it is with state tax information. For example, as evidenced above, the FTB indiscriminately discloses social security numbers and home addresses, regardless of the Federal or state tax return source, with the cavalier position that social security numbers and home addresses constitute public information and hence do not have to be protected. These activities are clear violations of Federal and state laws that specifically protect such information.

In other areas, the State of California receives Federal tax return information for tracking down "dead beat" dads. The state uses this confidential information to obtain child support payments from out-of-state parents, but then misuses the fact that child support payments are made by nonresident parents as "evidence" to tax these nonresidents as residents. This issue is addressed more fully in a memo by Mr. Gil Hyatt attached hereto as "Attachment E."

The receipt of Federal tax returns and return information from tax-sharing agreements with the IRS, whether used by the FTB in its "residency" and tax audits or by the state of California in other areas, should be subject to strict privacy safeguards. Unfortunately, there are cases under current law that show, regardless of the protections that the IRS provides for Federal tax returns and return information, these protections can be and are circumvented by the FTB and the state of California in a manner that recklessly disregards taxpayer protection safeguards.

E. Summary

As evidenced in the Gil Hyatt case and other cases, the FTB is one of many state taxing agencies which relies upon IRS information for its taxing activities, but which recklessly disregards any safeguards protecting confidential tax returns and return information. Moreover, since the tax laws of California have not been conformed with the Internal Revenue Service Restructuring and Reform Act of 1998 ("the Act"), the reforms and taxpayer rights protections in the Act do not apply to any such inappropriate actions by the FTB or the state of California.

Thus, while the IRS is required to operate under the taxpayer protections granted by the Act, State and local agencies, like the FTB, can and do end-run around the Congressionally mandated taxpayer protections and can reek havoc on unsuspecting taxpayers. Even worse, any safeguards that do exist are in some cases recklessly disregarded by the FTB, in effect blatantly violating State law with impunity. Again as evidenced in the Gil Hyatt case and other cases, nowhere is this more true than with the FTB's "residency" auditing department — the department responsible for going after former California residents now residing in other states.

Examples of improper and/or illegal activities by the FTB include the same type of activities that were under scrutiny by the Congress at the Federal level in 1998 when they passed the Act. These include not only blatant disregard of the requirements for proper treatment of confidential tax information, but also actually using the disclosure of such confidential information as a threat to exact unreasonable tax assessments from taxpayers. There are also indications that the FTB in its training materials, encourages its agents to inappropriately assess penalties so that they can intimidate taxpayers and then later negotiate away the penalty to exact the unfair tax assessment originally desired. Many of these same issues were under scrutiny by Congress in passing IRS reforms as past of the Act.

Any State or local agency guilty of such improper acts, bad faith or breaches of taxpayer confidentiality should not be allowed to receive Federal tax returns and return information. Agencies, like the FTB, that are incapable of providing the safeguards necessary to protect shared tax returns and return information or that recklessly disregard such safeguards should be prevented from receiving Federal tax return and return information. Moreover, any evidence that a state tax agency is using Federal tax information in conjunction with any kind of improper and/or illegal state tax examination or audit activities should be grounds for immediate suspension of any sharing by the IRS with that state tax agency.

IV. CONCLUSION

Congress should do whatever it can to protect the rights of U.S. citizens against overzealous State and local tax agencies that misuse confidential Federal tax return and return information.

Any state or local tax agency, like the FTB, that does not have proper safeguards in place or that recklessly disregards safeguards designed to protect taxpayer information should be prohibited from receiving Federal tax returns and return information from the IRS.

To implement this sound tax policy, the JCT in its study should consider making the administrative and legislative recommendations set forth at the beginning of this document.

ATTACHMENT A

[NEWS ARTICLES]

Think the Internal Revenue Service has problems?
Take a look at state revenue services.
Collectively, they are just as oppressive as the feds.

Tax torture, local style

By William P. Barrett

"WE ARE CONTACTING area businesses to see if they would be willing to make a donation of some type that we could give away as a door prize at our Christmas party. . . . We feel this would be good advertising for your business." A pitch from some charity? Nope. This November 1995 letter to 60 firms around Raleigh came, on official stationery, from the North Carolina Department of Revenue office that conducts state tax audits.

Extortion? No, just "thoughtless and misguided," an agency spokesperson said after the Raleigh *News & Observer* exposed the letter.

Thanks to recent congressional hearings, abuses by agents of the Internal Revenue Service are well known. But what about their cousins working in state capitals? There are at least half as many revenuers working for the states as for the federal government (which has 102,000 at the IRS), but they get far less attention. Tax enforcement mischief at the state level is just much less visible nationally.

The operations of the IRS and the state tax agencies are connected. They routinely share data. About 75% of states base personal income taxes on federal adjusted gross income. If the IRS catches you overstating a deduction or understating an item of income, you'll get hit up by a state tax agency as soon as you have paid the feds.

The states are thrilled to let the IRS absorb the public relations heat for overreaching tax enforcement while collecting their share of the loot. Then the states add their own layer of pain and suffering.

A strong contender for the most inept state tax agency is the New Mexico Taxation & Revenue Department. Last year it sent out tax packets missing a full page of instructions. This year the department sent 25,000 tax returns preprinted with taxpayers' names to wrong addresses.

Meanwhile, the short form, used by two-thirds of New Mexico taxpayers, contained an incorrect instruction likely to cause most filers to underpay taxes. Despite its own culpability, the department initially said anyone following the bad instructions would be subject to penalties—a position it quickly abandoned.

The ability of some states to make sweepingly false declarations of taxes due is stunning. Earlier this year the California Franchise Tax Board sent delinquency letters demanding taxes, interest and penalties to 28,000 taxpayers who had paid their state income taxes on time. The problem: These taxpayers had filed electronically, mailing a check for taxes due. The state's computer processed the returns—spitting out those threatening letters—without waiting for the checks to arrive.

Last year 3,600 low-income senior citizens in Indiana received erroneous bills saying they owed up to $140 for previous-year taxes. The Indiana Department of Revenue had neglected to take into account a tax credit. To make things worse, the false notices kept going out months after Indiana officials discovered the errors.

In neighboring Ohio, hundreds of couples received incorrect tax bills in 1995 for up to $650, plus interest, after state computers failed to recognize a joint filing credit. It turned out that the Ohio Department of Taxation knew about the bad bills shortly after they were mailed, but made no public announcement and had no plans to correct the errors—unless an affected taxpayer complained.

The Arizona Department of Revenue sent thousands of letters to businesses, mistakenly accusing most of not paying state taxes withheld from employee paychecks. Officials blamed "an error in programming."

A refund delayed is income denied. Since 1994 at least six states have stalled in issuing tax refunds, usually citing problems associated with new technology. New Mexico, unsurprisingly, is on the list. The others: Kansas, Minnesota, North Carolina, Oklahoma and Pennsylvania.

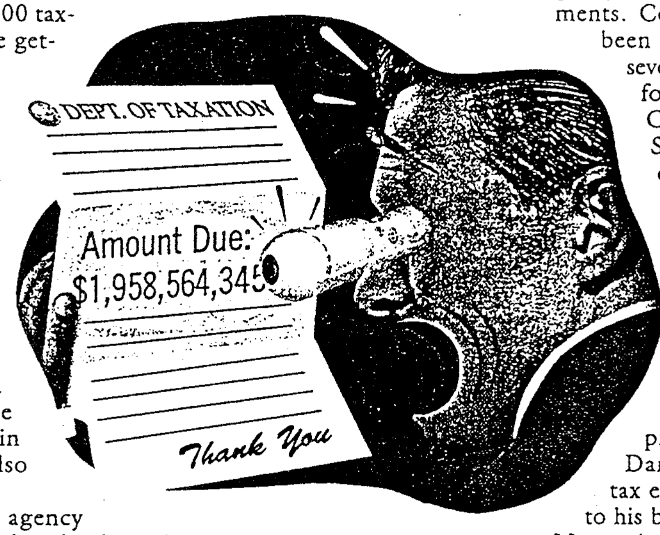
In 1995 the Michigan Department of Treasury discovered that an incorrect reference on the state's 1040EZ form to the federal Form 1040EZ meant that 40,000 taxpayers thought they were getting a bigger refund. Funny, the very same problem—identical line numbers, even—had hit Nebraska a year earlier.

The IRS certainly has no monopoly on wasting people's time and money. Last winter, says Robert Timineri, a tax preparer in Sausalito, Calif., a client went to a California State Franchise Tax Board office, paid in full a big tax bill and also got a receipt.

But two days later the agency mistakenly froze all the bank accounts of the client, of his business and even of his children. Even brandishing that receipt, Timineri says it took a week to convince the agency it already had the money and to get the accounts unfrozen. A Franchise Tax Board spokesperson knew nothing about this incident but said, "Anything can go wrong when you have 13 million returns."

A hallmark of tax administration is supposed to be the confidentiality of individual tax records. But in California this year the Tax Franchise Board mailed 8 million tax-return packets to taxpayers with their Social Security numbers clearly printed on the outside.

Two years ago Kentucky Revenue Cabinet auditor James Howitz in Lexington was found guilty of mis-



JOHN UELAND

using a government computer, received probation and left his job.

Why was he misbehaving? It seems that, because of a teller error, state and federal tax refunds due Howitz totaling $606 had been posted to the credit union account of an innocent party, Carol Shanklin. Howitz allegedly used confidential state tax records in the office computer to identify Shanklin, who was unaware of the error. He called her up, wrongly accused her of stealing the checks—then officially requested she be audited. (Howitz insisted he identified Shanklin through other means.)

The states are not always careful in their hiring. In February former Wisconsin Department of Revenue agent John Leutermann pleaded guilty to stealing $800 of tax payments. Court papers said he had been "desperate for money on several occasions." Last year a former Oklahoma Tax Commission employee, Syndi Sullivan, was accused of embezzling $5,000 by diverting delinquent business tax payments made in cash. Her case is still pending. She couldn't be reached for comment.

According to published reports, in 1994 Indiana discovered two problems concerning Danny Joe Lewis, a veteran tax examiner. First, unknown to his bosses, he had a record of 11 convictions for offenses including burglary and recklessness with a deadly weapon. Second, he had bilked the state out of $27,000 by issuing phony refund checks to three friends. He was sentenced to six years.

But for sheer audacity, it's hard to top the exploits of Jatin Patel. He was an expert in tax fraud who headed the Connecticut Department of Revenue Services team specializing in sales tax enforcement. On the side, he also owned a motel in Branford, Conn.

He combined his two callings. Authorities accused Patel of filing a dozen false tax returns related to the motel—paying workers off the books and understating room receipts—and also using the state tax computer to monitor four rival motels around Branford. In an April 1994 plea bargain, he admitted to one count of third-degree computer crime, repaid $2,500 in taxes and received a suspended jail sentence. He could not be reached for comment.

Congress is working on a bill to clip the IRS' wings. That leaves half the tax enforcement problem unsolved. ■

Taxing states

Agency problem	States affected
Mass erroneous tax-due bills	Arizona, California, Indiana, Michigan, Ohio
Mass delayed refunds	Kansas, Minnesota, New Mexico, North Carolina, Oklahoma, Pennsylvania
Flawed tax forms, instructions or attachments	Arizona, Indiana, Michigan, Nebraska, New Mexico
Privacy violations	California, Connecticut, Kentucky
Criminal or dubious activities	Connecticut, Indiana, Kentucky, New Mexico, North Carolina, Oklahoma, Wisconsin

Some state tax department difficulties reported since 1994.

Los Angeles Times

National Edition

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MONDAY, AUGUST 2, 1999

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State Agency Rivals IRS in Toughness

■ **Finances:** Franchise Tax Board is ruthless, arrogant, unwilling to compromise, critics say. Officials reply that they're doing their jobs well, and friendlier.

By LIZ PULLIAM
TIMES STAFF WRITER

California has a state income tax machine that puts a collar on cheats and keeps state coffers full, but a growing number of individual taxpayers, corporations and tax attorneys complain that the agency's efficiency too often is tainted by arrogance and a stubborn unwillingness to compromise.

With 6,500 employees and tax collections that top $34 billion, the Franchise Tax Board is second in size and scope only to the Internal Revenue Service—and by all accounts the state agency is the more efficient, more aggressive and more relentless of the two.

But while the IRS came under fire two years ago for alleged abuses of power, an inquiry that prompted new controls and oversight, the FTB has received far less scrutiny. Among recent developments that are raising pointed questions about the agency:

- For two years in a row, corporate tax executives have ranked California's among the toughest, least fair and least predictable state tax agencies in the country.
- The FTB's refusal to compromise led recently to a rare but important loss in the courts when it was ordered to refund at least $250,000 to a Newport Beach couple after the state Court of Appeal ruled the agency had made up a tax bill "out of thin air."
- The state auditor has questioned the cost-effectiveness of the FTB's aggressive audit squad.
- Until recently, the FTB rejected 96% of settlement offers by tax-strapped taxpayers as well as most pleas for installment agreements so tax bills could be paid off over time.

Tarzana accountant Michael Rozbruch makes his living battling tax agencies for clients: protesting assessments, arranging payment plans, negotiating for penalty waivers. But when it comes to the FTB, Rozbruch concedes defeat before he even starts.

"You can always negotiate with the IRS," said Rozbruch, a certified public accountant and principal of Tax Resolution Services Co. "I tell my clients to beg, borrow and steal if they owe the state."

The FTB and its defenders say the agency has become more service oriented and taxpayer friendly in the past year, though some conflict is inevitable given California's size, huge economy and complex tax laws.

"Our typical audit is a corporate audit or a very wealthy taxpayer with very sophisticated professional representation," said Gerald H. Goldberg, who has reigned as the FTB's top executive since 1980. "Aggressive taxpayers are forever going to be challenging the limits."

Even some top state tax officials, however, say the agency occasionally lets its vigilance go too far. State Treasurer KathleenConnell, who serves as chairwoman of the FTB, and Board of Equalization member Dean Andal have raised such concerns.

"The FTB probably has the most competent staff of any state tax agency, but they're brutal," said Andal, who also served as one of three board members of the FTB last year. "They tend to look at every audit as a battle. In the gray areas, they push the envelope rather than work out a reasonable compromise."

State Is Ranked Most Aggressive

Many corporate taxpayers agree. In both 1997 and 1998, company tax executives ranked California at the top of a "worst offenders" list compiled by CFO magazine to rate the tax agencies of the 50 states. The magazine polled 300 of the nation's 1,000 largest companies, and 91 tax managers responded.

These corporate financial officers ranked California as the most aggressive of the states during audits. The state was described as among the least predictable in administering tax policy and among the most likely to take a black-and-white stance on unclear areas of tax law.

By contrast, the FTB has a lower profile with individual taxpayers, who are far less likely to have contact with the state tax agency than with the IRS. About one in five individual taxpayers gets some kind of routine contact—typically an automatic penalty or request for more information—from the IRS each year. About five in 1,000 people actually are audited.

The FTB contacts fewer than one in 20 state residents for administrative matters, and its audit rate is about half that of the IRS. In addition, most FTB audits of individuals are merely follow-ups on IRS audits. IRS leads account for the preponderance of the FTB's individual taxpayer audits.

Nonetheless, some taxpayers and business leaders say that when the FTB does strike, it is hard and sometimes arbitrary.

The FTB admitted it didn't have enough information when it made up a tax bill for John and Barbara Wertin, a Newport Beach couple whose 1983 return was audited by the IRS.

The FTB had destroyed the Wertins' return, but rather than waiting for them to dig up their copy, the FTB levied taxes and interest using erroneous electronic information. The Wertins argued successfully that the agency had to base assessments on an actual return.

The FTB "loitered," "dawdled" and then "panicked" as the statute of limitations on the case began to run out, Court of Appeals judges said in a case brought by the couple. "Instead of seeking an extension of the statutory period from the Wertins, who were under a duty to produce their returns, the FTB ignored statutory directives and computed their tax deficiency out of thin air," the judges wrote. -233-

The Wertins' attorney, M. Edward Mishow, said the couple offered to settle the case before it went to trial. Now, the Wertins are expected to get more than $600,000 from the state. The FTB appealed but the state Supreme Court refused to hear the case.

The FTB "didn't get a dime," Mishow said. "I said, 'If you guys lose, it's going to make an untenable precedent. . . .' You have to wonder why they didn't have a better assessment of the risks."

Johan Klehs, chairman of the State Board of Equalization and an FTB member, said the case was a rare loss for the state, which he said wins 90% of the cases that go to trial.

But critics say such cases add to suspicion that the agency is trying to wring out the maximum amount of tax regardless of circumstances.

The chief financial officer for a large Silicon Valley company, a former FTB auditor, said the state's auditors increasingly focus on big assessments, bypassing areas in which a company might be owed a refund.

"We overpay a lot and we underpay a lot; that's what happens when you're filing in so many different states," the executive said. "We really want them to do a fair, complete audit and not ignore the areas where we might get a refund."

The president of California Taxpayers Assn., which represents more than 600 companies that do business in the state, said such fears about the FTB are common.

"They won't talk for fear of retribution . . . [but] we hear a lot of complaints from members that they think decisions are made by auditors based on a revenue result," Larry McCarthy said.

Other corporate executives, however, suggest that complainers merely resent getting caught after taking too many tax shortcuts.

"I think that's probably sour grapes," said Larry W. Berlant, head of Ernst & Young's state and local tax division in Los Angeles.

FTB member Klehs agreed.

"The head of a corporation's finance division has one job: to make sure the corporation pays as little as possible," Klehs said. "The tax agency's job is to collect the correct amount of tax, and therein lies the rub. It's a healthy although stress-filled relationship that has gone on since the beginning of time."

State Official Defends Agency

Meanwhile, Lynette Iwafuchi, head of the FTB's auditors and a 24-year employee, said the agency's mandate for audits hasn't changed and that, unlike the IRS, the agency has never rewarded auditors based on their assessments against taxpayers.

Iwafuchi said the FTB has largely switched from general audits to more focused versions in an effort to be less intrusive, not to raise revenue.

But she acknowledges that auditors do get more pleasure from big assessments than small ones.

"I can tell you to this day how many audits I did and what they were about and the great issues I uncovered," Iwafuchi said. "That's where I got my satisfaction."

The power of FTB auditors has unnerved some taxpayers who have been targets of audits initiated by the state.

Gerald M. Steiner, whose home was damaged in the 1993 Anaheim Hills landslide, said he has spent $20,000 so far in attorney and accountant fees to defend a casualty loss deduction worth about $70,000 to the state. The IRS, meanwhile, accepted the $727,000 deduction on his federal return, according to Steiner and his accountant, Gary Capata.

"I feel like I've been raked over the coals," Steiner said. "I've never experienced anything like it in my life. They're relentless."

The FTB auditor in the case rejected the contention that Steiner's home had sustained significant damage, even though the Small Business Administration estimated repairs would cost $98,000 and an engineer hired by Steiner said that restoring stability to his land would cost millions. More than 40 families, including Steiner's, were evacuated from the neighborhood of million-dollar homes in January 1993.

Steiner said he has been willing to compromise, but so far the FTB has rejected his efforts.

The cost-effectiveness of the agency's approach to audits recently came under scrutiny after state Auditor Kurt R. Sjoberg questioned whether a burgeoning audit staff had resulted in greater revenues to the state.

The FTB added 362 auditors between 1992 and 1996, promising the Legislature that the new positions would boost collections. Although revenues rose by $558 million during that time, the additional auditors weren't responsible, Sjoberg said. (Sjoberg's complete report is available on the Bureau of State Audits' Web site at *http://www.bsa.ca.gov/bsa/*.) Instead, the increased revenues came from cases that the FTB would have pursued anyway—follow-ups on IRS audits and cases with potential for large assessments, Sjoberg said. When Sjoberg looked at more marginal cases where he expected the new auditors would be assigned, he found that collections in those categories actually dropped by $128.6 million between 1992 and 1996.

The FTB vigorously protested the audit's conclusions, disputing the way that Sjoberg made his calculations.

But now the situation is evolving in other ways. Changes at the IRS mean the FTB is already starting to lose some of its best audit leads.

The FTB's most profitable audits come from following up on cases in which the IRS has assessed extra taxes. Such audits generally result in $30 to $50 of state tax for every dollar spent in auditing cost. Audits from IRS leads account for 71% of the additional personal income taxes assessed each year, Sjoberg found. Initiating its own audits generally returns $4 to $12 in added assessments for each dollar the FTB spends. But the number of IRS leads has dropped 40% since March 1998.

The FTB estimates that each 10% drop in leads costs the state $41 million in revenue.

Critics worry that the dearth of "easy money" may lead to even more aggressive audits.

Sacramento tax attorney Eric J. Miethke believes there is little to stop the FTB from becoming more aggressive if it chooses. Most politicians and members of the state Legislature turn a blind eye to FTB excesses rather than risk losing revenue, he said.

"It's like 'Heart of Darkness.' As long as the ivory keeps coming in, we don't care what you're doing up at the headwaters," Miethke said.

Klehs, a former state legislator who was elected to the State Board of Equalization in 1994, said that criticism is unfair.

"Every tax official is elected, from the members of the board . . . to the county tax collectors," Klehs said. "California has a very strong history of taxation with representation."

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SPECIAL REPORT

TAX ANALYSTS

STATE TAXATION OF PROFESSIONAL ATHLETES: CONGRESS MUST STEP IN

by Paul Barger

Paul Barger is an associate at the law firm of Jenner & Block in Chicago.

In this report, Barger explains why Congress should intervene and establish a uniform allocation method for the taxation of professional athletes. The current system of taxation, he argues, is unfair and inequitable for two reasons. First, the different allocation methods create an unreasonable burden on the player to comply with the laws of the different jurisdictions. Second, even with the use of tax credits by the states, opposing formulas have often led to the double taxation of athletes. This report not only argues that Congress should step in, but also offers a solution that will lead to a lesser burden on the athlete's wallet as well as on the state tax administrator's calculator.

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I. Introduction

Professional athletes are perhaps as high profile as any individuals in the United States. Their salaries often receive more coverage in the press than the games that they play.[1] Because of this,[2] states have easy access to an athlete's schedule and have very little trouble determining the income that an athlete has derived in the state.

The problem is that athletes are basically the only people receiving this treatment.[3] Law firm associates crisscross the country every day, but they have income tax consequences only in their home state. Corporate employees are constantly sent on business trips to different jurisdictions, but they still have to file a state income tax return in only one jurisdiction.

Athletes, and perhaps big-time entertainers, are the ones who have been forced into an administrative nightmare.[4] Consider how many different states the average baseball player must play in during the season.[5] A tax return may have to be filed in every single one of those states in order for the taxpayer to be in compliance with the law. There are more complicated issues that arise for athletes who reside in one state but play for a team that is located in another state.[6] This situation can result in double taxation or, in some cases, incomplete taxation.[7]

[1]*See, e.g.*, "1999 Major League Baseball Salaries," *USA Today*, Apr 6, 1999, at 14C. Full-page story on baseball players' salaries for 1999 season.

[2]Green, Richard E., "The Taxing Profession of Major League Baseball: A Comparative Analysis of Nonresident Taxation," 5 *Sports Law. J.* 273, 275 (1998). The article discusses how cutbacks in federal funds have caused both state and local governments to tax big-money athletes.

[3]Ekmekjian, Elizabeth C., "The Jock Tax: State and Local Income Taxation of Professional Athletes," 4 *Seton Hall J. Sport L.* 229, 251-52 (1994). Many other types of professions, including salespersons, doctors, and lawyers, involve interstate activity. The states have not been aggressive in trying to tax these fields. (This report also appeared in *State Tax Notes*, Feb 28, 1994, p. 553, and at *94 STN 42-33*.)

[4]*Id.*

[5]Chicago Cubs Team Schedule (visited Apr 12, 1999) http://www.espn.go.com/mlb/teamsched/chc.html. The Chicago Cubs, for example, played 81 away games during 1999. Included in these away games were series against teams in 11 different states. It also included a series against the Montreal Expos in Canada.

[6]Wynne, Michael J., "Nonresident Ballplayer Files Complaint in Illinois Circuit Court," *Doc 96-30014 (63 pages)*, *96 STN 223-33*. Full text of complaint in *Radinsky, et al. v. Zehnder, et al.*, No. 96L 051192 (1996). There is a detailed discussion of the case below.

[7]*Id.*

The purpose of this report is to explain why Congress should intervene and establish a uniform allocation method for the taxation of professional athletes. The current system of taxation is unfair and inequitable for two reasons. First, the different allocation methods create an unreasonable burden on the player to comply with the laws of the different jurisdictions.[8] Second, even with the use of tax credits by the states, opposing formulas have often led to the double taxation of athletes.[9] This report not only argues that Congress should step in, but also offers a solution that will lead to a lesser burden on the athlete's wallet as well as on the state tax administrator's calculator.

II. Background

Simply put, states have the right to tax professional athletes that derive a portion of their income within a given state.[10] Any state can tax the personal income of an individual if the taxpayer either earned the income or generated the income within that state's jurisdictional boundaries.[11]

The Supreme Court of the United States explained in *Quill Corp. v. North Dakota*[12] that a state has the right to tax anyone that has had "minimum connection" with a state and has purposefully availed oneself of the taxing benefits of that state.[13] (Of course, *Quill* was not a personal income tax case.) A state can defeat a due process challenge by showing that there is some "definite link" between the state and the party that is being taxed.[14]

Athletes are clearly performing services within the state of an athletic contest and they have purposely availed themselves of the state's resources when they participate in a sporting event. Because of this, state taxes on nonresident professional athletes have consistently survived constitutional challenges[15] and will continue to do so in the future.

[8]Yassinger, Marc, "An Updated Consideration of a Taxing Problem: The Harmonization of State and Local Tax Laws Affecting Nonresident Professional Athletes," 19 *Comment* 751, 755-56 (1997). "Accountants for professional athletes must fill out nearly fifteen tax returns in some circumstances; then they must compute the tax credits earned to be applied to the player's resident state."

[9]Ringle, Leslie A., "State and Local Taxation of Professional Athletes," 2 *Sports Law J.* 169, 181 (1995).

[10]*Id.* at 171. "Two cases decided by the Supreme Court in 1920 firmly established the ability of states to tax nonresidents on income derived from sources within their state."

[11]Yassinger, *supra* note 8, at 755-56.

[12]*Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

[13]Krill, Pamela M., "*Quill Corp. v. North Dakota:* Tax Nexus Under the Due Process and Commerce Clauses No Longer the Same," 1993 *Wis. L. Rev.* 1405, 1410-12 (1993). "[T]he Court inquires into whether the taxpayer has purposefully availed itself of the substantial privilege of carrying on business within the taxing state."

[14]*Quill*, 504 U.S. at 306.

[15]This has been the situation since the landmark case of *Cohn v. Graves*, 300 U.S. 308 (1937).

III. Problems With Taxation of Nonresident Athletes

A. The Current Allocation System

Imagine the outrage that would result if every lawyer in the nation had to file a tax return in every state from which he or she derived income. That would mean that every trip to St. Louis to see a client and every flight to Denver to conduct a deposition would result in the need for the attorney to file a tax return in the state where the work took place. Obviously, this would never happen because the administrative costs to the states would far outweigh the potential gains in revenue.[16] Lawyers, especially trial lawyers, travel a great deal, but because their salaries are not that high (many would argue otherwise) and because of the difficulties in determining where their income is earned, the legal community avoids the obligation to file returns in multiple jurisdictions.[17]

Athletes are not so lucky. Because of the incredibly high salaries they receive, professional athletes are subject to this extraordinary tax compliance nightmare. The burden is heightened on athletes because they will almost certainly participate in sporting events in a great many jurisdictions throughout a given season.[18]

> *Congress should intervene and establish a uniform allocation method for the taxation of professional athletes.*

This seems unfair. Athletes have this burden simply because it is the easiest and most profitable way for states to tax nonresidents.[19] To ease the strain on professional athletes, a strain that much of corporate America is immune from, the states should be forced by Congress to adopt a uniform system of allocation.[20] This would not only ease the headaches that accountants have in determining their clients' liability, but it would also greatly reduce the fees that athletes must pay to the experts that figure out how much they owe and what state they owe it to.[21]

1. The duty days method. There are a variety of different allocation methods that have been suggested and employed by the states. The most commonly used formula is called the "duty days" method.[22] The formula requires the athlete to determine how many days he or

[16]Yassinger, *supra* note 8, at 752-53.

[17]*Id.*

[18]*See infra* section I.

[19]*Id.* The states know what an athlete's schedule is and they know how many games are played in their state.

[20]Ekmekjian, *supra* note 3, at 251. "One point that should be noted is that the states' focus on professional athletes appears to be unfair."

[21]Krasney, Jeffrey L., "State Income Taxation of Nonresident Professional Athletes," 47 *Tax Law.* 395, 404-06 (1994). "[T]he current system places an unreasonable compliance burden on the athlete as well as tax administrators."

[22]Yassinger, *supra* note 8, at 757.

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she worked in a particular state during the tax year.[23] "Working days" includes almost anything: game days, practices, travel days, etc.[24] This number is placed in the numerator of the formula.[25]

The denominator is generally the number of days during the year that the athlete either prepares for or participates in competition.[26] This includes training camp, preseason games, regular season contests, the playoffs, and any all-star games.[27] Individual off-season training, autograph signings, and other personal activities are not a part of the formula.

The formula is relatively simple and results in a lesser tax for nonresidents than do some of the other suggested methods.[28] Currently, Illinois, New York, and California use some form of this method.[29]

The real problem with the duty days formula is the denominator of the equation. The number is based on the number of days an athlete is under contract to participate in team activities during the tax year.[30]

In *Stemkowski v. Commissioner*,[31] it was established that an athlete's contract does not cover the off-season. This was a rather significant development in determining an athlete's tax liability to a specific state. A state employing the duty days method need only use the number of days the athlete is contracted for to determine the athlete's tax liability.[32] The smaller number in the denominator results in a higher tax burden for the athlete.

Former National Football League quarterback Marc Wilson challenged the determination of what constituted a duty day in 1993.[33] Wilson was drafted by the Los Angeles Raiders in 1983 and played for the team from 1984 to 1988.[34] At all times during these years, Wilson remained a resident of Washington State.[35]

California taxed Wilson on the portion of his income derived within its borders.[36] The ratio used to determine Wilson's liability was the number of days worked in California over the number of days that he actually worked during the year.[37] California determined that the actual work days for the year totaled 165.[38] Wilson argued that the denominator should have been 365.[39]

Under California's formulation, Wilson had to pay a higher amount to the state than he felt was fair[40] — especially considering that his home state of Washington has never administered a state income tax.[41]

In both *Stemkowski* and *Wilson* the court decided that an athlete's work days only included the time from the preseason through the postseason.[42] This not only shows a lack of understanding of the sports world, but is also completely unfair.

> ***The use of the term 'off-season' is completely misleading. There is no such thing as an off-season.***

Athletes have a duty 365 days a year. They must stay in condition, sign autographs, and appear in public, and they are often forbidden from playing in other leagues or in other sporting events during the year. The use of the term "off-season" is completely misleading. There is no such thing as an off-season. Athletes are under contract to play for a team and are, therefore, always on duty. As explained in the *Wilson* case:

> Raiders coaches stated that, while failure to attend off-season camps, train, treat injuries, or consult with coaches was not directly punished, and, in that sense, such activities were technically voluntary, the ultimate sanction was the team's unilateral ability to decide whether a player made the regular season team. Although acknowledging these off-season activities were not expressly mandated under Wilson's contract, the coaches considered them mandatory parts of players' team participation and obligations as professional athletes.[43]

While his contract may have only been for 165 days, Wilson was required to be a part of the team and to prepare for the season 365 days. If Wilson had not participated in the off-season workouts, he would not have a job when training camp opened in July.

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[23] *Id.*

[24] *Id.*

[25] *Id.*

[26] *Id.* at 758-59.

[27] *Id.* at 759-60.

[28] Ekmekjian, *supra* note 3, at 238-40. The duty days method takes into account all of the player's "contractual responsibilities" during the season.

[29] Green, *supra* note 2, at 281-90. Illinois does not specifically enforce a tax on nonresident athletes, only on those athletes who reside in a state that taxes Illinois residents. It is strictly a retaliatory tax. *But see* Krasney, *supra* note 21, at 406. The fact that two states employ the same allocation method does not mean that the possibility of double taxation has been eliminated. Other factors, such as travel days spent in different states, may lead to a multiple tax on an athlete.

[30] Ringle, *supra* note 9, at 282-83.

[31] 690 F.2d 40 (2nd Cir. 1982).

[32] *Id.* at 46. "We agree, however, that off-season is not covered by the contract."

[33] *Wilson v. Franchise Tax Bd.*, 93 STN 248-2 (1993).

[34] *Id.* Case only involves 1984 through 1986.

[35] *Id.*

[36] *Id.*

[37] *Id.*

[38] *Id.*

[39] *Id.*

[40] *Id.*

[41] Almond, Elliott, "Pay for Play: According to Schedule Pros' Taxes Get Progressively Bigger," *The Seattle Times*, Apr. 12, 1998, at D1. Eight other states do not impose a state income tax: Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, and Wyoming.

[42] Ringle, *supra* note 9, at 176-77.

[43] *Wilson*, *supra* note 33.

2. The games played method. The "games played" method, used by New York until 1995,[44] is easier to administer than the duty days formula, but it results in a higher tax burden on nonresidents.[45] The numerator is simply determined by the number of games played in the source state.[46] The athlete must actually have participated in the game to be subject to the tax.[47] That means that players who were injured or benched for a particular game would not be taxed by the state where that game took place.[48]

The denominator of the formula is determined by adding the total number of games that the athlete participates in, including preseason and postseason contests, throughout a given season.[49]

Illinois is perhaps the prime example of the problems with the taxation of nonresident professional athletes.

The use of this formula would make it very easy to determine a player's tax liability to each state. There are, however, some problems with the games played method. Most notably, the formula completely ignores the fact that the athlete is under contract to do much more than just play in games.[50] In addition, it could create a situation where a player would rather stay on the bench instead of coming in for mop-up duty at the end of a game. This way, the athlete would avoid tax consequences to the state where the game is taking place.[51]

Other allocation methods that have received support include the home state apportionment formula and the composite return model.[52]

3. Home state apportionment system. The home state apportionment system allows an athlete to pay all of his salary to the state where he plays his home games.[53] The athlete would only have to file a maximum of two tax returns under this method: one to the athlete's state of residence and one to the state where the athlete's organization is located. This is the model that has been widely endorsed by the players' associations of the major sports leagues. The reciprocity of sports[54] would result in something just short of equitable allocation. It would limit the compliance difficulties for athletes and would ease the administrative burden on the individual states.

This system was rejected on the recommendation of noted state tax expert Professor Walter Hellerstein.[55] It is a violation of the Due Process Clause and perhaps of the Commerce Clause.[56]

It is a due process violation to tax an individual on property that is not derived in that state.[57] An athlete living in Connecticut but playing for the New York Yankees would pay all of his state income taxes to New York. This is a violation because the player only has a "source basis" in New York on a portion of his income.

In addition, the home state apportionment method may violate the Commerce Clause as it has been analyzed in *Complete Auto Transit Inc. v. Brady*.[58] The Supreme Court set forth a four-part test that must be satisfied to pass constitutional muster under the Commerce Clause.[59] Included in that test is the idea that a state tax must be "fairly related" to the services provided by the state.[60]

Again, consider the Connecticut Yankee discussed above. While New York would be providing the Connecticut resident with the requisite services for part of the season, the state certainly has no claim on the amounts earned in other jurisdictions. Those other portions of the athlete's income must be fairly apportioned to the state where the game or other contractual responsibility took place.

4. Composite return method. The composite return method has not received much attention up to this point, but it is beginning to gain some support.[61] Under this system, an athlete would have virtually no responsibility to file a state tax return. The organizations would each file a composite return for all of the members of the team.[62]

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[44]Green, *supra* note 2, at 285. New York changed its allocation method after the games played method was "criticized for disregarding that professional athletes earn compensation for services other than competing in games."

[45]Ekmekjian, *supra* note 3, at 240.

[46]*Id.*

[47]Salmas, John, "Professional Athletes Taxed to Death? Even They Can Strike Out!!!" 4 *Sports Law. J.* 255, 270-71 (1997).

[48]*Id.*

[49]Ekmekjian, *supra* note 3, at 240.

[50]Green, *supra* note 44.

[51]For example, a basketball team from the Eastern Conference (e.g., the Washington Wizards) may make only one trip to Utah during the season. Assuming that the Jazz are beating up on the Wizards, the Washington coaching staff may want to empty the bench in the final two or three minutes of the game. No player on the Wizards is going to want to have to file an additional tax return to the state of Utah for playing in one minute of one game.

[52]Yassinger, *supra* note 8, at 761-62. Also discusses the "base state model," which did not receive any support from the Federation of Tax Administrators Task Force. The model is discussed later in this paper.

[53]Ekmekjian, *supra* note 3, at 247.

[54]Green, *supra* note 2, at 300.

[55]Ekmekjian, *supra* note 3, at 248-49.

[56]*Id.*

[57]*Id.*

[58]430 U.S. 274 (1977).

[59]*Id.* at 279. "These decisions . . . have sustained a tax against Commerce Clause challenge when the tax is applied to an activity with substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State."

[60]*Id.*

[61]Green, *supra* note 2, at 300. Explains that either the composite return method or a simplified withholding method would decrease the compliance burden on athletes.

[62]Yassinger, *supra* note 8, at 762.

	McGwire	Sosa
Duty Days in State (approx.) games, practice, travel days	10	10
Total Duty Days (approx.) preseason, regular season, postseason(?)	220	220
Tax Rate of Nonresident State	3% (IL)	6% (MO)
Liability to Nonresident State	$6,818.18	$13,636.36
McGwire: (5,000,000 x 1/22 x 0.03)		
Sosa: (5,000,000 x 1/22 x 0.06)		
Tax Credit From Home State for Amount Paid to Nonresident State	$6,818.18	$6,818.18

B. Multiple Taxation

The greatest injustice in the current system of nonresident taxation is the distinct possibility of double taxation.[63] In *Cohn v. Graves*,[64] the Supreme Court held that the possibility of double taxation is *not* prohibited by the Due Process Clause.[65] In response, most states enacted a system of tax credits that ideally protect each state's own residence from multiple taxation.[66]

1. Failure of credits to compensate athletes. This protection, however, does not always prevent the double taxation of athletes. Former Chicago White Sox pitcher Scott Radinsky found that out the hard way in 1993 when he received a notice of deficiency from the state of Illinois for the 1992 tax year.[67]

Radinsky was a resident of California in 1992.[68] For the 1992 tax year, Radinsky and his wife properly reported 100 percent of Scott's income within and without of the state of California.[69] Radinsky also filed an Illinois tax return reporting all of the income he earned for activities within Illinois.[70] After payment, Radinsky received a notice of deficiency from the Illinois Department of Revenue.[71]

The Illinois legislature had just recently passed a special rule that "residents of states that impose a comparable tax liability on residents of Illinois, services performed by a professional athlete in Illinois are deemed to be entirely performed in Illinois."[72] Because California does tax Illinois athletes that derive income in California, Illinois strictly enforces a similar tax on California residents that participate in athletic competition in Illinois.[73] Radinsky was forced to pay income tax to Illinois as if he was a full-time resident.[74]

The double taxation occurred because Illinois only grants credits for taxes paid to other states when the taxpayer is *actually* a resident of the state of Illinois.[75] Consequently, Radinsky was forced to pay tax on 100 percent of his total income to California and to pay tax on 100 percent of his total income to Illinois without any tax credit.[76]

Illinois is perhaps the prime example of the problems with the taxation of nonresident professional athletes because of the motivation of the state government in enacting legislation.[77] The Illinois law is casually known as "Michael Jordan's Revenge."[78]

California has traditionally been one of the most aggressive states in attempting to increase revenue through the taxation of nonresident athletes.[79] Its efforts received a great deal of publicity in Chicago and throughout the nation when California sent Michael Jordan a tax bill for income derived during the 1990 National Basketball Association Finals.[80] It is probably not a coincidence that the bill was sent soon after the Bulls finished off the Lakers in five games.[81]

In response, the Illinois legislature adopted what is essentially a retaliatory tax.[82] The tax is imposed only on individuals who reside in states that impose a tax on athletes who reside in Illinois.[83] The state's only purpose is to recover the money that it loses to states such as California that are basically taking revenue directly out of the Illinois budget.

In theory, what Illinois did was completely fair. It had every right to recover money from states with aggressive taxation of nonresidents.[84] But, because of the lack of uniformity in the system, athletes are often stuck paying the same tax twice.[85] Illinois's desire to protect its own residents has made it very difficult for nonresidents who play for Chicago-based teams.

Scott Radinsky and others like him have no choice but to pay double taxes.[86] The revenue battle between

[63] Ekmekjian, *supra* note 3, at 242-43.

[64] 300 U.S. 308, 314 (1937).

[65] *Id.*

[66] Krasney, *supra* note 21, at 400-01. "To avoid this result, many states grant tax credits to their residents to offset taxes paid to other states."

[67] Wynne, *supra* note 6.

[68] *Id.*

[69] *Id.*

[70] *Id.*

[71] *Id.*

[72] IITA section 304 (a)(2)(b)(iii).

[73] Wynne, *supra* note 6.

[74] *Id.*

[75] *Id.*

[76] *Id.*

[77] Green, *supra* note 2, at 277.

[78] *Id.*

[79] *Id.* at 281. "California and New York are among the frontrunners in taxing nonresident athletes."

[80] Almond, *supra* note 41.

[81] This was the first of six titles that Jordan and the Bulls won in an eight-year stretch.

[82] Ekmekjian, *supra* note 3, at 235.

[83] *Id.*

[84] Green, *supra* note 2, at 289-90.

[85] Ekmekjian, *supra* note 3, at 242. "Until the several states agree on a uniform taxing scheme, a nonresident athlete will risk double or even greater multiple taxation."

[86] *Cohn v. Graves*, 300 U.S. 308 (1937). Double taxation is not a violation of the Constitution.

California and Illinois continues to produce this wholly unfair and inequitable result. So, not only do athletes have to deal with the costs and the headaches of filing in an excessive number of states, but they are also sometimes taxed by two different jurisdictions on the same income.

2. Use of different allocation methods. Double taxation may also occur because of the different allocation methods or different tax rate scales employed by the states.[87] States will generally determine the amount of credit that a taxpayer will receive based on what the taxpayer *would have* paid if the income had been earned in his or her home state.[88] This often results in a situation where a player's tax credit is inadequate.[89]

> *Double taxation may occur because of the different allocation methods or different tax rate scales employed by the states.*

Consider the following hypothetical scenario: Sammy Sosa lives in Illinois and plays for the Chicago Cubs; Mark McGwire lives in Missouri and plays for the St. Louis Cardinals. Illinois and Missouri both use a derivative of the duty days formula. As explained above, the duty days method will result in a lesser burden on the taxpayer than the games played method.[90]

Because Missouri taxes players from other states, the Illinois retaliatory tax is in effect in this situation.[91] McGwire must file a return in Missouri for 100 percent of his income. The highest state tax bracket in Missouri is 6 percent.[92] He would also be forced to file a return with Illinois and would pay a 3 percent tax on all of the income apportioned to Illinois under the duty days method.[93] Missouri would then credit back to him the amount paid to Illinois. Because the Missouri tax rate is higher, McGwire would be fully covered by the credit for his payment to Illinois.

Sosa, on the other hand, would pay 100 percent of his tax to Illinois and receive a credit back for the amounts taxed by Missouri. However, Sosa will only receive a credit based on the 3 percent rate imposed by Illinois.

Assume that both McGwire and Sosa have a 1999 salary of $5 million.[94] McGwire played six games in Chicago and had no road games against the White Sox.[95] Sosa played six times at Busch Stadium in St. Louis and had no games against the Kansas City Royals in Kansas City.[96]

McGwire will owe the state of Illinois approximately $6,818.18 (see chart, previous page). He will get a credit in that amount back from the tax administrator in Missouri. This would not be the case in states (such as Minnesota at 8.5 percent)[97] that have a higher tax rate for individuals in the top tax bracket.

Sosa will owe Missouri $13,636.36 for the duty days spent in St. Louis. He will get a tax credit back from Illinois for $6,818.18. This means that Sosa will be taxed by Missouri and Illinois on the same portion of income.[98]

IV. Congressional Intervention

The Supreme Court has made it clear that the U.S. Constitution does not grant the judicial branch the power to force the individual states to use uniform methods of taxation.[99] There are only two ways, therefore, that a uniform allocation method can be reached.[100] Either the states get together and voluntarily adopt a uniform method or Congress may take action by ordering the use of a uniform apportionment model.[101]

The states have never made much progress toward uniformity in taxation,[102] so the only way to truly solve the problems associated with the taxation of nonresident professional athletes is congressional intervention.

It is well settled that Congress has the power under the Commerce Clause and the Supremacy Clause to preempt state income tax of individuals.[103] In the last 10 years, however, only one bill in the area of individual income tax has made it to the floor.[104]

[87]Ringle, *supra* note 9, at 181.

[88]*Id.*

[89]*Id.*

[90]*Id.*

[91]*See infra* section III.B.1.

[92]The Federation of Tax Administrators (visited Apr. 17, 1999) http://www.taxadmin.com/.

[93]*Id.*

[94]McGwire's actual 1999 salary is $8,833,333 and Sosa's is $9 million (from http://www.cbs.sportsline.com /u/baseball/mlb).

[95]St. Louis Cardinals Team Schedule (visited Apr. 17, 1999) http://www.espn.go.com/mlb/teamsched/stl.html. The White Sox played three games in St. Louis, but the Cards did not play in Comiskey.

[96]Chicago Cubs Team Schedule (visited Apr 17, 1999) http://www.espn.go.com/mlb/teamsched/chc.html. Kansas City played a three-game series at Wrigley Field in 1999.

[97]*Supra* note 92.

[98]Spring training begins at the end of February and the regular season lasts through early October. Assume that both players report to camp on February 25. The season ended with the Cubs playing at St. Louis October 3. Neither team made the playoffs. This equals approximately 220 duty days.

[99]Moore, Kathryn L., "State and Local Taxation: When Will Congress Intervene?" 23 *J. Legis.* 171 (1997).

[100]*Id.*

[101]*Id.*

[102]*Id.* at 172.

[103]Rogers, James R., "State Tax Competition and Congressional Commerce Power: The Original Prudence of Concurrent Taxing Authority," 7 *Regent U. L. Rev.* 103, 105 (1996). "To be sure, modern Commerce Clause jurisprudence grants Congress expansive powers."

[104]Moore, *supra* note 99, at 201-02. "That bill was a very limited bill that prohibits Oregon from taxing compensation paid to a Washington resident for service as a federal employee at a federal hydroelectric facility located on the Columbia River."

The inactivity is likely a result of the federal government's desire to leave state issues to the states.[105] Once Congress intervenes in this area it is likely that the states' power to control taxation will be systematically reduced.[106] "The tendency of national regulation is that, once asserted, it tends to grow and dominate an area."[107]

The taxation of nonresident professional athletes is, however, an area where it is necessary for the federal government to step in. The states are very unlikely to voluntarily adopt a uniform system. In fact, as explained above, states are basically waging taxation warfare.[108] Illinois enacted its tax on nonresident professional athletes for the purpose of not only recovering lost revenue, but also exacting revenge on the state of California.

Taxation warfare between the states is completely inefficient. If the states would come to an agreement on an allocation method it would save both the states and the taxpaying athletes a great deal of time and money.

"More uniformity in state and local taxation would benefit our society at large in a number of ways. First, it would reduce the states' administrative costs and taxpayers' compliance costs. In addition, it would eliminate the risk of multiple taxation and undertaxation that exists under our current system of state taxation."[109]

The different allocation methods have resulted in an inefficient and completely unfair system of taxing athletes. Most have found it a tremendous hassle to try, in good faith, to comply with the differing tax laws. Only congressional action can solve this problem.

So, which allocation method should Congress introduce into law?

V. Proposed Allocation Method

Most agree that uniformity is the answer to most of the problems in the taxation of nonresident professional athletes.[110] And, it appears that the allocation method that has been receiving the most endorsements is the duty days method.[111] If Congress ever does step in and mandate uniformity, it is almost certain that the duty days method, or some derivative of it, will be the method that is adopted.[112]

This, however, is still not entirely fair to the athletes. Because athletes are the ones that have been strapped with this additional tax burden, they should be given the easiest method available. The home state apportionment system would ease the burden, but, as explained above, it would never pass constitutional muster.[113]

Another formula worth considering is the composite return method.[114] The players basically would not have to do anything but pay their tax bill because the bulk of the work would fall on the shoulders of the team's management. The players' accounting costs would be greatly reduced and the burdens caused by the multiple filings would all but disappear.

The method, however, that should be imposed by Congress is what the Federation of Tax Administrators has termed a "Base State Model."[115] Under this method, the athlete would have to file a return only in the state where his team plays its home games.[116] The state is then responsible for determining how to distribute the payment to the relevant states.[117]

The compliance burden on the athlete would be all but eliminated. The responsibility would be passed onto the states. Because the states have decided that they are going to specifically go after athletes, it seems only fair that the states should be saddled with the responsibility of determining how much each athlete owes to each state.

It seems only fair that the states would be saddled with the responsibility of determining how much each athlete owes to each state.

Consider that uniform use of the base state model would still lead to a positive result for the states when compared with the current system. The confusion and administrative costs would be greatly reduced. Administrators would simply have to work with each other to determine who gets what. There would be no trouble with compliance because the athletes would simply have to figure out one lump sum. There would be no double taxation or undertaxation. The inefficient warfare between the states would be eliminated. And, most importantly, the only burden on the athletes would be the unpleasantness of actually having to pay the tax. This is an equitable result.

VI. Conclusion

"There's really only one answer: hire a good tax consultant."[118] That is popular sentiment, especially when one considers the size of today's professional athletic contracts. But the animosity toward athletes does not change the need for a fair and equitable system of state taxation.

[105]Rogers, *supra* note 103, at 138.

[106]*Id.* at 139.

[107]*Id.*

[108]*See infra* section III.B.1.

[109]Moore, *supra* note 99, at 179-80.

[110]Ringle, *supra* note 9, at 181. "Therefore, the FTA determined that establishing a uniform apportionment formula was of the utmost importance."

[111]Green, *supra* note 2, at 281-91.

[112]*Id.*

[113]*See infra* section III.A.3.

[114]*See infra* section III.A.4.

[115]Yassinger, *supra* note 8, at 762.

[116]*Id.*

[117]*Id.*

[118]Almond, *supra* note 41. Responding to the following question by Seattle Seahawks wide receiver James McKnight: "Something needs to be done about it but what can I do?"

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It is time for Congress to step and in force states to accept a uniform system of allocation for the taxation of nonresident professional athletes. The current system has created an unfair burden on athletes to comply with the tax laws of the various different states. It has led to taxation warfare between the states and to the double taxation of many athletes.

If Congress intervenes and forces the states to adopt an allocation method, the method should be the one that greatly reduces the compliance burden on the taxpaying athletes. The base state model eliminates an athlete's requirement to file a return in every jurisdiction where he competes during the year. Instead, the burden will fall on the states — the beneficiaries of the taxation of nonresident professional athletes.

Athletes have become a prime target of state governments trying to increase revenue. Although the tax is completely within the constitutional rights of state governments, the compliance burden is an absolute nightmare. Congress must intervene and force states to ease this burden.

Intervention and the forced adoption of a uniform allocation method would not only reduce the administrative costs of each state, but would also allow athletes to forget about tax law and concentrate on winning.

STATE OF CALIFORNIA
FRANCHISE TAX BOARD
333 N. GLENOAKS BLVD., SUITE 200
BURBANK, CA 91502-1170

DEMAND TO FURNISH INFORMATION

Authorized by
California Revenue & Taxation Code
Section 19504 (formerly 19254 (a) and 26423 (a)*)

The People of the State of California to:

Las Vegas Sun
800 S. Valley View Blvd.
Las Vegas, nevada 89153

In the Matter of:

[redacted]

Social Security No. : [redacted]
or Corporation No. :
For the years :

This Demand requires you to furnish the Franchise Tax Board with information specified below from records in your possession, under your control, or from your personal knowledge. The information will be used by this department for investigation, audit or collection purposes pertaining to the above-named taxpayer for the years indicated.

1. Indicate if the above individual has subscribed to the Las Vegas Sun during the period from 1991 to the present. If yes, please indicate the start and stop dates of service and the address that the subscription was sent to.

2. Indicate if there were any subscriptions to the Las Vegas Sun at [redacted] during 1991-1992 and at [redacted] from 1992 to the present. If so, indicate the start and stop dates of service and the name(s) of the person(s) on whose account it was billed.

FRANCHISE TAX BOARD

By: S. Cox
Authorized Representative

Dated: 8/4/95

Telephone: (818) 556-2942

* Legislation effective January 1, 1994 (S.B. 3, Stats. 1993, Ch. No. 31) consolidated certain provisions of the California Revenue & Taxation Code which caused some sections to be revised and renumbered.

FTB 4973-39 (REV 3-94)

ATTACHMENT B

[FTB DEMAND LETTER – HYATT CASE]

ATTACHMENT C

[MEMO BY MR. GIL HYATT]

STATE TAXING AGENCIES ARE ABUSING FORMER TAXPAYERS IN VIOLATION OF THE CONSTITUTION

THE WIDESPREAD ABUSE

When Congress passed the Internal Revenue Service Restructuring and Reform Act of 1998, an era of tyranny at the IRS came to an end. Congressional hearings revealed story after story of taxpayer abuse by the IRS. The stories of abuse so inflamed the public and Congress that sweeping reform soon followed. But taxpayer abuse is still as prevalent as ever – only the perpetrators of this abuse are the state taxing agencies. In its rush to reform the IRS, Congress overlooked a whole other level of taxpayer abuse at the state level. This type of abuse by state taxing agencies has received attention from the press. In the article "Tax torture, local style," W: iam Barrett discusses the "extortion," "sweepingly false declarations of taxes," "false notices," "[p]rivacy violations," and "[c]riminal or dubious activities" by state taxing agencies. (William Barrett, Forbes, July 6, 1998). Many states have resorted to the same type of abusive tactics for which their federal counterpart --the IRS-- was reprimanded by Congress.

In many cases, a state taxing agency has even exceeded the IRS in its recklessness and abusiveness. In a front-page LA Times article entitled "State Agency Rivals IRS in Toughness", Liz Pulliam compares the FTB unfavorably with the IRS--"the Franchise Tax Board is second in size and scope only to the Internal Revenue Service--and by all accounts the state agency is the more efficient, more aggressive and more relentless of the two". (Liz Pulliam, "State Agency Rivals IRS in Toughness", L.A. Times, August 2, 1999, at A1). She also quotes Mr. Dean Andal, a former FTB Board member, who criticizes the FTB as "brutal" and "hard and sometimes arbitrary" and states that "there is little to stop the agency from becoming more aggressive" (Pulliam, supra).

States are particularly abusive towards former residents who have moved to another state. Moving to another state is a common occurrence in the U.S., where citizens have the constitutional right to travel to and establish residency in any state in the United States. In 1996, Congress passed legislation which prevents states from taxing the pensions of retirees living in other states. This congressional legislation illustrates the need for federal intervention in order to prevent states from overreaching in their pursuit of tax revenue. Unfortunately, this action by Congress only focused on one small avenue in which states illegally pursue nonresidents for additional taxes. Another tactic is to assess a tax on citizens leaving the state by contesting when the former resident moved out of the state. Years after a citizen has relocated to another state, the state taxing agency will open a "residency audit" to extort a former resident.

THE ABUSE EXEMPLIFIED:
THE CALIFORNIA FRANCHISE TAX BOARD

The abusive taxing tactics used by states is best illustrated by the California Franchise Tax Board (FTB), as indicated in the LA Times article supra:

> "[The FTB] is tainted by arrogance and a stubborn unwillingness to compromise."
>
> "For two years in a row, corporate tax executives have ranked California's [FTB] among the toughest, least fair and least predictable state tax agencies in the country."
>
> **"State Is Ranked Most Aggressive**
> Many corporate taxpayers agree. In both 1997 and 1998, company tax executives ranked California at the top of a 'worst offenders' list compiled by CFO magazine to rate the tax agencies of the 50 states.... The state [California] was described as among the least predictable in administering tax policy and among the most likely to take a black-and-white stance on unclear areas of tax law." (Pulliam, supra).

The FTB particularly targets for abuse Nevada residents who formerly resided in California. The FTB agents are well trained in targeting such nonresidents. For example, the FTB targets wealthy and famous people living in gated affluent communities of Las Vegas. Agents develop a list of potential victims compiled from property rolls, tax records, and newspaper accounts. This list is supplemented by trips into the wealthy neighborhoods of Las Vegas in order to survey former California residents. Wealthy and famous individuals are the preferred targets because they are particularly vulnerable to threats of violating their privacy and causing them bad publicity. The FTB then audits the victim's financial and personal affairs. This includes agents making periodic trips across state lines in order to secretly survey victims. The agents trespass onto the victim's property, record the victim's movements, and even probe the victim's garbage and mail all while making sure to avoid contact with the victim. All of this is done stealthily, without the knowledge of the Nevada authorities. If the agents are caught in the act, they falsely claim immunity for their auditing tactics under color of authority and they claim a false constitutional right to collect taxes in Nevada -- all while violating the constitutional rights of their victims and the sovereignty of Nevada. This is not a legitimate investigation, but a covert operation to uncover private information for what is best characterized as extortion of the victim.

The FTB hires inexperienced and unsuccessful recruits as auditors. Many of these auditors are untrained and unsupervised. They are given training manuals that they do not study. The training materials are illustrated with such sadistic cartoons as a skull-and-crossbones on the cover of the penalties section (which is to illustrate how to pirate an additional 75% override on the tax assessment). They have little or no legal background or training and do not know nor do they care about the victim's Constitutional rights. They excerpt legal cliches and case law from other audits and insert them throughout their workpapers indiscriminently. They mimic comments that they read that supports the FTB's position and they ignore information that supports the victim's position. Some auditors are so inept that they actually use pseudonyms from "boilerplate" and training manuals audits (e.g., Marie Assistant) in their own audits because they do not understand such an obvious step as the need to replace the pseudonyms in the "boilerplate" audits with the actual names of the individuals in the particular case under audit. These are the kind of people that California has charged with the awesome power of auditing taxpayers -- "the power to tax is the power to destroy".

The FTB gathers large quantities of private information about the victim during the audit. The FTB goes to the victim's adversaries, who are not privy to the victim's private information, and offer them a way to help dispose of their adversary, the FTB's victim, by concocting damaging evidence against the FTB's victim. A bitter ex-spouse or ex-girlfriend, an estranged relative, or a vengeful former employee are preferred. The FTB avoids contacting the victim's friends, associates, and close relatives who are privy to the victim's private information because such witnesses would undermine the FTB's attack on the victim. The FTB has actually sent out intimidating and harassing letters to the victim's friends, colleagues, and business associates and has even gone so far as to audit these people apparently to intimidate and harass them, to isolate the victim, and to deprive the victim of the support that he or she needs at such a crucial time. The FTB's apparent intent is to have the victim embattled by adversaries and separated from supporters. "They tend to look at every audit as a battle. In the gray areas, they push the envelope rather than work out a reasonable compromise." (Pulliam, supra).

The FTB auditors boldly admit to emphasizing bad evidence for the taxpayer and ignoring good evidence for the taxpayer. In one of the FTB's largest residency audits, the auditor trumped-up a large assessment with penalties based on false affidavits from the victim's adversaries while completely ignoring all of the victim's close relatives, friends, and associates. Also in this same audit, the auditor relied on about fifty false California connections while ignoring a thousand solid Nevada connections and preempted submission of thousands-more solid Nevada connections by the victim. Even more significant, the thousands of Nevada connections involved thousands-of-times more value (purchase offers on custom homes, large stock purchases, large mutual-fund transactions, and large business transactions) than the trumped-up California connections (gifts to adult children and mail-order purchases).

This approach of emphasizing bad evidence and ignoring good evidence violates not only notions of fair play and substantial justice, it also violates the FTB's Multistate Reference Material (for FTB auditors) which provides in part: "It is never acceptable to limit the scope of your audit to exclude issues that are in the taxpayer's favor. Once you decide to open an audit, potential adjustments that are in the taxpayer's favor have to be addressed."

The FTB gathers even more information about the victim by sending out unauthorized quasi-subpoenas across state lines to anybody remotely affiliated with the victim, even if the person had no connection with the victim whatsoever during the audit period in question. These quasi-subpoenas are entitled "Demands for Information" in bold letters and are sent to entities in other states, falsely stating as authority on the face of the quasi-subpoenas that California has the authority to make such a demand outside its borders.

The FTB is so merciless in its search for damning evidence against the victim that it has stooped to the point of typing up summaries of interviews with adverse witnesses, falsely stating in writing that the persons were sworn-in when they were not, and falsely labeling these interview summaries as "affidavits". This appears to violate California's own tax statute making it a crime to falsify tax records. The FTB then furthers its tax auditing scheme by claiming to have devastating "affidavits," by misrepresenting what the phony-affidavits actually state, and then by refusing to let the victim see these phony-"affidavits."

The FTB based one of its largest residency audits on the credibility of three allegedly "devastating", but actually phony and frivolous, affidavits. Two of the affiants admitted that they had no contact with the victim during the relevant period of time. Only after the FTB was sued for fraud did the auditor in charge of the case while being questioned in deposition testimony finally change her story and admit that indeed there were no real affidavits. Falsifying an audit record violates California's own tax laws (e.g., California Revenue and Taxation Code § 19405) making it a crime to falsify tax records, particularly affidavits. In order to counter the charge of crime-fraud, the FTB reacted to this auditor's admission by recharacterizing the phony affidavits as merely interview notes and the auditor as only a layperson. This exemplifies the extremes to which the FTB will go when a multi-million dollar assessment is at stake. The FTB continues to pursue this largest residency audit based upon the shaky foundation of interview notes by a layperson who had admittedly exaggerated the evidence in the audit record.

In addition, there is little that the victim can do to correct erroneous FTB information, which becomes part of the audit file used by the FTB to make its audit determination. Both the U.S. Congress and the California Legislature passed very important information privacy laws in the 1970's which set out the basic requirements for government agencies to follow to collect personal information on individuals. But the FTB shows blatant disregard for these laws. Even though these laws permit an individual to have access to his or her audit record, the FTB illegally refuses legitimate access to such records without justification. In addition, the Information Practices Act of 1977 (California Civil Code §§ 1798 et seq) allows individuals to formally request that a California government agency -- the FTB -- amend, correct, and complete an individual's record by providing factual information so that the FTB's records on the individual will be accurate, relevant, timely, and complete as required by §§ 1798.35. But the FTB's disclosure office prides itself on having never once corrected an individual's record in accordance with §§ 1798 even though it has received thousands of requests. The FTB also flaunts the California statutory requirement for the FTB to respond to such an amendment within 30 days by totally ignoring amendment requests. Naturally, the FTB will not make changes to its erroneous records because maintaining erroneous records is an important component of the FTB's auditing power to assess improper taxes.

In a large residency audit, the FTB overstated the taxes owed, alleging fraud on the part of the victim, adding-on 75% penalties to the total owed, and then adding interest (10% per year compounded daily) onto both the taxes and penalties. The FTB accomplished this by distorting government records to make it appear as if the victim has acted improperly. The FTB fraudulently alleges fraud by the victim so that it can nearly double the victim's already trumped-up tax assessment with fraud penalties. If this amount does not meet the FTB's dollar-amount objectives, the FTB goes so far as to simply add whatever additional amount it needs to meet its objective without excuse or clarification. The FTB then threatens to expose the victim's private records and finances and the falsified government records to the public, all the while ignoring the victim's submissions of evidence which show the FTB's errors. The FTB describes what it does as effective tax collecting, but a taxpayer would view the wrongful use of threats that instill fear under color of official right as extortion.

But the audit investigation is just the beginning of the long delays that the FTB creates in order to intimidate a victim into settling. In a current case, the FTB audited a Nevada resident for the 1991 tax year. The audit phase lasted from 1993 to 1995 and the "protest" phrase has sat without any activity from 1995 to the present and will continue into the next century. This case now has its third protest officer and still without a shred of evidence other than three phony affidavits that are thoroughly discredited.

Unbelievably, the first protest officer admitted in deposition testimony to destroying "protest" documents and the second protest officer was accused by a subordinate in deposition testimony of ordering her to destroy an important audit file, all during a Nevada litigation in which these destroyed materials were essential to the victim's case. The FTB has a practice of destroying documents produced by the auditors, reviewers, and protest officers. By the time a victim gets access to his or her audit file, important documents have been destroyed. Unfortunately, FTB lawyers, who should know better, have been among the worst perpetrators of this wrongful practice.

After devastating the victim with enormous assessments and a fraud determination and then forcing the victim into the "protest" proceeding to avoid getting an immediate bill for the extortionate assessment, the protest officer threatens that the wealthy or famous victim settle the case to avoid having his or her private life and finances made public. Public disclosure of a finding of fraud can ruin the careers and businesses of famous and wealthy victims and public disclosure of private lives and financial information can destroy lives and businesses and make the victims prey to criminals, stalkers, and even murderers. That is why the FTB Settlement Bureau is very successful.

Only after the FTB finally acts will this victim then be allowed to appeal. But the victim must first exhaust all administrative remedies before taking the case to a courtroom. And delays arising from court backlogs could potentially delay an eventual trial by up to 25 years from the year being audited. By this time, the interest (accruing at the rate of 10% per year compounded daily) would be about eight times the original assessment. Even worse, the FTB adds 75% penalties to the total amount owed. And since interest also accrues on the penalties, the total amount owed to the FTB can grow to be 14-times the original assessment. The victim must also pay significant ongoing legal fees in order to fight the assessment over the long period of delay. This is why the FTB's settlement division is so successful: trump-up excessive taxes and penalties, negotiate away part of the penalties, and the victim will settle out of shear desperation and fear.

The FTB's auditing of nonresidents makes a joke out of the FTB's mission statement: "[t]o collect the proper amount of tax revenue ... [and] perform in a manner warranting the highest degree of public confidence in our integrity, efficiency and fairness."

The California Legislature was so suspicious of and concerned about the FTB that it passed the Taxpayer's Bill Of Rights statute, which among other things, forbids the FTB from evaluating employees based upon revenue collected or assessed or upon production quotas. The law also states specifically that the head of the FTB must certify in writing annually to the California State Legislature that the FTB has not evaluated employees based upon revenue collected or assessed or quotas. But this certification is misleading since, by all indications, promotions and rewards still go to those FTB employees who bring in the most revenue. And quotas by different names abound in the FTB. One FTB employee rapidly progressed from a low-ranking auditor to a high-prestige position for making one of the FTB's largest residency assessments ever. FTB auditors must generate over $1,000 of revenue for every hour charged to an audit. A quota system is indicated in the LA Times article <u>supra</u>: "The agency [FTB] added

362 auditors between 1992 and 1996, promising the Legislature that the new positions would boost collections."

Furthermore, there is little supervising of FTB auditors. Instead, this type of auditing and tax collection appears to be encouraged by management. The FTB claims to have layers of review in order to ensure accuracy and fairness; however, these layers actually proliferate the fraud of the FTB auditors. The auditor's supervisors do not get involved in the audits, instead relying completely on an auditor's self-serving narrative report in reviewing an audit without any regard for the victim's evidence or arguments. Unbelievably, FTB auditors and management get credit for assessments and get promotions and rewards immediately after the audit even though the assessments may never be collected at all and any collection may be decades away. This encourages excessive tax assessments for immediate promotions and rewards, but the feedback that it was a bad audit may be more than a decade away.

The legal department gets involved in reviewing penalties, but indications are that the lawyers encourage unwarranted penalties to force a settlement rather than provide an independent review. This is confirmed by the fact that the FTB audit and protest proceedings are expressly exempted from the California administrative proceedings act to permit the FTB to proceed in violation of the victim's Constitutional right to due process. The FTB implies that the "protest" proceeding is an independent review by an objective protest officer, when in fact it is a continuation of the investigation to gather more information, to attempt to force the victim into an extortionate settlement, and to prepare the FTB's case for any appeal by the victim to the next stage of the administrative proceeding. The victim tells his case to a wolf-in-sheep's-clothing, misleading the victim into presenting his or her case to an independent reviewer when in fact the protest officer is an important part of the FTB's abuse. The FTB's denial of due process to a victim under the sham that the audit and the protest are merely investigations is untenable and will be easily declared unconstitutional when challenged. The FTB has deprived victims of their Constitutional rights for too long.

THE FTB'S PLOT – FALSIFY THE OFFICIAL RECORDS

By contesting the residency of former California residents who have moved from the state, the FTB assesses additional taxes on money earned <u>after</u> the former resident moved from California. This type of treatment of nonresidents is a blatant violation of the victim's Constitutional right to move between states. Despite overwhelming evidence to the contrary from the victim, the FTB will often allege a residency date that allows it to encompass as much additional tax revenue as possible. In order to support its outlandish residency date, the FTB will disregard the victim's substantial Nevada connections, will overly emphasize and rely upon minimal (and often erroneous) California connections, will distort Nevada connections into California connections, and will devise nonexistent California connections.

The FTB maintains, for example, that a six-month lease on an apartment in Nevada and opening escrow on a custom home purchased in Nevada are **not** Nevada residency connections. The FTB has gone so far as to actually maintain that, for purposes of residency, a former California resident can only claim to have resided in a Nevada apartment if: 1) the apartment complex has security gates, 2) the apartment is left "trashed" after moving out, 3) the apartment managers can provide information on the movements of the tenant (even after several years have passed since the tenant lived there), and 4) poor people do not reside in the apartment complex.

Furthermore, the FTB maintains that a former California resident is only permitted to sell a California house to a stranger and that a former California resident is only permitted to reside in a Nevada house if he can prove the Nevada house was **not** purchased for investment or appreciation and only if the Nevada house has security gates. The FTB asserts that California voter registration and obtaining a California driver's license are significant California residency connections, but disregards the same actions when taken in Nevada as mere formalities that are easy to do and not relevant to the issue of Nevada residency despite the FTB's own regulations and decades of case law to the contrary. All of these holdings can be found in the FTB's own audit files.

Unbelievably, the FTB relies on the following considerations as supporting California residency:

- an overnight stay in a California motel is a California residency connection while a six-month lease on an apartment in Nevada is not a Nevada residency connection;
- a bank account in a Nevada bank is a California residency connection because the Nevada bank also has a California branch;
- a mail-order purchase made from Nevada to a California mail order provider for delivery of merchandise to a Nevada home is a California residency connection even though the mail order purchase was made from Nevada by a Nevadan and was delivered to a Nevada address;
- this type of California mail-order purchase is a sham purchase because, the FTB argues, the Nevadan could have bought the product in Nevada and saved the cost of freight;
- the FTB uses circular reasoning by concocting a late Nevada residency date and then alleging that purchases made in Nevada <u>after</u> the concocted Nevada residency date are California residency connections for the period <u>before</u> this concocted Nevada residency date in order to attempt to support this date;

- actual Nevada receipts are not Nevada connections while false California receipts that the FTB concocts are California connections;
- a credit-card purchase made in Nevada for use in a Nevada house is a California residency connection if the credit-card charge, unknown to the Nevadan, is cleared through a California credit-card office;
- a California driver's license, surrendered to the Nevada DMV upon obtaining a Nevada driver's license, is a California residency connection because the surrendered California driver's license had not yet expired while the Nevada driver's license is not a Nevada residency connection because it is easy to get;
- gifts sent by a Nevadan to an adult child or a grandchild living in California constitutes a California residency connection;
- checks drawn on a Nevada bank are California residency connection even though the checks were written in Nevada by a Nevada resident to Nevada workers for work done on a Nevada house and where the checks were even cashed in Nevada; and
- a regulated investment company open-ended fund (a mutual-fund money-market account) was deemed by the FTB auditor to be a California bank account constituting a California residency connection and a basis for a fraud determination even though the FTB Legal Branch gave a legal opinion stating that the regulated investment company is not a bank and normally not a California residency connection.

This is only a partial list of the kind of absurd considerations that the FTB will use to rationalize its residency determinations. Such far-fetched and concocted California connections are what the FTB relies upon to support its residency determinations -- the FTB must make the most of what it has available and what it can concoct in order to extort California income taxes from nonresidents.

THE LAW OF THE U.S. SUPREME COURT ON RESIDENCY

The FTB's approach -- classifying former California residents as current residents of California for the purpose of state income tax -- not only violates California's own laws, but also violates the law of the U.S. Supreme Court. According to the Supreme Court, residency is determined by two simple tests: 1) physical presence and 2) intent to remain indefinitely. The FTB pays lip-service to this Supreme Court holding, but the FTB tax auditors ignore the Supreme Court's precedent in favor of self-serving criteria concocted to arrive at a decision of residency to assess the income taxes that the FTB desires. But none of these self-serving California residency tests are condoned by the Supreme Court. In fact, they are prohibited by the

Fourteenth Amendment because they interfere with a citizen's Constitutional right to travel and to move between states. The "durational test" (has the new resident lived in the state for a reasonable duration of time -- usually one year) is condoned by the Supreme Court, but it is not used by the FTB because it would establish the California nonresidency of its victims.

The Supreme Court has held that the Fourteenth Amendment permits a citizen to choose his or her state of residency but prohibits a state from choosing its citizens. The FTB's auditing actions and tactics towards former California residents violate this Constitutional law by giving auditors the power to make residency determinations in such a way that allows the FTB to choose its citizens for the purpose of taxation. In addition, the Supreme Court has held that all state residency requirements must be "appropriately defined and uniformly applied." But the FTB's rules on residency are neither "appropriately defined" nor "uniformly applied" because each auditor makes up self-serving rules as needed to extort money from a former resident over whom it has no legal jurisdiction.

The FTB is even so bold as to argue to a Nevada court that it has a Constitutional right to collect taxes in Nevada and that Nevada courts cannot interfere. Just as bold is the FTB's argument indicating that Nevada residency is synonymous with California tax avoidance. It is not surprising that these arguments were not persuasive to the Nevada court where the FTB is currently defending against charges of tortuous conduct including fraud, invasion of privacy, and outrage. These charges are based on the FTB's extortionate pursuit of a former California resident. Despite the FTB's arrogant claims, it has no authority to collect taxes outside of California. The Supreme Court expressly prohibits a state from taxing income of nonresidents.

CONCLUSION

While Congress' investigation into IRS auditing abuses led to sweeping reform of the IRS, it only partially remedied the tax abuse that taxpayers face. Many taxpayers are enduring abuse at the hands of state taxing agencies. The California FTB with its residency audits is one of the worst examples of an unrestrained, unchecked taxing agency that has the power to ruin people's lives under the color of authority and under the guise of immunity. These state taxing agencies perform their abusive activities without any fear of reprisal. They have been violating the Constitutional rights of American citizens for far too long. If these agencies were not state agencies, they would have been prosecuted under laws designed to prosecute organized crime. Nevertheless, even the color of governmental authority does not give a state taxing agency absolute immunity despite what the agents working within the agency may have come to believe over many years of abusing taxpayers without any consequences.

The IRS was once an impenetrable organization with free rein to abuse citizens under the guise of tax collecting. This all changed once Congress called the IRS to task for its misdeeds. The time has come to send a "wake-up" call to every state taxing agency similar to the one heard by the IRS after congressional hearings revealed the abuse and corruption underneath its nearly impenetrable exterior. By taking action against these abusive state taxing agencies, Congress can put an end to their reign of terror, devastation, fear, and intimidation over Americans.

ATTACHMENT D

[MEMO BY MR. GIL HYATT]

The FTB[1] arbitrarily applies undefined residency rules to exact taxes from former residents.

Introduction

The FTB violates both established residency laws as well as taxpayers' state and federal constitutional rights. First, the FTB ignores U.S. Supreme Court law on residency and a citizen's constitutional right to travel and move to other states in favor of its own self-serving rules for California residency. Second, FTB auditors make up their own residency "rules" to justify tax assessments not otherwise justifiable under even the FTB's own self-serving rules. Third, FTB auditors intentionally generate errors in the record in order to justify their residency determinations knowing that the inaccurate record will not be corrected by the FTB even though it is required to do so when errors are brought to the FTB's attention by the taxpayer. The FTB makes a mockery of the facts and the law in order to maximize its tax assessments.

The fundamental law on residency according to the U.S. Supreme Court, California, and other states in the union is that residency is based upon "physical presence" with an "intent to remain." While the FTB pays lip-service to this fundamental residency test, the FTB's residency determinations are actually based upon a multitude of distorted "facts" gleaned from one-sided investigations performed by its residency auditors. By manipulating facts and relying upon their own self-serving rules, the FTB auditors create a fictional story that bears no resemblance to the taxpayer's true factual situation, but that is nevertheless used by the FTB to create California residency "out of thin air"[2].

For the last century, it has been well-settled law that a state cannot tax a nonresident on out-of-state income. The U.S. Supreme Court has held that such a tax on nonresidents is a violation of substantive due process.[3] In order to circumvent this constitutional barrier, the FTB locates an out-of-state taxpayer and fabricates a case of California residency in order to levy an otherwise illegal and unconstitutional tax on the nonresident taxpayer's out-of-state income. The FTB mischaracterizes California connections and fabricates nonexistent California connections to concoct California residency. The FTB also mischaracterizes and ignores out-of-state connections that disprove California residency. The FTB is very hypocritical and arbitrary in its use or the lack thereof of residency connections. A connection that supports the FTB's determination of California residency is given significant weight in the FTB's residency audit, and yet the same type of connection when it shows nonresidency is disregarded. For example, if a newly arrived citizen registers to vote in California and obtains a California driver's license, the FTB considers these two connections as indisputable evidence that the citizen is a California resident; however, if a California resident were to move to another state, register to vote in that state, and obtain a driver's license in that state, the FTB disregards these connections as showing residency in that state because registering to vote and obtaining a driver's license are considered by the FTB as easy tasks to do.

In one specific case involving a Nevada taxpayer, an FTB supervisor directed his auditor in writing to analyze the information to show the strength of the taxpayer's ties to California. The aggressive auditor proceeded to create nonexistent California connections, ignore the taxpayer's Nevada connections, and even recast Nevada connections as California connections. This auditor went so far as to contend that checks drawn on the taxpayer's Nevada bank account to a Nevada handyman for repair to the taxpayer's Nevada home were not Nevada residency connections but instead were California residency connections.

The FTB's audits are fraught with examples of one-sided, self-serving audit analyses contending that significant bona fide out-of-state residency connections are insignificant and subsequently disregarding them as formal residency connections, while contending that insignificant or concocted California connections are very significant and using them as formal California residency connections. Charles Rettig, a prominent Caifornia tax expert, verifies the use of this audit approach by FTB auditors in a quote from the Los Angeles Times: "From [the FTB's] perspective, it seems that just about the only nonresident is someone who has never been present in or flown over California on their way elsewhere.... Residency auditors often overemphasize any California contact they can locate and underemphasize or even ignore relevant out-of-state contacts."[4] This audit approach is particularly

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[1] The Franchise Tax Board (FTB) is California's income tax collection agency.

[2] The court in Wertin v. FTB, 68 Cal. App. 4th 961, 80 Cal Rptr. 2d 644 (1998) condemned the FTB for assessing taxes "out of thin air" and sanctioned the agency severely.

[3] Dewey v. Des Moines, 173 U.S. 193 (1899).

[4] Liz Pulliam, Los Angeles Times, August 28, 1999, at C-3.

egregious because the chief executive of the FTB, Mr. Gerald Goldberg, announced in February 1997 that the FTB had adopted a mission statement promising that the agency will collect taxes fairly and Mr. Goldberg signed the FTB's 1997 Strategic Plan which directs the FTB and its employees to "treat everyone with fairness, honesty, courtesy, and respect". But the FTB is anything but fair, or honest, or courteous, or respectful. Unfortunately, the FTB is all too often unfair, dishonest, discourteous, and disrespectful. In some cases, the FTB's behavior in its residency audits has been so egregious that it has been accused of fraud and extortion.

The FTB's Blatantly Inconsistent and Arbitrary Analysis of Residency Connections - One Specific-Nevada-Resident's Ordeal[5]

The following comparisons represent documented examples of the FTB, despite its promises of fairness, treating California connections and out-of-state connections very differently and often hypocritically for the purpose of creating California residency "out of thin air." These examples come from a single FTB residency audit of just one Nevada resident. They illustrate how the FTB classified this specific-Nevada-resident as a California resident by disregarding numerous Nevada connections, thereby implicitly contending that the Nevada connections were not Nevada residency connections, and by strongly maintaining that any California connection, regardless of how tenuous it may be, is a firm California residency connection. The comparisons are made between FTB contentions in both the same residency audit and the audits of two Nevada couples (George & Donna Archer and Joseph & Emily Gilbert). These comparisons all demonstrate the kind of illogical, inconsistent, and unfair FTB residency audit ordeal that the specific-Nevada-resident has been dealing with for the last 6 years with no end to the siege anytime soon.

The FTB contends that the specific-Nevada-resident's six-month-lease on a Nevada two-bedroom apartment is not a Nevada residency connection but that his transitory-overnight stay in a California motel room is a California residency connection.

The FTB contends that the specific-Nevada-resident's visit to a hospital in Nevada is not a Nevada residency connection but that his visit to a hospital in California is a California residency connection.

The FTB contends that the specific-Nevada-resident's Nevada driver's license is not a Nevada residency connection but that his California driver's license is a California residency connection despite the fact that it was surrendered to the Nevada DMV to obtain the Nevada driver's license.

The FTB contends that opening a Nevada escrow, signing Nevada escrow documents, making payments into the Nevada escrow, and many other Nevada escrow acts relating to the purchase of the specific-Nevada-resident's Nevada home did not constitute even a single Nevada residency connection but a check paying off a first trust deed on the specific-Nevada-resident's former California house that he sold was a California residency connection because the trust deed lending bank was located in California.

The FTB contends that credit card charges from a Nevada barber for haircuts were not Nevada residency connections but that credit card charges for a mail order purchase from a California mail order company was a California residency connection.

The FTB contends that checks drawn on the specific-Nevada-resident's Nevada bank account and paid to Nevada entities were not Nevada residency connections but that checks drawn on the specific-Nevada-resident's Nevada bank account and paid to close accounts with California entities were California residency connections.

The FTB contends that mail addressed to the specific-Nevada-resident's former California addresses and forwarded by the Post Office to his Nevada address in conformity with a formal change of address to Nevada signed and filed by the specific-Nevada-resident is not a Nevada residency connection but instead is a California residency connection.

The FTB contends that a formal declaration by a business associate personally confirming the specific-Nevada-resident's personal and business activities in Nevada were not evidence of Nevada residency but that interview notes, mislabeled by the FTB as affidavits, by an estranged-relative and a bitter ex-spouse who were not involved in the specific-Nevada-resident's life and who admitted to a lack of knowledge of his activities during the relevant period were alleged to be important evidence of California residency.

This is just a small sampling of the many absurd FTB contentions asserted in the audit of the specific-Nevada-resident. See Exhibit A attached herein for additional examples of FTB contentions in this one

[5] The Nevada resident discussed is hereinafter referred to as "the specific-Nevada-resident."

residency audit alone.

The FTB recently lost in a decision by the California State Board of Equalization (BOE) when it sought a tax assessment against George and Donna Archer by claiming they were California residents.[6] George Archer, a top professional golfer and a member of the California Golf Hall of Fame, had fought the FTB for over six years before getting this decision from the BOE. While the FTB adamantly maintained that the Archers were California residents, the BOE ruled in favor of the Archers finding that they were Nevada residents, not California residents, during the tax years in dispute. The case was so egregious that BOE Chair Johan Klehs ordered the FTB to stop harassing the career golf pro and his wife.[7]

The FTB's inconsistent and often hypocritical approach to residency audits and residency connections is further illustrated by comparing the FTB's contentions (or lack thereof) in the Archer case with those made by the FTB in the residency audit of the specific-Nevada-resident.

The FTB contends that a sale of the specific-Nevada-resident's former California house is a sham sale because the buyer was a close business associate of the seller but the FTB did not contend that the Archers' sales of two California houses were sham sales even though they sold the houses to their children.

The FTB contends that mail forwarded to a Nevada address from the specific-Nevada-resident's former California address is not a Nevada residency connection but that mail forwarded to the Archer's California address from their Nevada address is a California residency connection.

The FTB contends that the Archers' insurance on California property that they owned is a California residency connection but the fact that the specific-Nevada-resident did not have any insurance on any California property (because he did not even own any California property, but only owned Nevada property which did have Nevada based insurance) is not a Nevada residency connection.

The FTB contends that the fact that the Archers had a bank account in California with more activity and a larger balance than their Nevada bank account is a California residency connection[8] but the fact that the specific-Nevada-resident closed down his California bank accounts and rendered the rest of his California bank accounts inactive before moving to Nevada is nevertheless disregarded by the FTB as a Nevada residency connection.

The FTB contends that the fact that the Archers paid minimal utility bills in Nevada and normal utility bills in California[9] is evidence of California residency but the fact that the specific-Nevada-resident paid no utility bills in California and paid normal utility bills in Nevada is nevertheless disregarded by the FTB as a Nevada residency connection.

This list of comparisons is also just a small sampling of the numerous examples of FTB inconsistencies in the audit of the specific-Nevada-resident relative to the FTB's positions in the Archer's audit. See Exhibit B attached herein for additional examples.

The inconsistency of the FTB's position on residency connections with regards to the specific-Nevada-resident is even more blatant in light of the BOE's decision involving Joseph and Emily Gilbert.[10]

The BOE decided that Mrs. Gilbert's California driver's license and California voter's registration are important California residency connections but the FTB contends that the specific-Nevada-resident's Nevada driver's license and Nevada voter registration are not Nevada residency connections because both are easy to obtain and because the California driver's license surrendered by the Nevada resident at the Nevada DMV had not yet expired.

The BOE decided that preparation of Mrs. Gilbert's 1991 and 1992 tax returns by a California tax preparer was an important California residency connection but the FTB contends that preparation of the specific-Nevada-resident's tax returns by a Nevada tax preparer is not a Nevada residency connection.

The BOE decided that Mr. Gilbert's move into a Nevada apartment was an important consideration in establishing his Nevada residency but the FTB contends that the specific-Nevada-resident's Nevada apartment was not a Nevada residency connection because the apartment did not have security gates.

The BOE decided that Mr. Gilbert was a Nevada resident in 1991 even though he continued to own a

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6 In the Matter of the Appeal of George and Donna Archer, State Board of Equalization Appeal No. 98A-0848.

7 BOE Rule FTB Bogeyed Golfer Archer's Case, CalTaxLetter (California Taxpayers' Association), Vol. XII, No. 32, September 6, 1999.

8 In the Matter of the Appeal of George and Donna Archer, State Board of Equalization Appeal No. 98A-0848, Respondent's Opening Brief at 12.

9 Id. at 8.

10 In the Matter of the Appeal of Joseph and Emily Gilbert, State Board of Equalization Appeal No. 96R-0827, October 9, 1997.

California home through 1993, he maintained his California homeowner's exemption on his California residence through 1992, and his wife and minor children lived in the California home; however, the FTB contends that the specific-Nevada-resident is not a Nevada resident despite having sold his California home contemporaneously with his move to Nevada, canceling his California homeowner's exemption as of the date of the sale of his California home, and having no wife or minor children in California.

The BOE decided that Mr. Gilbert was a Nevada resident even though he claimed to be a California resident on joint 1991 and 1992 California income tax returns and the BOE decided that Mrs. Gilbert was a Nevada resident in 1993 even though she also claimed to be a California resident on her 1993 California tax return[11]; however, the FTB contends that the specific-Nevada-resident is not a Nevada resident even though he claimed to be a Nevada resident on his part year 1991 California tax return and on all IRS tax returns since 1991.

The BOE decided that Mrs. Gilbert was a Nevada resident in 1993 particularly because she had engaged an architect and was actively involved in building a home in Las Vegas even though she had a California apartment and a full time job in California following a long time California residency; however, the FTB contends that the specific-Nevada-resident is not a Nevada resident even though he had an apartment only in Nevada, he moved his entire business to Nevada, he was making purchase offers on homes in Nevada, and eventually purchased a home in Nevada in which he still resides to this day.

In short, the FTB is highly inconsistent when it characterizes minor connections to California as significant residency connections while major connections to another state demonstrating significant residency connections are either discounted, disregarded, or just plain ignored.

The Erroneous Contentions are Forever Part of the Record

Unfortunately for the taxpayer, erroneous contentions made by the FTB become part of the taxpayer's official record. Even though California law provides that a taxpayer can request the FTB to correct the record to accurately reflect the facts, the FTB has in fact never acted on any of the taxpayer requests for error corrections according to the testimony of the FTB official in charge of making such corrections. While California tax law makes it a crime to intentionally falsify an official tax record, this tactic is neither discouraged nor investigated and indeed is implicitly encouraged by the FTB since such a tactic increases the FTB's revenue collection. This has led to a culture within the FTB where FTB auditors make intentional errors to increase tax assessments and the FTB refuses to correct such errors even after these errors are called to its attention in writing by the taxpayer and despite the fact that the FTB is obligated to make such correction under California law. Such actions on the part of FTB employees are actually encouraged by the FTB by the rewarding of awards and promotions (incentives that violate California law) to auditors and superiors based upon the assessments made (regardless of how erroneous the assessment may be) and not upon how much of those assessments are actually collected. And all of this is performed by auditors that even the FTB admits are ill-trained, inexperienced, and unsupervised.

Conclusion

Unfortunately for the average taxpayer, the administrative review set up by the FTB basically "rubber-stamps" the auditor's findings without examining the type of absurd, inconsistent assumptions and contentions made by FTB auditors. In addition, because the findings of the FTB are given deference both at the next level of review (the State Board of Equalization) as well as at the Superior Court level and on up through the appellate courts, there is no incentive for the FTB to be accurate or fair in its audits.

While the head of the FTB may promise the public that it will be fair, the FTB actually represents the essence of an abusive government agency preying not only upon its own residents, but also upon former residents now residing outside of California. The FTB has continued to reign fear and terror among taxpayers for far too long. The Archers, the Gilbert's, and the subject-Nevada-resident are only a select few of the many former California residents who have endured the torment that the FTB is capable of inflicting upon former residents daring to leave California to establish a residence in another state. After winning his battle against the FTB, George Archer expressed the sentiment of many taxpayers best when he asked, "Why has the Franchise Tax Board made my life a living hell for the last six years?" The FTB's pattern of using inexperienced, untrained, and unsupervised auditors who follow one-sided rules and concoct self-serving evaluations must not be allowed to continue.

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[11] In the Matter of the Appeal of Joseph and Emily Gilbert, State Board of Equalization Appeal No. 96R-0827, Respondent's Opening Brief at 1.

EXHIBIT A

The following discussion continues the documented examples of the FTB's disregard for out-of-state connections and exaggeration of tenuous California connections in the actual residency audit of the specific-Nevada-resident for the purpose of creating California residency in order to justify a large tax assessment.

The FTB contends that a license agreement that expressly stated the specific-Nevada-resident's Nevada address as his residence address is not a Nevada residency connection but that a license agreement that merely referenced an old California post office box as a mailing address is a California residency connection.

The FTB contends that water and gas utilities that were paid for by checks drawn on the specific-Nevada-resident's Nevada bank account were not Nevada residency connections but that water and gas utilities that were not paid for by the specific-Nevada-resident at his former California home that he had sold were California residency connections.

The FTB contends that a Nevada house owned by the specific-Nevada-resident is not a Nevada residency connection but that a California house that the FTB admits was sold contemporaneous with the specific-Nevada-resident's move from California to Nevada continued to be a California residency connection.

The FTB contends that a one-day round-trip airline flight beginning and ending in Nevada is not a Nevada residency connection but is a California residency connection because the flight had a stop-over in the San Francisco area for a professional meeting despite the fact that there was not even an overnight stay in California.

The FTB contends that the specific-Nevada-resident's very active Nevada bank account with large transactions is not a Nevada residency connection but that an inactive California bank account with a negligible balance is a California residency connection.

The FTB contends that the specific-Nevada-resident's attendance at a professional convention in Nevada is not a Nevada residency connection but that his attendance at a professional convention in California with California motel accommodations are California residency connections.

The FTB contends that numerous walk-in purchases of products in Nevada are not Nevada residency connections but that a mail-order purchase of a product from a California company that was delivered to the specific-Nevada-resident's Nevada home is a California residency connection.

The FTB contends that a check drawn on the specific-Nevada-resident's Nevada bank account and paid to a television service provider for television service to his Nevada home is not a Nevada residency connection but that a check drawn on the Nevada bank account and paid to a California television supplier for the mail-order purchase of a video tape is a California residency connection.

The FTB contends that a check drawn on the specific-Nevada-resident's Nevada bank account and paid to a satellite television company for television service to the specific-Nevada-resident's Nevada home is not a Nevada residency connection but instead is a California residency connection because the television company deposited the check in a California bank.

The FTB contends that a check drawn on the specific-Nevada-resident's Nevada bank account and paid to a Nevada cleaning lady for cleaning his Nevada home is not a Nevada residency connection but that a check drawn on his Nevada bank account and paid by mail to a California babysitter for babysitting services for a grandchild is a California residency connection.

The FTB contends that a check drawn on the specific-Nevada-resident's Nevada bank account and paid by hand to a Nevada handyman for work on a Nevada home is not a Nevada residency connection but that a check drawn on the Nevada bank account and paid by mail to a California handyman is a California residency connection.

The FTB contends that flowers bought by the specific-Nevada-resident from a Nevada florist for the secretary of the Governor of Nevada is not a Nevada residency connection but that a check drawn on the taxpayer's Nevada bank account and mailed to pay a final bill on a closed California service account is a California residency connection.

The FTB contends that the subject Nevada resident's leased apartment and purchased house in Nevada are not Nevada residency connections because they did not have security gates (even though the taxpayer has never lived in a location with security gates to this day) but that his former-home in California which also did not have security gates is a continuing California residency connection.

The FTB contends that various formal purchase offers and counter-offers on Nevada homes (each with large earnest money cash deposits) did not constitute even a single Nevada residency connection but that several infrequent single-night motel stays in California each constituted a California residency connection.

The FTB contends that trips by the specific-Nevada-resident's adult children to visit him at his home in Nevada were not Nevada residency connections but that checks drawn on his Nevada bank account and sent to the adult children from Nevada in order to reimburse them for their expenses during the Nevada trips were California residency connections because the adult children cashed the checks in California where they lived.

The FTB contends that meetings in Nevada with officials of investment firms are not Nevada residency connections but that investments by mail from Nevada to mutual fund investment accounts were California residency connections because the mutual fund had an office in California.

The FTB contends that newspaper articles stating that the specific-Nevada-resident had moved to Nevada or that he resided in Nevada are not Nevada residency connections but that a newspaper article stating a California residence based on old, obsolete information is a California residency connection.

The FTB contends that a letter from the FTB to the specific-Nevada-resident's Nevada address was not a Nevada residency connection but that a check paid by mail from Nevada and drawn on his Nevada bank account to pay taxes to the FTB for a prior year was a California residency connection because the taxes were paid to California.

The FTB contends that a Nevada medical provider who provided medical services after the specific-Nevada-resident's move to Nevada is not a Nevada residency connection but that a California medical provider who did not provide medical services after his move to Nevada is a California residency connection.

The FTB contends that an estranged-relative and a bitter ex-spouse were primary witnesses to the specific-Nevada-resident's personal activities even though their express statements clearly indicate that they had no contact with the taxpayer during the period of his move; however, the FTB intentionally ignored the specific-Nevada-resident's friends, business associates, and close relatives who had close contact with him and who were involved in planning his move to Nevada.

The FTB contends that a meeting in Nevada with officials of the specific-Nevada-resident's alma mater who traveled to Nevada to meet with him is not a Nevada residency connection but that a check drawn on his Nevada bank account and sent by mail from Nevada to his alma mater, which he had not attended for more than 30 years, was a California residency connection because it was a California university.

The FTB contends that a meeting in Nevada with a U.S. Senator from Nevada is not a Nevada residency connection but that a meeting with a world-famous nuclear scientist is a California residency connection because the specific-Nevada-resident met with the scientist in California even though the meeting involved traveling from Nevada to California and then directly back to Nevada without even an overnight stay in California for the meeting.

The FTB contends that the specific-Nevada-resident's membership cards for Nevada stores were not Nevada residency connections because years later the new store managers did not remember his name but that mail-order purchases from California mail-order stores were California connections (without even checking with the California mail-order store personnel to see if they remember his name).

The FTB contends that the specific-Nevada-resident's relationship with the Governor of Nevada and the use of the Nevada Governor's private Las Vegas conference room for week-long meetings with representatives of major foreign companies are not Nevada residency connections but that a short stopover in San Francisco for a brief meeting is a California residency connection.

The FTB contends that the specific-Nevada-resident's established relationships with Nevada professionals are not Nevada residency connections but that terminated relationships with California professionals are California residency connections because the final closing bills were paid shortly after the move to Nevada.

The FTB contends that the specific-Nevada-resident's memberships in Nevada professional organizations are not Nevada residency connections but that checks drawn on his Nevada bank account and paid to a California University for his adult son's tuition and books are California residency connections.

The FTB contends that trips by business associates from other states and from other countries (Europe and Japan) to Nevada to meet with the specific-Nevada-resident in Nevada were not Nevada residency connections and that interviews by Japanese reporters from major Japanese newspapers who traveled from Japan to Nevada to interview him and who published newspaper articles on the interviews were not Nevada residency connections but that a day-long trip (without an overnight stay) from Nevada to California and back to Nevada the same day for a short business meeting is a California residency connection.

The FTB contends that a badge from a professional conference identifying Nevada as the specific-Nevada-resident's place of residence is not a Nevada residency connection but instead is a California residency connection because the conference was held in California.

EXHIBIT B

The following discussion continues the documented examples where the FTB, by disregarding out-of-state connections and exaggerating tenuous California connections, has taken an inconsistent approach to the actual residency audit of the specific-Nevada-resident in light of contentions it made during the audit of George and Donna Archer.

The FTB contends that visits to the specific-Nevada-resident in Nevada by his adult children are not Nevada residency connections but that the Archers' visits to their adult children in California were California residency connections.

The FTB contends that "[i]nsurance coverage, especially on contents, is compelling evidence of where taxpayers' valuables are located and thus where they reside"[12] and that the Archers having insurance on California property that they owned is therefore a California residency connection but the specific-Nevada-resident having home insurance on a Nevada home and through a Nevada insurance agent is not regarded by the FTB as a Nevada residency connection.

The FTB contends that the Archers fit the pattern of a sham Nevada move because "they either allege that family members are staying in it [their California home] or provide excuses for living in the [California] home and failing to sell it"[13] but the fact that the specific-Nevada-resident sold his California home is nevertheless disregarded by the FTB as a Nevada residency connection.

The FTB contends that the Archers did not move to Nevada because a sham Nevada move "is always [to] a border town"[14] (Incline Village, Nevada where the Archers live is near the California border) but the fact that the specific-Nevada-resident moved to a large well-known destination in Nevada that is not a border town is disregarded by the FTB as a Nevada residency connection.

The FTB contends that the Archers fit the pattern of a sham Nevada move because the Nevada home "is usually smaller and less well appointed that the home in California"[15] but the fact that the specific-Nevada-resident resident sold his old California tract home and purchased a virtually-new luxurious custom-built home twice as large is nevertheless disregarded by the FTB.

The FTB contends that the Archers' purchase of "a new more deluxe California home as their income increased"[16] is evidence of their California residency but the fact that the specific-Nevada-resident sold his California home and purchased a new more deluxe Nevada home is nevertheless disregarded by the FTB as a Nevada residency connection.

The FTB contends that the Archers' pattern of paying normal living expenses in California ("groceries and other necessities and day to day items"[17]) after their move to Nevada is evidence of their California residency, but the fact that the FTB has not one single shred of evidence that the specific-Nevada-resident bought any "groceries and other necessities and day to day items" in California after moving to Nevada is nevertheless disregarded by the FTB as evidence of Nevada residency.

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12 In the Matter of the Appeal of George and Donna Archer, State Board of Equalization Appeal No. 98A-0848, Respondent's Reply Brief at 2.
13 In the Matter of the Appeal of George and Donna Archer, State Board of Equalization Appeal No. 98A-0848, Respondent's Opening Brief at 5.
14 Id. (emphasis added).
15 Id. at 6.
16 Id.
17 Id. at 6.

ATTACHMENT E

[MEMO BY MR. GIL HYATT]

The FTB Missuses Federal Tax Information in Violation of Public Policy, American Family Values, and the U.S. Constitution.

The FTB obtains Federal tax information from the IRS for the sham-purpose of tracking down so-called "dead-beat dads" (among other things). The FTB, however, has an abusive policy that actually discourages out-of-state fathers from supporting their in-state (California) children and discourages out-of-state grandfathers from supporting their in-state grandchildren. The FTB does this by contending that support paid by out-of-state parents and grandparents to in-state children and grandchildren establishes these parents and grandparents as California residents and subjects them to California taxes. The FTB has even expressly stated that if a college-age child of a Nevada resident attends a California university, then this would be reason for auditing the Nevada resident for California taxation.

The FTB's policy toward out-of-state parents and grandparents is a misuse of Federal tax information by the FTB. The policy violates public policy by discouraging out-of-state parents and grandparents from supporting their in-state children and grandchildren because of concern for being taxed as California residents as a result of this child support. The policy is contrary to the notion of American family values and family ties by discouraging out-of-state parents and grandparents from having relationships with their in-state children and grandchildren because of concern for being taxed as California residents as a result of these family relationships. The policy conflicts with American educational values by discouraging out-of-state parents and grandparents from helping to educate their in-state children and grandchildren because of concern for being taxed as California residents as a result of the educational assistance. The policy also violates the U.S. Constitution, which makes it a right of every American to live in the state of his or her choosing and be able to communicate with residents (children and grandchildren) of other states without fear of discrimination or abuse by the other states. Finally, the FTB's policy is also offensive to our intelligence and respect as Americans with the FTB promoting such schemes to extort revenue from out-of-state parents and grandparents just because California happens to hold hostage their children and grandchildren.

The FTB's aggressive scheme of preying upon parents and grandparents residing outside of California is at the cost of discouraging those out-of-state parents and grandparents from support of and gift-giving to their in-state children and grandchildren, of discouraging out-of-state parents and grandparents from having family relationships with their in-state children and grandchildren, and of discouraging out-of-state parents and grandparents from assisting with the education of their in-state children and grandchildren. The FTB is so blatant about this scheme that they even contend that gifts (cash and health gifts) as well as travel reimbursement to adult children living in California for out-of-state visits to their out-of-state parents and grandparents constitutes California residency connections for the out-of-state parents and grandparents for California tax purposes.

In the case of George and Donna Archer, the FTB contended that maintaining their relationship with and helping support their adult children and grandchildren who live in California helped established this Nevada couple as California residents and subject to California taxes. In the appeal hearing on the FTB's abusive audit of the Archers, the California Board of Equalization ("BOE") severely reprimanded the FTB for its ridiculous contention that connections with adult children living in California constitutes California residency connections.

In the case of Gil Hyatt, a Nevada resident, the FTB contends that support, tuition, and text book payments for his adult son attending college in California are California residency connections and the FTB contends that Gil Hyatt was a California resident partially as a result of these educational payments to his adult son.

Also in the case of Gil Hyatt, the FTB contends that his partial support of and occasional cash gifts to his children and grandchildren living in California are California residency connections and the FTB contends that Gil Hyatt was a California resident partially as a result of this support and these gifts.

Also in the case of Gil Hyatt, the FTB contends that his mail order purchase of an air purifier for his asthmatic adult daughter living in California is a California residency connection and the FTB contends that Gil Hyatt was a California resident partially as a result of this mail order health gift to his daughter.

Also in the case of Gil Hyatt, the FTB contends that his reimbursement of travel expenses for his adult children and grandchildren visiting him in Nevada were California residency connections and the FTB contends that Gil Hyatt was a California resident partially as a result of this travel reimbursement.

The result of this abusive scheme by the FTB is to discourage out-of-state parents and grandparents from supporting and having family relationships with their in-state children and grandchildren for fear of being declared California residents and being subject to California taxation. The IRS is an unwitting party to the FTB's abusive scheme to exact unfair taxes from non-residents of California by supplying the FTB with the Federal tax information it uses to find out-of-state parents and grandparents having in-state children and grandchildren.

THE WHITE HOUSE

WASHINGTON

JAN 19 2000

January 18, 1999

Ms. Lindy L. Paull
Chief of Staff
Joint Committee on Taxation
Congress of the United States

Dear Ms. Paull:

I have received your letter of January 4, 2000 regarding 26 U.S.C. § 6103 of the Internal Revenue Code. I thank you for asking my opinion on this matter and hope that my response is helpful to you.

Your letter inquires about the Executive Branch's use of two subsections of § 6103, which permit access to otherwise confidential taxpayer information under specified conditions. The first, § 6103(c), permits a taxpayer to authorize the disclosure of his or her tax information. The second, § 6103(g), permits certain Administration officials to access tax information upon the personal written request of the President (or, in some cases, the heads of federal agencies). You have asked why the Executive Branch generally obtains tax checks under subsection (c) rather than (g).

This Administration follows the practice of prior Administrations in relying on subsection (c) rather than (g) for conducting tax checks on potential appointees. In our view, there are several persuasive reasons for this practice.

Subsection (c), unlike subsection (g), has the advantage of requiring taxpayer consent, which we believe is a preferable means of obtaining sensitive taxpayer information when practicable. If tax checks were routinely conducted under subsection (g), no prior authorization of the taxpayer would be required. Indeed, under (g)(1), the taxpayer would not even be entitled to notification within three days, as is required under (g)(2). In addition, subsection (c) has the advantage of enabling us to obtain the taxpayer's consent for certain information that is not obtainable under subsection (g)(2), such as information confirming proper filing and payment prior to the immediately preceding three tax years. Finally, please note that subsection (c) is a practicable means by which a President-elect can vet potential candidates for a new Administration, whereas subsection (g) might not be applicable to Presidents-elect.

In the rare event that extraordinary confidentiality or other exigencies require the President to obtain a tax check on a potential candidate before informing the candidate that he or she is under consideration, subsection (g) provides appropriate authority. As I discuss below, we believe that the availability of such an option is important. Nonetheless, routine reliance on subsection (g) by the White House for each and every potential appointment would be burdensome and unwarranted. To suggest that the President should personally approve numerous routine consensual requests would trivialize the extraordinary element of personal Presidential approval embodied in subsection (g).

Your letter indicates that you are considering whether to recommend to Congress that subsection (g) be repealed as "deadwood" because it has never been used. In our view, the fact that subsection (g) has been viewed as an extraordinary remedy to be used in rare instances, and that it has not been used to date, does not support a repeal of the authority granted in that subsection. To the contrary, it may in fact indicate that the law has worked precisely as intended. We believe that occasions might arise when the Chief Executive might need to seek, upon his personal approval, access to certain taxpayer information for which he cannot obtain taxpayer consent, in order properly to carry out his constitutional authorities. Such an instance might arise, for example, in a situation raising national security concerns. Without conceding that the President could not seek such information even in the absence of statutory authority to do so, it seems far sounder to leave in place a statute setting forth the appropriate procedures and limitations, including necessary reporting requirements, should that contingency arrive, rather than to create a void that would have to be filled with only a moment's notice. As it stands, subsection (g) reflects a pragmatic understanding between Congress and the Executive Branch regarding the balance between Executive authority and the important privacy interests of American taxpayers. That the President has not chosen to use subsection (g) does not mean that Congress should eliminate that authority.

In conclusion, I would like both to thank you for asking our input on this matter and to compliment your staff for its cooperation. Please call me if you would like to discuss this matter further.

Sincerely,

Beth Nolan
Counsel to the President

Re: Study on taxpayer confidentiality
Our concerns: ① We don't trust the IRS
and are uncomfortable with present laws.
Stricter limits on taxpayer information
(more on internet) and stiff penalties for
violating confidentiality laws are needed.
② No release of tax return info without
taxpayers permission.
③ No sharing of info with state & local government
We will be watching our legislators to
see how they handle this
Mr & Mrs Robert Way
1705 Gordon Dr.
Naples, FL 34102

SEP 16 1999

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II. REPRINT OF COMMENTS RECEIVED BY THE JOINT COMMITTEE STAFF RELATING TO DISCLOSURE RULES APPLICABLE TO TAX-EXEMPT ORGANIZATIONS

The following documents are reproductions of the comments received by the Joint Committee staff in connection with its study of disclosure rules applicable to tax-exempt organizations. Submissions that include comments both on the general disclosure provisions and provisions relating to tax-exempt organizations are included in Part I above.

INTEROFFICE MEMORANDUM

Date: 25-Oct-1999 08:03pm
From: john.d.anderson@juno.com
Dept:
Tel No:

Subject: Public Comments Per JCT PR 99-03

Lindy L. Paull, Chief of Staff
Joint Committee on Taxation

I wish to submit comments to the Joint Committee on Taxation and was hoping if it could be done by e-mail in the interest of saving time since I just learned of the Joint Committee on Taxation Press Release 99-03 today.

JCT Press Release 99-03 reads in part as follows:

"... the staff of the Joint Committee invites comments on disclosure of information with respect to tax-exempt organizations described in Code section 501.

Accordingly, the staff of the Joint Committee solicits comments on:

(1) whether the public interest would be served by greater disclosure of information with respect to tax-exempt organizations described in Code section
501; and

(2) the extent to which the present-law tax-exempt disclosure provisions assure
accountability of exempt organizations to the public, the Internal Revenue Service, and
other agencies that provide oversight.

Written comments on these issues and any other issues relevant to the study, including specific recommendations, should be submitted by October 1, 1999 (recently changed to October 31, 1999), in writing, to the attention of Lindy L. Paull, Chief of Staff, Joint Committee on Taxation. Comments should also be submitted on diskette (Word Perfect 8 format preferred). The staff of the Joint Committee may make the comments submitted publicly available as a part of its report; unless specifically noted, individuals and organizations submitting comments will be considered to have consented to such publication."

Having worked in the not-for-profit sector for over twenty years and also having been responsible for the preparation of Forms 990 and Forms 990-T at one prominent tax-exempt organization in southern California for more than ten years, I would like to recommend the following:

1) All tax-exempt organizations required to file Forms 990 each year should be required to disclose on the Form itself each and every government grant received during the year and each and every government grant still being accounted for on the books of the organization no matter what level of government is involved, i.e., International,

- Federal, State, Regional, or Local. The following information pertaining to the grant should be disclosed:

i) Name and purpose of the grant.
ii) Amount of the grant.
iii) Name and position of principal investigator, if a research grant.
iv) Name and address of source where published info about the research can be found.
v) Name of Government agency making the grant.
vi) Date grant was received by the tax-exempt organization.
vii) Amount of the grant used up during the fiscal year of the organization.
viii) Amount of the grant still left unused at the end of the fiscal year.
iv) Summary explanation of what was purchased with grant money during the year.
x) Summary explanation of what was accomplished with grant money used up thus far.

The public interest would be greatly served by having this additional information made available since the general public could quickly see what some of their tax dollars were actually being used for. The general public could also be made more quickly aware of research that is taking place with tax dollars and research which might benefit them personally, especially in the areas of health and medicine. Please understand that this particular recommendation applies only to "Government" grants and not to private grants.

2) All tax-exempt organizations required to file Forms 990 and/or 990-T each year should be required to have their returns reviewed or audited (not just prepared) by a reputable Certified Public Accounting firm or Tax Attorney who is considered an expert in the area of tax-exempt organizations before the return is actually filed with the IRS. The firm retained for this purpose should be required to also sign the return as reviewer/auditor indicating that to the best of their knowledge and belief the information disclosed on the return is true, correct, and complete. The way it is at the present time, many tax-exempt organizations take very risky positions with respect to the Forms 990 and 990-T because they believe the IRS is never going to come around and audit their returns since far fewer than 1% of all Forms 990 filed each year are audited. This new requirement would hopefully help these organizations to be more honest and above reproach knowing that an expert in matters dealing with tax-exempt organizations is going to review their returns first before they're filed with the IRS.

3) It is very obvious to me after reviewing a number of Forms 990 filed by many different tax-exempt organizations that the Forms are not always accurate or they are not always complete. Sometimes whole sections are left undone probably as a way of saving time since the organizations many times will wait until the final due date before filing the Form, or they just plain refuse to provide certain information on the Form because they feel it is none of government's business. When organizations file inaccurate or incomplete Forms 990 they are subject to the late filing penalties. This is an additional source of revenue that the IRS should investigate further. Maybe the IRS doesn't currently have the collection personnel needed to do this, I don't know. In any event, this area should be looked at much more closely. (This problem may resolve itself to some degree once the IRS makes available on CD-ROM all the Forms 990 filed each year by all tax-exempt organizations required to file them.

- Knowledgeable investigative reporters will find a lot to inquire about once this CD-ROM is made available to the general public or the information is made availabe on web sites such as: <http://www.Guidestar.org> or <http://www.nonprofits.org>.)
-

Thank you so much for considering my comments.

Sincerely,

John D. Anderson
32251 Avenue 'E'
Yucaipa, CA 92399-1783
Home telephone: (909) 797-0110
E-mail address: <John.D.Anderson@Juno.com>

asae

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OCT 04 1999

October 1, 1999

Lindy L. Paull
Chief of Staff
Joint Committee on Taxation
Room 1015
Longworth House Office Building
Washington, DC 20515

Dear Ms Paull:

The American Society of Association Executives ("ASAE") is a Washington, D.C.-based association comprised of more than 25,000 professionals who manage approximately 11,000 trade, individual, and voluntary organizations. Almost all the associations represented by ASAE's membership are exempt from taxation under §501(c)(3), §501(c)(4) or §501(c)(6) of the *Internal Revenue Code*.

ASAE welcomes the opportunity to provide its input in response to the Joint Committee on Taxation's ("JCT") general invitation, pursuant to the 1998 *Internal Revenue Service Reform and Restructuring Act*, for comments on disclosure of information with respect to tax-exempt organizations described in §501 of the *Internal Revenue Code*. The JCT's announcement seeks response to the following questions in particular:

"(1) whether the public interest would be served by greater disclosure of information with respect to tax-exempt organizations described in code section 501; and

"(2) the extent to which the present-law tax-exempt disclosure provisions assure the accountability of exempt organizations to the public, the Internal Revenue Service, and other agencies that provide oversight."

Increased Public Disclosure Recently Made Effective: ASAE would like to note at the outset that the enhanced disclosure provisions of the *Taxpayer Bill of Rights 2* law that was enacted in 1997 have only recently (June 8, 1999) taken effect. Those provisions require tax-exempt organizations to mail to legitimate requesters, or else make widely available on the Internet, copies of their three most recent Form 990 and/or Form 1023 or 1024. Previously, tax-exempt organizations could require requesters to come in person to the organization's headquarters in order to conduct such a public inspection. Therefore, now is a very difficult time to gauge the effect that this wider, more accessible disclosure of information might have in advancing the purposes evidenced by the JCT's questions (above).

Streamlining Public Information Based on Type of Exempt Organization: In response to the Committee's first question, ASAE believes that the volume of public information disclosure required by the Form 990 is more than adequate to serve the public interest. In fact, ASAE believes that it would be much more useful to the public if the items subject to public disclosure were condensed (in order to allow more precise focus) to those items most relevant to the public interest with respect to each of the various separate types of section 501 organizations. It should be noted that the "public interest" and the needs of the Internal Revenue Service and the states' regulatory authorities, vary widely among the various sub-paragraphs of section 501 organizations (section 501(c)(1) through 501(c)(27)). ASAE will confine its comments to the differing public interest objectives relating to §501(c)(3) organizations, §501(c)(4) organizations and §501(c)(6) organizations, which together comprise almost all of ASAE's membership.

The Form 990 and the Schedule A attachment required of §501(c)(3) organizations have grown in length considerably over the past 20 years. Since 1988, both the 990 and Schedule A have increased from 4 to 6 pages each, plus numerous attachments that are often required. This enlargement is traceable in part to the number of Statutory provisions added over that time period, but is also traceable to the addition of more in-depth and detailed questions designed to enhance the IRS's and the state regulatory agencies' ability to perform what might be called "desk audits" - being able to discern pertinent information without conducting a first-hand inquiry.

In ASAE's opinion, the 990 has become a "catch-all" document for all exempt organizations, that often asks for information that might not apply to the particular type of organization completing the form. A great deal of the information the 990 now requires §501(c)(6) organizations to report to the IRS is of little use to the legitimate interests of the general public, and in fact may serve more to confuse than enlighten. These 990 questions might be perfectly relevant to organizations exempt from tax under other sections of the tax-exempt code, such as §501(c)(3) and §501(c)(4), given that §501(c)(3) and §501(c)(4) organizations by definition must have a primary purpose of serving the public. In addition, the complexity of the form has increased the likelihood of unintended errors in filing.

Salary and Benefit Information: For example, ASAE has found that the vast majority of public inspection inquiries are directed almost exclusively to the salaries and benefits of exempt organization leaders. The primary issue, therefore, is whether the assistance that publicity provides to members and contributors in their legitimate exercise of control over those salaries outweighs the strong privacy concerns of the individual leaders and the needs of the exempt organizations to attract quality candidates for leadership posts.

The most popular portion of any organization's Form 990 will likely be the Part V listing of compensation received by certain organization leaders. This information is required by law to be Disclosed by §501(c)(3) organizations under §6033(b)(7) of the Internal Revenue Code. However, such information is not required by statute to be provided by other tax-exempt organizations (like §501(c)(4) or §501(c)(6) organizations), it is only required by regulatory fiat. ASAE believes that compelling individuals to disclose publicly information that is as private as their own annual salaries should only occur when they are required by statute to do so.

ASAE therefore urges that the reporting of officers and key employees' salary and benefits (Form 990, Part V, columns c, d, and e) not be made subject to public inspection except where they are required to be made public by statute. This is consistent with the legislative history of the original public disclosure statute, although not consistent with the IRS's past implementation of that statute.

Parts VII, VIII and IX: ASAE further believes, for similar reasons, that for §501(c)(6) organizations, Parts VII, VIII and IX of Form 990 should not be made subject to public disclosure. Those three Parts relate to the sorting of revenue into the categories of related to exempt purpose, unrelated but excluded from unrelated business income, and unrelated business income, plus details regarding taxable subsidiaries (the existence of which is already disclosed elsewhere (see Part VI, question 80). The public disclosure of these items of information generally serves the interests of an organization's public policy opponents, as well as the interest of idle curiosity, but neither of these have a legitimate voice in directing an organization's choice of revenue sources.

Parts IV-A and IV-B: Likewise, the disclosure of Parts IV-A and IV-B (reconciling the audited financial statements to Part I of the 990) serves no legitimate public interest, particularly where §501(c)(6) organizations are concerned. Part I, which shows the amounts and major categories of revenue expense, together with Part IV (the beginning and ending balance sheet for the year) provide ample information to the public about an organization's financial size, health, and sources of funding. Part III requires the disclosure of considerable narrative information about an organization's activities and programs. The identity (but not the compensation) of officers and key employees shown in Part V might be a legitimate subject of public disclosure in the case of §501(c)(6) organizations. So would the answers to most of the "Yes-No" questions in Part VI, in which substantial changes in structure, relationship to other organizations, compliance with various filing and disclosure requirements, and amount of non-deductible lobbying, are addressed. Taken together, the public disclosure of those Parts (I, III, IV, names, titles and addresses in Part V, and Part VI, would give the general public all it needs to know about a §501(c)(6) organization.

In truth, it is ASAE's opinion that Parts I, III, IV, V and VI should provide sufficient information to the public even for those organizations exempt from taxation under sections §501(c)(3) and §501(c)(4) which are primarily membership organizations that do not generally raise funds from the general public. Still, ASAE recognizes the regulatory difficulties inherent in this distinction might be too burdensome from a practical standpoint.

Part II: In ASAE's opinion, the enumeration of categories of expense in Part II of the 990, in which §501(c)(6) organizations are required only to sort their expenses into natural categories (occupancy costs, rent, supplies, telephone, printing, etc.), only adds to the volume of extraneous information currently available to the public concerning all exempt organizations. The same is true of most of the required schedules supporting Part IV, which give supporting detail for investments, property and equipment, mortgages payable, etc. Only those required schedules relating to transactions between the organization and related parties would be of any value to the public.

Duplicative Questions: As the Form 990 continues to grow, exempt organizations (particularly those exempt from tax under §501(c)(3)) are now required to answer the same or similar questions in more than one location. For example, §501(c)(3) organizations must answer in Schedule A redundant questions about their lobbying activities in Parts III and VI. Also, §501(c)(3) organizations are required in line 80 of the Form 990 to file a list of related organizations, and are then required in Part VII of Schedule A to again list related organizations (and detail transactions with such organizations). On the main form 990 itself, there is considerable overlap between Part I and Part VII. It is ASAE's belief that this type of duplication serves to confuse the public more so than enlighten it.

Conclusion: ASAE believes that the intent of increased public disclosure of Form 990 filings is to enhance public understanding of exempt organizations. However, it is concerned that this increased disclosure will have the effect of further confusing the public. In particular, the Form has become a bulky, catch-all document that is confusing and that collects information in different categories which may or may not be relevant to the particular type of exempt organization that is filing the form. And even where the document is collecting relevant information, it at times does so in a duplicative manner. Also, the public airing of information like salaries of certain exempt organization leaders raises serious privacy concerns, especially considering that this information is made public not by statute, but by regulation. In summary, the public would be best served by a document that is much more streamlined and more tailored to gather pertinent information than the current Form 990.

Thank you for the opportunity to provide our remarks on this issue. Please feel free to contact me at 202/626-2703 if you have any questions.

Sincerely,

Jim Clarke

Jim Clarke
Vice President, Public Policy

COUNCIL ON FOUNDATIONS
1828 L STREET NW WASHINGTON, DC 20036-5168
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November 15, 1999

Elizabeth P. Askey
Office of Tax Legislative Counsel
Department of the Treasury
1500 Pennsylvania Avenue, NW
Room 1321-A
Washington, D.C. 20220

Dear Ms. Askey:

This letter responds to the request for comments in connection with a report Treasury is drafting concerning the scope and content of public disclosure of information concerning tax-exempt organizations. At the outset, please let me state the Council's belief that the information presently provided to Treasury on Forms 990 and 990-PF is more than sufficient to ensure effective oversight of both public charities and private foundations. Moreover, the new public disclosure rules for these documents will further enhance public scrutiny of the activities of tax-exempt organizations.

We do agree with Independent Sector that the readability of both forms could be substantially enhanced. In its separate letter to you, Independent Sector has made several excellent suggestions about how to do this; the Council endorses these ideas. In addition, we would suggest that you consider whether two specific revisions to Form 990-PF might not further enhance the overall accountability of private foundations. Foundations filing Form 990-PF must include two attachments that add considerable bulk to the filing without shedding commensurate light on the activities of the foundation. Part II requires foundations to attach schedules listing all of their investment holdings. Part IV of the form requires a complete listing of all capital gain and loss transactions during the year. Particularly for large foundations, these two schedules can add hundreds of pages of text to the Form 990-PF filing. We believe that the public interest would be equally well served if Form 990-PF were redesigned to permit foundations to submit this information in more summary fashion, while continuing to maintain the appropriate records for inspection at the foundation's offices. In addition, shortening the Form 990-PF schedules would accelerate the posting of these forms on web sites. The sheer length of the document now serves as a significant deterrent to placing the return on the web.

The Council supports strong public accountability requirements for private foundations and public charities. For this reason, we have supported efforts to make Forms 990 and 990-PF more widely and readily available to the public. We would be most interested in working with you and any other interested individuals on ways to improve the reporting and disclosure of the extensive information charitable entities provide to the federal government and to the public.

Sincerely,

Janne G. Gallagher
Deputy General Counsel

c: Morey Ward
Dorothy S. Ridings

SEP 29 1999

the evergreen state society

tel: 206.329.5640
fax: 206.322.8348

September 21, 1999

Lindy L. Paull
Chief of Staff, Joint Committee on Taxation
1015 Longworth House Office Building
Washington, DC 20515

1122 east pike st.
suite number 444
seattle, washington
98122.3934

Dear Ms. Paull:

The provisions of the United States Code under which entities are recognized as entitled to special tax treatment by virtue of their nonprofit organization and charitable missions have become a de facto standard for many other public and semi-public purposes. To some extent, this extension of their scope is contemplated directly in the Code itself – for example, private foundations are encouraged to give support primarily to organizations recognized as tax-exempt under section 501(c)(3). In addition, of course, many other jurisdictions have adopted such recognition as a criterion for exemptions or eligibility while philanthropic intermediaries such as the Combined Federal Campaign often follow a parallel course.

In this context, therefore, otherwise welcome and appropriate restrictions on the authority of the Internal Revenue Service to cooperate with agents of other jurisdictions may have the damaging effect of impeding the careful regulation of America's large, effective and valuable nonprofit sector.

I urge that the Joint Committee on Taxation recommend to Congress that new language on this topic be inserted in the Internal Revenue Code. The new language should explicitly encourage and authorize the Internal Revenue Service to cooperate in every way possible, including reciprocal sharing of information from tax returns, audits and enforcement actions both pending and completed, with state and local officials engaged in the regulation or supervision of tax-exempt and nonprofit organizations. Discretion based on assessment of specific circumstances should be permitted by administrative decision; the clear preference and intent of the new language should be, though, for the Internal Revenue Service to further its own responsibilities while working in open and collaborative partnership with counterparts in other jurisdictions.

Thank you for the opportunity to comment on this important subject.

With best wishes,

Putnam Barber

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MCDERMOTT, WILL & EMERY

December 22, 1999

JAN 03 2000

Lindy L. Paull, Chief of Staff
Joint Committee on Taxation
1015 Longworth House Office Building
Washington, DC 20515

Elizabeth P. Askey
Office of Tax Legislative Counsel
U.S. Treasury Department
1500 Pennsylvania Avenue, N.W.
Room 1321A
Washington, DC 20220

Re: Exempt Organization Closing Agreements/Confidentiality

Dear Ms. Paull and Ms. Askey:

This letter is sent to you in response to JCT Press Release 99-03 and Treasury Announcement 99-101 soliciting comments on the disclosure of information respecting tax-exempt organizations.

Specifically, I urge that closing agreements executed between exempt organizations and the Internal Revenue Service under section 7121 of the Code be kept confidential and that their disclosure not be required by legislation or administrative action.

Exempt organizations, by virtue of their exemption, are recipients of government support and the public is entitled to more information about their operations than is the case with respect to taxable entities. Nevertheless, balancing is required between the public's right to know about the conduct of organizations that it is supporting and the need for the process by which the IRS examines exempt organizations to operate smoothly and efficiently. Based on my years of experience as a private practitioner who has represented many exempt organizations in IRS examinations and who has negotiated closing agreements with the IRS, I am concerned that public disclosure of closing agreements would seriously impair the ability of the Service to conclude audits efficiently and expeditiously.

The laws and regulations affecting exempt organizations are necessarily complex, and many organizations find themselves in technical violation of the rules through inadvertence. Common situations include the incorrect treatment of employees as independent contractors, the failure to report the value of meals and housing provided to employees as income, and the failure properly to advise donors about goods and services given in exchange for contributions. It is obviously in the Internal Revenue Service's best interest to have such organizations come to it voluntarily and reorder their affairs so that they will be in full compliance in the future. Exempt organizations may be reluctant to come forward, however, if there is a significant danger that any closing agreements will become public knowledge. This in part relates to a fear of embarrassment if noncompliance becomes known and in part a concern with how the media will report the incident. If closing agreements were made public, an exempt organization that agreed to correct an inadvertent and innocent footfault could find itself the subject of a newspaper article headed: "hospital concedes cheating on its taxes."

The issue is of concern with respect to audits as well as with respect to voluntary disclosure of past noncompliance. The typical audit of a major exempt organization involves dozens of issues. It is a rare organization that will emerge from a CEP audit totally unscathed. Even if there are no major areas of noncompliance, adjustments will typically be required because executives have failed to adequately report full details of personal use of organization-owned automobiles and similar items. In many audits, more serious questions are raised respecting the qualification of section 403(b) annuity arrangements, the reasonableness of compensation paid to officers, and the status of particular individuals as employees or independent contractors. Often, the resolution of these issues is unclear and there is genuine doubt as to whether the organization is in compliance with the tax laws.

Exempt organizations often agree to compromise disputed issues even where they think that their positions are correct so as to avoid the expense, inconvenience, and uncertainty of protracted administrative proceedings. In this respect, exempt organizations are no different from taxable entities. I have had many experiences in which exempt organizations agreed to compromise with the IRS with respect to issues on which they strongly felt that their positions were correct so they could conclude the audit and get on with their exempt purposes.

If closing agreements resolving audits were made subject to public disclosure, the process of negotiating settlements would be severely inhibited. Exempt organizations would be reluctant to concede some issues or compromise others if they knew that the details of the final agreement would appear on the front pages of the local newspapers the next week. Instead of settling cases on a compromise basis with the auditors, organizations would be tempted to take their cases up to the Appeals Office in hopes that the IRS would be persuaded to concede on one or more issues. The result would be extended controversies, with added expense and inconvenience for the IRS as well as for the organizations. The resolution of any complex audit is a negotiation and involves the normal given-and-take that one sees in negotiating commercial transactions. If the final closing agreement is to be a public document, the process will be significantly undermined. As a practical matter, real negotiations can never take place in public view and people who serve on school boards and other bodies that are required to have their meetings in public can attest to the fact that those bodies' real work takes place behind the scenes.

The intermediate sanctions provisions illustrate the problem. One effect of those provisions may be that IRS challenges to the reasonableness of executive compensation will become common in audits, even where the situation is not so egregious as to call into question the organization's tax exemption. Assume, for example, that the CEO of a hospital receives compensation in a given year of $300,000. An IRS agent takes the position that he is only worth $280,000 and proposes penalties under section 4958. The issue probably would not have been raised under prior law, because the difference was not great enough to implicate the hospital's tax exemption, but it may well be raised under present law because even a small amount of unreasonable compensation can now result in a tax liability and repayment obligation for the executive. The hospital feels that $300,000 was indeed reasonable compensation but would be willing to compromise the issue at $290,000 to avoid the expense, aggravation, and protracted uncertainty of contesting the point. Would the hospital be willing to compromise the issue if the closing agreement, including what arguably is a concession that it overpaid its CEO, were to be a public document? I doubt it. Most hospitals in that situation would carry the fight further, hoping that at a higher level the Service would concede the point.

Exempt organizations are subject to a substantial amount of disclosure under current law. Applications for tax exemption and annual information returns are public documents. If the Service feels that disclosure of a closing agreement in a particular instance would benefit the public, it can always negotiate such an arrangement with the organization, as it did with the Hermann Hospital and, more recently, with the Bishop Estate. But this should be the exception and not the rule. If closing agreements are made public as a matter of routine, the current process for resolving disagreements and insuring compliance, which most of us "in the trenches" think works well, will be seriously undermined

Sincerely,

Peter L. Faber

c: Evelyn A. Petschek, Internal Revenue Service
Carolyn Ward, Joint Committee on Taxation
Steven Arkin, U.S. Treasury Department

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INDEPENDENT SECTOR

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OCT 0 6 1999

October 6, 1999

Ms. Lindy L. Paull
Chief of Staff
Joint Committee on Taxation
1015 Longworth House Office Building
Washington, D.C. 20515

Dear Ms. Paull:

I am writing in reference to the Joint Committee on Taxation ("JCT") study on taxpayer confidentiality and in particular, in reference to those aspects of your study that bear on tax-exempt organizations. I appreciate the opportunity to present the views of INDEPENDENT SECTOR to you and your staff as you consider these issues and prepare your recommendations and final report.

Historically, the Form 990 has served several dramatically different purposes. First and foremost, it provides information on the tax-exempt organization to the Internal Revenue Service for its use in administering our tax laws. At the same time, it has also served as the vehicle for communicating information about the organization to the general public. Finally, the 990 serves as an important source of information for government and private sector researchers tracking trends among the nonprofit sector. Balancing these various purposes puts the inevitable strains on a single document, and makes it challenging to makes changes to the information collected on the form.

Let me first turn to the question of whether the current public disclosure rules are sufficient to provide clear guidance to the public and to tax-exempt organizations. As you know, a new set of public disclosure rules for public charities went into effect earlier this year, and the Internal Revenue Service has recently released proposed rules that would apply similar rules to private foundations. These new rules, as a general matter, both improve public access to information about tax-exempt organizations as well as simplify the compliance burden for these organizations. As helpful as the new rules are, however, some organizations, unfortunately, attempt to evade these disclosure requirements. Having said that, it is important to note that the evolving use of technology may transcend these rules. Within a matter of days, a web site should be available to the public where an exact replica of every Form 990 will be just a couple of mouse clicks away. Other sites are currently in development. For example, the Combined Federal Campaign intends to post copies of the Form

990 for each tax-exempt organization that participates in the program so that participating employees can easily review this information before making their giving choices. Similarly, Charitableway.com operates an online donation site that will include copies of the Form 990 for charities that participate in their service. In the years to come, the World Wide Web will almost certainly become the preferred method by which individuals and organizations secure information about tax-exempt organizations. Congress and the Internal Revenue Service should carefully monitor these developments and be prepared to consider modifications to these rules if and when they become appropriate.

You have also asked whether the public interest would be served by increased disclosure of information by tax-exempt organizations. In order to answer this question, it is useful to review the type and amount of information that is already publicly disclosed, and how easily the public can understand that information. Reviewing the Form 990 and its attachments, as well as Form 990PF, one is struck by the amount of financial and other information that is currently reported. Looking at just the first page of the 990, the organization is required to disclose several key pieces of financial data, such as how much public support it received, both in the form of gifts and government grants, how much program revenue was collected, and the total revenue of the organization. These figures allow an interested party to gauge the relative size of several important revenue streams, and make judgements about the organization from that data. Similarly, the first page of the 990 lists expenses for programs carried out by the organizations, as well as management and fundraising expenses. There are countless other examples of important information and data that is collected on the 990.

Unfortunately, much of the most valuable information to the public is hidden among more than 400 separate pieces of data (not including attachments and schedules) that are found on the six page Form 990. In addition, there is a glaring lack of a simple guide for the public to use in reading the Form 990, suggesting what portions of the document have information that a typical reader of the form would find interesting and useful. Put most simply, the public needs the tools to understand the information that is already disclosed before it would be possible to judge whether additional information would be useful and meaningful. In this connection, we believe that the Internal Revenue Service could facilitate increased public understanding of the Form 990 by considering ways to either reorganize the form so that key pieces of information are presented in one place, or by developing some type of summary sheet where key information is highlighted for the public. We also believe that the Service should provide some kind of readers guide to maximize the value of public disclosure.

The final issue on which you requested comments is whether the current disclosure rules assure accountability to the public, to the Internal Revenue Service, and to other agencies that provide oversight of tax-exempt organizations. As a general matter, the public disclosure requirements are one tool among many that Page collectively assure the public accountability of tax-exempt organizations. These accountability "systems" can be divided into two categories: those that are internal to organizations, and those that operate externally. Examples of internal systems include codes of ethics, credentialing systems, and evaluation mechanisms. Examples of external systems include: 1) regulatory agencies such as the Internal Revenue Service as well as state regulatory agencies (typically the attorney general); 2) oversight agencies such as the Council of Better Business Bureau's Philanthropic Advisory Service, the National Charities Information Bureau and the American Institute on Philanthropy, and; 3) subsector organizations which may operate evaluation programs of subsector entities.

The availability of information about tax-exempt organizations provides some of the external systems with some of the materials they need to be effective. However, some of these external oversight agencies collect their own information to supplement what data is available on the Form 990. Outside regulatory agencies, such as the Internal Revenue Service and state attorneys general also have certain statutory powers to require additional information from tax-exempt organizations, such as when the organization is under examination. In the past, some of these examinations have been opened as a result of public concern over a tax-exempt organization, and in this way, the public disclosure requirements may facilitate the regulatory functions of these agencies.

I should point out that the mechanism by which the Internal Revenue Service processes the Form 990 does not facilitate the effective and efficient selection of tax-exempt organizations for examination. The manual processing and handling of the Form 990 does not yield data that could be useful in the selection of organizations for further examination. Rather, the advent of electronic filing of the 990 has the potential to provide regulators with a database that could be critically examined and that would significantly increase the ability of examiners to select organizations that most require further scrutiny. We urge Congress to fully support electronic filing of the Form 990 to give the Service the tools and information it needs to carry out an effective examination program.

Of course, internal accountability systems do not rely on the public disclosure requirements that are the subject of your review, but the existence of public disclosure requirements is likely to at least indirectly strengthen these internal systems.

I appreciate the opportunity to comment on these issues, and I would be happy to answer any questions that you or your staff may have on these issues.

With best regards, I am

Very truly yours,

Matthew W. Hamill

Matthew W. Hamill
Vice President, Public Policy

NCA
National Club Association

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JAN 14 2000

January 11, 2000

Lindy Paull
Chief of Staff
Joint Committee on Taxation
1015 LHOB
Washington, DC 20515

Re: Study on the Public Disclosure of Exempt Organizations

The National Club Association (NCA) is aware that the Joint Committee on Taxation is conducting a study concerning the public disclosure of information by tax-exempt groups. The study will consider whether there should be greater public disclosure of information by such groups and whether the Form 990 collects sufficient and relevant information to provide effective disclosure.

NCA is a trade association representing the legal, business and legislative interests of social, recreational and athletic clubs. Member organizations include country, golf, city, yacht, tennis and athletic clubs. The scope of these clubs range from small organizations, with limited memberships and facilities, to larger, full-scale operations with dining and extensive recreational facilities.

The majority of the clubs NCA represents are tax exempt under section 501(c)(7). These clubs are organized for social activities, recreation and other nonprofit purposes. This exemption reflects the recognition by the government that these clubs are not-for-profit mutual endeavors by their members.

NCA has been interested in the issue of the public disclosure of Form 990 and related documents by tax-exempt groups as well as what we consider to be redundant and often unnecessary requirements for information on the Form 990. As such, we submit the following comments concerning the public disclosure of certain information by tax-exempt clubs, particularly Form 990.

Redundant and Unnecessary Information Required on Form 990

NCA believes there are several areas where information requested on form 990 is either redundant, unnecessary or both. As such, we believe that clubs should be exempt from the public disclosure of such information but also exempt from submitting such information in the first instance.

For example, Part VII of Form 990 requires a tax-exempt club to split its income into two components--unrelated business income and related income and to report that information in separate sections of the form. This would appear to be an unnecessary requirement for Form 990, since this same information is also required on Form 990-T for purposes of determining taxable income.

We fully understand that related income must "contribute importantly to the accomplishment of the organization's exempt purposes (other than providing funding for such purposes)." However, it seems unnecessary to have to explain (as required by Part VIII of Form 990) what would appear to be obvious, *i.e.*, how a club's income from dues, cart and greens fees and other charges relates to the activity for which the club was organized, such as golf.

Furthermore, there is no practical way to allocate what portion of dues income funds each exempt activity since dues are obviously used to subsidize a number of club operations. Not only is this information therefore difficult to provide, more importantly it serves no real public purpose.

Privacy Concerns Regarding Salary/Benefit Disclosures

NCA remains concerned about the public airing of information like salaries and benefits of certain key club personnel. We believe such disclosures serve no vital public purpose. Furthermore, such disclosures raise a number of issues relative to the privacy concerns of individual citizens (serving in a nonpublic capacity) who may simply be employed as senior level executives at the club.

In communities where several clubs exist, the disclosure serves little purpose other than to raise awareness of a purely confidential personnel issue. In addition, it may also serve to drive up wage costs for clubs that may not be competitive. We believe that such a result was not intended by the public disclosure requirements and fails to serve any public purpose.

Thank you for the opportunity to present our views. We look to forward to reviewing the results of the study when it is completed.

Sincerely,

Elizabeth Kirby Hart

Elizabeth Kirby Hart
Vice President, Legal and Government Relations

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December 21, 1999

DEC 22 1999

Ms. Lindy L. Paull
Chief of Staff
Joint Committee on Taxation
1015 Longworth House Office Building
Washington, DC 20515

Dear Lindy:

This letter is a late response to requests for comments in connection with your taxpayer confidentiality and return information study, along with Treasury's study. Although submitted beyond your deadline, I hope that you and your colleagues can consider the problem that is posed by the prohibition on release of letter rulings with respect to transactions by exempt organizations. If appropriate, please pass this on to Treasury.

The issue I raise here is the result of the work my colleagues and I have done this year on behalf of the Coalition for Fair Competition in Rural Markets (the "Coalition") regarding the law that applies to rural electric cooperatives ("RECs") that are exempt under sec. 501(c)(12). The Coalition is comprised of companies in the propane industry and of their national and state propane trade associations. On September 28, we delivered a memorandum to the IRS discussing the limitations that should be imposed on RECs which enter the propane retailing business. (I sent copies of the memo to you.) On November 9, we delivered another letter to the IRS (I will send copies under separate cover), responding to a public report in an REC newsletter that the IRS had issued four private letter rulings holding that sales of propane by an REC are considered to be a "like activity" for purposes of sec. 501(c)(12).

We disagree strongly with this holding "as reported" but we are hampered in our ability to contest it because of our inability to obtain redacted copies of these texts. Following phone conversations with IRS officials, one of my colleagues looked into the letter ruling disclosure rules more thoroughly and found the existing disclosure limitations imposed by sec. 6104 relating to letter rulings issued to exempt organizations. The interaction of secs. 6104 and 6110 is the matter which we believe needs attention in your study.

Generally, under sec. 6110, a letter ruling (as well as the related background file) is open to public inspection. Prior to public disclosure, the IRS redacts information, including but not limited to, information pertaining to the identity of the taxpayer and third parties, trade secrets and information exempt from disclosure by any statute applicable to the IRS.

However, the general public inspection/disclosure rules outlined in sec. 6110 do not apply to matters to which sec. 6104 applies -- namely, public disclosure of information relating to exempt organizations. The rules in sec. 6104 providing for inspection of tax exemption documents expressly override the general inspection/disclosure provisions of sec. 6110. Treas. Reg. § 301.6104(a)-1(i). Under sec. 6104, the public inspection of letter rulings pertaining to exempt organizations only extends to documents relating to exempt status such as exemption applications, information returns, and annual returns. Treas. Reg. § 301.6104(a)-1(i) provides in relevant part that:

> Some determination letters and other documents relating to tax exempt organizations that are not open to public inspection under section 6104(a)(1)(A) and this section are nevertheless within the ambit of section 6104 for purposes of section 6110. These determination letters and other documents are therefore not available for public inspection under either section 6104 or section 6110.

Treas. Reg. § 301.6104(a)-1(i)(6) further provides that materials not open to public inspection under secs. 6104 or 6110 include:

> Any other letter or document filed with or issued by the Internal Revenue Service which, although it relates to an organization's tax exempt status as an organization described in section 501 (c) or (d), does not relate to that organization's application for tax exemption, within the meaning of paragraph (d).

Therefore, an exempt organization's written request for a letter ruling as to whether it may engage in certain types of activities or specific transactions as well as the ruling issued by the IRS would not be subject to disclosure. Treas. Reg. § 301.6104(a)-1(i)(6).

We are less concerned with disclosure of letter ruling requests by exempt organizations (other than the exemption application) because, given the inherently factual nature of such requests, redacted letter ruling requests would not reveal much meaningful information in most cases.

But in contrast to the nondisclosure of letter ruling *requests*, the nondisclosure of letter rulings issued by the IRS is far more troublesome, particularly in situations such as that facing the propane retailing sector. Here, the IRS reportedly has been asked to rule - and has ruled - that an REC can engage in a particular activity without violating the statutory requirements of its exempt status. We believe the IRS is wrong, but we are hindered in addressing the problem when we cannot read the rulings themselves. The non-precedential nature of such rulings does not change the importance of making public a ruling in which the IRS says, in essence, that an exempt entity can begin to engage in direct competition with taxable companies in a sector in which there is neither historical precedent nor, we believe, a sound argument for such action.

Tax practitioners and other exempt organizations, as well as the general public, should be afforded every opportunity to examine guidance issued by the IRS, particularly with respect to rulings which expand the scope of an exemption from the income tax. This would be a natural and parallel rule for the principle of statutory construction which holds that exemptions are to be applied narrowly. For other exempt organizations (and tax practitioners advising those organizations), disclosure allows information to spread more efficiently. But our primary interest is that disclosure of such rulings also will allow taxable competitors to have some notice that an exempt entity is, in effect, being granted a new tax exemption for a new business activity.

We believe that the public, including taxpayers competing with exempt organizations, have a right to know the types of transactions and activities that the IRS endorses and the rationale for such decisions. Taxpayers should not be forced to wait (possibly for years) for the IRS to publish guidance in the form of a revenue ruling or technical advice memorandum addressing permitted types of activities, or worse yet, to speculate both as to the types of permitted activities being engaged in, as well as the IRS's underlying analysis endorsing such activities.

Recognizing that this is a late submission, I hope that you can take it into consideration before the project closes and your recommendations are provided to Congress.

Sincerely,

Cliff

Cliff Massa III

cc: Tim Hanford

ATTORNEY GENERAL
STATE OF NEW HAMPSHIRE

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PHILIP T. McLAUGHLIN
ATTORNEY GENERAL

STEVEN M. HOURAN
DEPUTY ATTORNEY GENERAL

September 22, 1999

OCT 01 1999

United States Congress
Lindy L. Paull, Chief of Staff
Joint Committee on Taxation
Washington, DC 20515

RE: Internal Revenue Service Reform and Restructuring Act

Dear Ms. Paull:

I am Michael S. DeLucia, the Director of Charitable Trusts, Department of the Attorney General in the State of New Hampshire. The Attorney General through the Director of Charitable Trusts exercises all the common law and statutory authority regarding the administration, enforcement, and supervision of charities and charitable trusts active in the State of New Hampshire.

It is my understanding the Joint Committee on Taxation is inviting public comment on the proposed Internal Revenue Service Reform and Restructuring Act and I would therefore submit the following for the committee's consideration.

Billions of dollars are donated to charitable organizations each year and although the majority of the funds are expended for legitimate purposes, cases of fraud, deception, and theft do exist requiring enforcement action by state regulators. These cases are often complicated requiring many hours of review, research, and preparation for trial. The IRS taxpayer privacy laws currently in effect permit the IRS to disclose information on specific Code section 501 organizations only after the IRS concludes its investigation of an organization. There is no authority for the IRS to disclose information to state regulators while the federal investigation is ongoing, even though it is sometimes the case that state regulators and the IRS are conducting parallel inquiries into the operation of a particular nonprofit organization involving the same or similar issues. Scarce personnel and resources at the state level limit the effectiveness of investigation and enforcement and therefore does not deter similar illegal activity by others. In my opinion, federal/state cooperation and the sharing of information would save time and avoid unnecessary duplication. This cooperation

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may result in a higher success rate in cases against charitable fraud and deception and in better protection for donors and the general public.

At the present time the IRS is authorized to share information on individual taxpayers with state revenue offices and may conduct joint federal/state examinations on private tax returns. It is my understanding this process works well and I see no reason why the procedure could not be modified or amended to include exempt organizations.

I therefore respectfully request the Congress consider amending the privacy/disclosure rules with respect to tax-exempt organizations described in Code section 501 to permit the IRS to share taxpayer information with state officials having jurisdiction over the regulation of Code section 501 organizations in a manner consistent with the procedure currently in effect for state revenue officials.

Thank you for your consideration.

Very truly yours,

Michael S. DeLucia, Director
Charitable Trusts Unit
603-271-3591

MSD:ksa

Cc: Dept of the Treasury, Assistant Secretary for Tax Policy

OCT 01 1999

STATE OF NEW YORK
OFFICE OF THE ATTORNEY GENERAL
(212) 416-8401

ELIOT SPITZER
Attorney General

DIETRICH L. SNELL
Deputy Attorney General
Division of Public Advocacy

September 30, 1999

Lindy L. Paull, Chief of Staff
Joint Committee on Taxation
United States Congress
Washington, DC 20515

Dear Ms. Paull:

I am writing in response to the request for public comment on the proposed Internal Revenue Service Reform and Restructuring Act.

New York State common law and statutes charge the Department of Law with the oversight of exempt organizations that conduct activities in New York. Exempt organizations are required to file annual financial reports with our office, including form 990. Our responsibilities include the audit and investigation of exempt entities and the imposition of a wide range of legal remedies including restitution, penalties, removal of directors and officers, appointment of receivers and dissolution.

In carrying out our statutory responsibilities to regulate tax exempt entities active in this state, we bear a responsibility similar to that of the state tax authorities in the for-profit sector. In that capacity we audit and investigate such entities. Information gathered in connection with IRS enforcement of the Internal Revenue Code could be of assistance to us as we are sure it is to the State Department of Taxation and Finance in for-profit matters. For example, information developed by the IRS in connection with imposition of intermediate sanctions or revocation of exempt status would assist us in enforcing state laws that regulate the disposition of charitable assets and solicitation of contributions from the public.

Information concerning a failure to secure tax exempt status, and the reasons for such failure, could be of great assistance to us in regulating entities that are active in our State and may be acting in violation of state law. For example, such entities may be misrepresenting their tax status to New Yorkers in the course of charitable solicitations. Likewise, information concerning taxes and penalties imposed on charitable entities might be relevant to our oversight of trustees of charitable assets. Our early intervention on state law issues might prevent future misuse of charitable funds. Such intervention is clearly in the public interest.

Charities Bureau
120 Broadway, New York, NY 10271● (212) 416-8401 ● Fax (212) 416-8393

We are aware that agreements entered into between the IRS and state tax offices permit those offices to share information concerning individual taxpayers and to cooperate in conducting proceedings against such taxpayers. Such cooperation between the IRS and state charities regulators would serve both the IRS and state charities regulators by making more efficient use of our resources while allowing simultaneous enforcement of state and federal law.

From time to time, this Bureau has referred to the IRS matters that appear to us to involve violations by exempt organizations of both the Internal Revenue Code and New York law or just the Internal Revenue Code. We do not generally receive any IRS acknowledgment of referrals by us nor do we receive any subsequent information as to whether or not the IRS intends to proceed or how it intends to proceed.

This lack of relationship has a negative impact on our law enforcement efforts. For example, statute of limitations constraints may require that we proceed blindly on the State law issues even though we might believe the matter would be better handled by the IRS or by joint efforts.

Also, if we were able to cooperate, the risk might be reduced of depleting charitable assets in the defense of two separate proceedings. If both agencies proceed separately against the same entity, we also run the risk of arriving at inconsistent results.

The State's primary interest is to return funds to charity. We would like opportunities in particular cases to persuade the IRS that its primary interest should be in obtaining penalties from the exempt organization's managers rather than from the exempt organization itself, because this would not reduce the funds available for charitable purposes.

In sum, if the IRS disclosed information concerning on-going exempt organization investigations, administrative proceedings and litigation to state attorneys general, we could work cooperatively on matters which involve both the Internal Revenue Code and state laws.

Sincerely,

William Josephson
Assistant Attorney General-in-Charge
Charities Bureau

OFFICE OF THE ATTORNEY GENERAL · STATE OF TEXAS
JOHN CORNYN

OCT 25 1999

October 19, 1999

Ms. Lindy L. Paull, Chief of Staff
United States Congress Joint Committee on Taxation
Washington, DC 20515

Ms. Elizabeth Askey
Office of Tax Legislative Counsel
U.S. Department of Treasury
1500 Pennsylvania Ave, NW Room 3121A
Washington, DC 20220

Exempt Organizations Division
Attn: Joseph J. Urban, Room 6413
Internal Revenue Service
1111 Constitution Ave, NW
Washington, DC 20224

RE: Internal Revenue Service Reform and Restructuring Act

Dear Ms. Paull, Ms. Askey, and Mr. Urban:

As Chief of the Charitable Trusts Section for the Attorney General of the State of Texas, I am writing to provide public comment related to potential changes in the Internal Revenue Code pertaining to disclosure of Internal Revenue Service information to state officials responsible for monitoring the activities of tax exempt organizations. The Attorney General of Texas, through his Charitable Trusts Section, exercises statutory and common law authority to enforce the laws pertaining to activities of charitable trusts within the State of Texas.

I understand that the Joint Committee on Taxation has invited public comment on the proposed Internal Revenue Service Reform and Restructuring Act and therefore submit this comment for the Committee's consideration as well as for the consideration of the Internal Revenue Service and Department of Treasury as they conduct their respective reviews of the IRS disclosure laws.

As you are aware, the IRS laws currently in affect only allow the IRS to disclose information on specific IRC section 501 organizations after the IRS concludes its investigation of an organization. The IRS has no authority to disclose information to state regulators while a federal investigation is ongoing, although quite frequently the state enforcement agencies and the IRS are conducting parallel investigations into the operation of particular nonprofit

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organizations involving the same or similar issues. The failure of the law in this manner can limit the effectiveness of investigations and enforcement without deterrence of similar illegal activity by other organizations.

The public interest of the State of Texas and other states would be greatly served by the sharing of information that would save time for both the federal entities and state organizations and avoid unnecessary duplication of investigations. These cooperative efforts may also result in a higher success rate in cases against charitable fraud and deception and better protect the donors as well as the general public.

The IRS is authorized to share information on individual taxpayers with state revenue officers and may conduct joint federal/state examinations on private tax returns. There should be no reason why such a procedure could not be amended to include exempt organizations.

On behalf of the public interest in charity within the State of Texas, I would respectfully request that Congress consider amending the privacy/disclosure rules with respect to tax exempt organizations described in IRC section 501 to permit the IRS to share taxpayer information with state enforcement agencies having jurisdiction over the regulation of IRC section 501 organizations in a manner consistent with a procedure currently in effect for state revenue officials.

If I can provide any additional information or assistance in this matter, please do not hesitate to contact me. Thank you for your consideration of these comments.

Respectfully yours,

Mary T. Henderson

Mary Taylor Henderson
Chief, Charitable Trusts Section
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MTH/ibs

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30 COUNTRIES

December 21, 1999 DEC 22 1999

Lindy L. Paull
Chief of Staff
Joint Committee on Taxation
1015 Longworth HOB
Washington, D.C. 20515

Elizabeth P. Askey
Office of Tax Legislative Counsel
Department of the Treasury
1500 Pennsylvania Ave, NW
Room 1321A
Washington, D.C. 20220

RE: Confidentiality Study

Dear Ms. Paull and Ms. Askey:

I am writing pursuant to JCT Press Release 99-03 and Treas. Ann. 99-101 to comment on disclosure of information with respect to tax-exempt organizations described in Internal Revenue Code section 501. Specifically, I am commenting on the rules governing disclosure of Internal Revenue Service ("IRS") closing agreements under section 7121 of the Code as applied to exempt organizations. The fact that Congress required a study of the taxpayer confidentiality provisions in the IRS Restructuring and Reform Act of 1998 suggests it may be contemplating legislative changes in that area.

As a tax-exempt organizations practitioner and former IRS official who has negotiated several closing agreements on both sides of the table,[1] I am very concerned that a legislative change compelling disclosure of closing agreements will effectively end a dispute resolution mechanism vital to both the Service and tax-exempt organizations. Given the regulatory nature of the IRS' role in the exempt organizations area, the widespread occurrence of inadvertent

[1] Though I often help negotiate closing agreements for specific clients and negotiated them for the IRS from 1989 to 1996, I was not personally involved on either side in the Church of Scientology case that brought this issue to public attention.

technical violations voluntarily disclosed by exempt organizations or discovered by the Service on examination each year, taxpayer-specific closing agreements negotiated under Section 7121 are a crucial mechanism for improving compliance and avoiding revocation of exemption. I fear that the Service will be less able to compromise and taxpayers less willing to acknowledge errors if closing agreements are required to be made public.

In my experience, a strong desire to avoid public embarrassment underlies nearly every exempt organization decision to voluntarily disclose past misconduct to the IRS and seek a closing agreement. The Service obtains assured compliance and, often, some form of negotiated sanction, while the taxpayer obtains certain resolution of an exemption issue without the public attention that might accompany a notice of proposed revocation. Requiring disclosure of closing agreements, even in redacted form, might well discourage these efforts and thus have a harmful effect on compliance.

Generally, I believe that the public interest is served by greater disclosure of information with respect to tax-exempt organizations. In this regard, I have always supported moves by former Representative Pickle and others to make exempt organizations more accountable through public disclosure of Applications for Recognition of Exemption and Annual Information Returns. As you know, the new regulations implementing the amended disclosure rules and the appearance of Forms 990 on the Internet are about to revolutionize the amount of information available to the public about exempt organization operations.

In much the same fashion, I also support public release, in redacted form, of Treasury and IRS documents that may shed light on agency interpretation of law or policy. In the long run, both taxpayers and the government almost always benefit from administration of our nation's laws in the sunshine. Disclosure of general counsel memoranda, private letter rulings, and field service advice memoranda has helped the tax-exempt community and the public better understand agency positions. Clarifying the law with respect to the scope of private letter rulings that should be disclosed under section 6104 is one meaningful way in which the Committee might further advance that goal.

It is against this backdrop that I am urging the Committee and Treasury not to recommend changing the existing rules governing disclosure of closing agreements applicable to exempt organizations. I recognize the public interest in having access to internal agency documents that may illuminate IRS legal interpretation or policy. Also, it is completely understandable, given the size and visibility of the Church of Scientology and the notoriety of its legal disputes with the IRS, that the press and members of the exempt organizations community were curious about the Church's closing agreement with the IRS. That curiosity and a single-minded commitment to expanding disclosure led Tax Analysts to sue for disclosure of a variety of closing agreements entered into by the IRS. Now that the Scientology agreement has, for better or worse, been made public, and the Service has, with the Bishop Estate agreement, as with the earlier Hermann Hospital agreement, again demonstrated its resolve to require disclosure of the few closing agreements having educational or deterrent value, I hope you will balance the interests here in favor of retaining current law regarding confidentiality.

The balance struck by current law is appropriate because the public interest that would be served by mandatory disclosure in most cases is weak and far outweighed by the public interest in the continued availability of closing agreements as an enforcement tool and correction mechanism. It is a rare closing agreement with an exempt organization that would shed any meaningful light on agency interpretation of law or policy, other than the Hermann Hospital agreement, which the parties made public for precisely that reason. Closing agreements are essentially private contracts of compromise. Unlike letter rulings, general counsel memoranda, or field service advice, they are products of negotiation that contain no legal analysis or interpretations of law. This is not just my view, but the conclusion reached by U.S. District Court Judge Hogan earlier this year in denying Tax Analysts' request for disclosure. *Tax Analysts v. Internal Revenue Service*, 53 F.Supp. 2d 449 (D. D.C. 1999).

The public interest in the continued availability of the closing agreement mechanism for resolving controversy, in contrast, is much stronger than the interests served by mandatory disclosure. If, as would be the inevitable result of mandatory disclosure, the availability of closing agreements is curtailed, the IRS would lose an effective tool for bringing about improved compliance. Tax-exempt organizations would lose a meaningful mechanism for avoiding revocation of exemption or other harsh penalties while agreeing to correct mistakes or otherwise improve operations.

For all the above reasons, I hope you will conclude that the competing goals are best balanced and the public interest best served by leaving existing law governing the confidentiality of closing agreements unchanged.

Sincerely yours,

T. J. Sullivan

TJS/
cc: Evelyn A. Petschek, Internal Revenue Service
Carolyn O. Ward, Joint Committee on Taxation
Steve Arkin, Treasury Department

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DRAFT 12/21/99 4:49 PM

III. REPRINT OF GAO REPORTS

The following documents are reproductions of two GAO reports prepared in connection with the Joint Committee staff study.

United States General Accounting Office

GAO

Report to the Joint Committee on Taxation, U.S. Congress

August 1999

TAXPAYER CONFIDENTIALITY

Federal, State, and Local Agencies Receiving Taxpayer Information

GAO

Accountability * Integrity * Reliability

GAO-GGD-99-164

GAO
Accountability * Integrity * Reliability
United States
General Accounting Office
Washington, D.C. 20548
General Government Division

B-282749

August 30, 1999

The Honorable Bill Archer
Chairman
The Honorable William V. Roth, Jr.
Vice Chairman
Joint Committee on Taxation

The concerns of citizens and Congress regarding individual rights to privacy have made it important to assess the disclosure practices and safeguards employed by the Internal Revenue Service (IRS) and other federal, state, and local agencies to protect taxpayer information. Federal, state, and local agencies are authorized under Internal Revenue Code (IRC) section 6103 to receive from IRS the taxpayer information they need to assist in their administration and enforcement of laws. These agencies are required to protect the confidentiality of the information they receive and implement safeguards that are designed to prevent unauthorized access, disclosure, and use.

Section 3802 of the IRS Restructuring and Reform Act of 1998 requires that both the Joint Committee on Taxation and the Secretary of the Treasury conduct a study of the scope and use of section 6103 provisions regarding taxpayer confidentiality. To assist in this effort, you requested that we provide you with information about

- which federal, state, and local agencies receive taxpayer information from IRS (see apps. I and II);
- what type of information they receive (see apps. III and IV);
- how the taxpayer information is being used (see app. V);
- what policies and procedures the agencies are required to follow to safeguard taxpayer information (see app. VI);
- how frequently IRS is to monitor agencies' adherence to the safeguarding requirements; and
- the results of IRS' most recent monitoring efforts (see app. VII).

Results in Brief

According to IRS, there were 37 federal and 215 state and local agencies that received, or maintained records containing, taxpayer information under provisions of section 6103 during 1997 or 1998. The information that the agencies received included, among other things, the taxpayers' names, Social Security numbers, addresses, and wages. The information came in a variety of formats (i.e., paper copy, electronic databases, and tape extracts). Some agencies received the information on a regular schedule (i.e., monthly, quarterly, or annually). Others received the information on an as-needed basis, such as while conducting criminal investigations.

Federal, state, and local agencies said they used taxpayer information for one of several purposes, such as administering state tax programs, assisting in the enforcement of child support programs, verifying eligibility and benefits for welfare and public assistance programs, and conducting criminal investigations.

Before receiving taxpayer information from IRS, agencies are required to advise IRS how they intend to use the information and to provide IRS with a detailed safeguard plan that describes the procedures established and used by the agency for ensuring the confidentiality of the information they want to receive. These safeguard plans are supposed to be updated every 6 years or if significant changes are made to the agencies' procedures. IRS Publication 1075, Tax Information Security Guidelines for Federal, State, and Local Agencies,[1] outlines what must be included in an agency's safeguard plan. Agencies are also required to submit annual reports to IRS summarizing their efforts to safeguard taxpayer information and any minor changes to their safeguarding procedures.

In addition to providing IRS with safeguard plans and annual reports, agencies' Offices of Inspector General (OIG) may also review internal agency programs for safeguarding restricted or classified information. For example, in March 1999, the Department of Veterans Affairs' (VA) OIG issued a report on its review of the Evaluation of VHA's Income Verification Match Program (Report No. 9R1-G01-054, Mar. 15, 1999).This report outlined possible inappropriate requests for and subsequent use of taxpayer information by VA's Health Eligibility Center.

IRS conducts on-site reviews to ensure that agencies' safeguard procedures fulfill IRS requirements for protecting taxpayer information. IRS' National Office of Governmental Liaison and Disclosure, Office of Safeguards, has overall responsibility for safeguard reviews to assess whether taxpayer information is properly protected from unauthorized use or access as required by the IRC and to assist in reporting to Congress. Safeguard reviews are to be conducted every 3 years.

IRS' safeguard reviews have identified discrepancies in agency safeguard procedures and made recommendations for corrections. The reviews have

[1]Publication 1075 has been revised periodically, most recently in March 1999.

uncovered problems with agency safeguarding procedures, ranging from inappropriate access to taxpayer information by contractor staff to administrative matters, such as the failure to properly document the disposal of information.

Background

IRS began exchanging federal taxpayer data with state tax administration agencies in the 1920s, but it was not until the Tax Reform Act of 1976 that Congress declared federal tax returns and return information to be confidential. The Tax Reform Act specified IRS' responsibilities for safeguarding taxpayer information against unauthorized disclosure while authorizing IRS to share this information with state agencies for tax administration purposes. Congress also authorized the sharing of taxpayer information with child support programs to assist with enforcement, such as locating individuals owing child support. In 1984, Congress authorized IRS to share data to support federal and state administration of other programs, such as Aid to Families With Dependent Children[2] and Medicaid, to assist in verifying eligibility and benefits.

Disclosures of federal taxpayer information to an agency are restricted to the agency's justified need for and use of such information. Unauthorized inspection, disclosure, or use of taxpayer information is subject to civil and criminal penalties.

Objective, Scope, and Methodology

The objective of this study was to provide the Committee with information on how federal, state, and local agencies use the taxpayer information they are authorized to obtain under section 6103.[3] To meet our objective, we met with officials in IRS' Office of Governmental Liaison and Disclosure, Office of Safeguards, and select IRS District Disclosure Offices. We also reviewed IRS documentation of reports submitted by federal, state, and local agencies on the safeguard procedures used to protect taxpayer information. In addition, we reviewed IRS reports of its monitoring efforts at these agencies.

IRS provided us with lists of federal, state, and local agencies that had received taxpayer information during 1997 or 1998. We surveyed the agencies, asking them under what authority they received taxpayer information, how they received it, what they used the information for, and

[2]The Aid to Families With Dependent Children program has been replaced by the Temporary Assistance for Needy Families program.

[3]Our study did not address disclosure of taxpayer information to agencies pursuant to taxpayer consents under section 6103(c), which are not subject to the safeguard requirements of section 6103(p)(4).

whether there were alternate sources of data they could use in lieu of taxpayer information. We also asked them about IRS' monitoring efforts and to identify any safeguard deficiencies that have been noted during recent internal or external reviews. Copies of our questionnaires are reproduced in appendix IX.

We surveyed all of the federal agencies in the Washington, D.C., metropolitan area that IRS identified as having received taxpayer information. The response rate was 100 percent from these agencies. In some cases, we sent a questionnaire to more than one contact for a particular agency. For example, for the Department of Labor, IRS identified four separate components as receiving taxpayer information. Thus, IRS gave us the names of four separate contact persons at Labor. We mailed our questionnaire to 50 agency contact persons. In our cover letter, we encouraged them to distribute copies of the questionnaire to all other entities within the agency that received taxpayer information from IRS and asked that an appropriate representative from those units return a completed questionnaire.

Several agencies that had only one contact person listed by IRS returned multiple questionnaires from different units within their agencies that use taxpayer information. For example, the Department of Transportation had only one contact person to whom we mailed our questionnaire, but staff in the Department completed and returned 10 questionnaires. In total, we received 98 questionnaires from the 50 agency contacts from whom we requested information.

From the list IRS provided of 215 state and local entities that had received taxpayer information, we drew a simple random probability sample of 35 entities. Each entity on the IRS list had an equal, nonzero probability of being included in the sample. Our sample, then, is only one of a large number of samples that we might have drawn because we followed a probability procedure based on random selection. Each sample could have provided different estimates; thus, we can express our confidence in the precision of our particular sample's results as a 95-percent confidence interval. This is the interval that would contain the actual population value for 95 percent of the samples we could have drawn. As a result, we are 95-percent confident that each of the confidence intervals in this report will include the true values in the study population.

We mailed questionnaires to the contact persons at each of the selected entities. Like the federal agencies, some of the state and local agencies completed more than one questionnaire. Thirty-four of the 35 state and local agencies we surveyed returned at least one questionnaire, for a response rate of 97 percent.[4]

Given the broad scope of our study and the required time frame for completion, our audit work focused on collecting and presenting the data from the agencies and IRS. As agreed with your office, we did not verify the information that we collected. We also did not evaluate the efforts of IRS or the federal, state, and local agencies to safeguard taxpayer information.

We performed our work at IRS' National Office of Safeguards and select IRS District Disclosure Offices. Our work was done between March and August 1999 in accordance with generally accepted government auditing standards.

We requested comments on a draft of this report from the Commissioner of Internal Revenue. IRS provided written comments in an August 16, 1999, letter, which is reprinted in appendix X. The comments are discussed near the end of this letter.

Which Federal, State, and Local Agencies Receive Taxpayer Information?

According to IRS, there were 37 federal and 215 state and local agencies that received, or maintained records containing, taxpayer information under provisions of IRC section 6103 during 1997 or 1998. We surveyed all of the 34 federal agencies in the Washington, D.C., metropolitan area that IRS identified as having received taxpayer information. In responding to our questionnaire, 3 of the 34 federal agencies—Agency for International Development, Department of Energy, and Environmental Protection Agency—indicated that they did not receive any taxpayer information during 1997 or 1998. In addition, two agencies—Equal Employment Opportunity Commission and Securities and Exchange Commission—indicated that they did not receive any taxpayer information during 1998. Among these 34 federal agencies, however, there were several that had more than one department or unit that utilized the taxpayer information received.

From the list IRS provided of 215 state and local entities that were receiving taxpayer information, we drew a simple random probability sample of 35 entities. Only one of our sampled state and local entities—Alabama Department of Human Resources—indicated that it did not

[4]The one outstanding agency, Maryland Department of Human Resources, Child Enforcement Agency, returned a questionnaire as we were processing this report. Because of the timing of when the questionnaire was returned, we were unable to include this response in our summary of information of state and local agencies.

receive any taxpayer information in 1997, and all of them indicated that they had received taxpayer information in 1998.[5]

According to IRS officials, they generally categorize the agencies into one of the following:

- **Child support agencies**–IRS discloses certain tax return information to federal, state, and local child support enforcement agencies.
- **Welfare/public assistance agencies**–IRS discloses certain tax return information to federal, state, and local agencies administering welfare/public assistance programs, such as food stamps and housing.
- **State tax administration/law enforcement agencies**–IRS discloses certain tax return information to federal, state, and local agencies for tax administration and the enforcement of state tax laws.
- **Federal agencies**–IRS discloses certain tax return information to federal agencies for certain other purposes.

What Type of Taxpayer Information Do Agencies Receive?

The type of taxpayer information agencies receive varies in content, format, and frequency according to how agencies use the information. Agencies may receive paper copies of individual tax returns, electronic databases of IRS' individual and business master files, or tape extracts from these files. The information can include such things as the taxpayers' names, Social Security numbers, addresses, or wages. Table 1 shows examples of the different types of taxpayer information agencies receive.

As shown in table 1, agencies receive taxpayer information in a variety of formats—for example, paper copy, electronic databases, and tape extracts. Some agencies receive this information on a regular schedule—for example, monthly, quarterly, or annually. Other agencies receive it on an as-needed basis—for example, while conducting criminal investigations.

[5]On the basis of the questionnaire responses, we estimate that between 0 and 9 percent of all state and local entities on IRS' list did not receive taxpayer information in 1998, and between 0 and 14 percent did not receive taxpayer information in 1997.

Table 1: Examples of Types of Taxpayer Information Received by Federal, State, and Local Agencies

Taxpayer information	Format	Frequency
Individual and corporate income tax, estate tax, partnership, fiduciary, excise tax, and exempt organization audit reports	Paper copy	Upon request
Payer and payee information from W-2s, K-1s, Form 1099s, and Form 5498	Paper copy	Upon request
Taxpayers' mailing addresses	Paper copy	Upon request
Information returns master file (SSN, name, address)	Tape	Annual
Individual master file extract (SSN, name, address, marital status, exemptions, dependents, income, and return type)	Tape	Annual
Corporate income tax return information (name, address, EIN, net income or loss, assets, and gross receipts)	Tape	Annual
Employment tax returns records (EIN, total compensation paid, taxable period, number of employees, total taxable wages paid, and tip income)	Tape	Weekly
Statistics of income corporate sample (credits, balance sheet, and income statement)	Tape	Annual
W-2s and W-3s (wage data submitted by employers)	Electronic, paper copy	Upon request
Unearned income from various Form 1099s	Tape	Monthly
Wages, self-employment earnings, and retirement income	Tape, electronic	Annual, monthly
SSN, filing and marital status, taxpayer name, address, employee EINs	Tape, electronic	Upon request

Legend

EIN Employee identification number
Form 1099s Interest, dividend, and miscellaneous income statements
Form 5498 Individual Retirement Arrangement Information
K-1s Beneficiary's, partnership's, and shareholder's share of income, deductions, credits, etc.
SSN Social Security number
W-2s and W-3s Wage and tax statements

Source: IRS Office of Safeguards.

We asked the agencies we surveyed to indicate how they received taxpayer information from IRS during 1997 or 1998 and how often they received that information. Tables 2 and 3 show the survey results.

Table 2: Formats in Which Agencies Received Taxpayer Information From IRS in 1997 or 1998

	Agencies	
Format	Federal	State and local[b]
Paper copy	56%	44%
Electronic databases	50	15
Tape extracts	44	88
Other[a]	28	18

Note: Percentages may add to more than 100 percent because agencies can receive the information in different formats for different purposes.

[a]Some agencies indicated that they received the information on a diskette or via direct-connect.

[b]The percentages shown reflect the raw percentages obtained in the sample. The population percentages associated with the 95-percent confidence interval are: paper (30%-59%), database (6%-28%), tape extracts (75%-96%), other (8%-32%).

Source: GAO analysis of responses from agencies surveyed.

Table 3: Frequencies With Which Agencies Received Taxpayer Information From IRS in 1997 or 1998

	Agencies	
Frequency	Federal	State and local[b]
Yearly	34%	18%
Quarterly	19	15
Monthly	19	53
Weekly	47	18
Other[a]	47	29

Note: Percentages may add to more than 100 percent because agencies can receive the information at different intervals for different purposes.

[a]Some agencies indicated that they received the information upon request or on an as-needed basis.

[b]The percentages shown reflect the raw percentages obtained in the sample. The population percentages associated with the 95-percent confidence interval are: yearly (8%-32%), quarterly (6%-28%), monthly (39%-67%), weekly (8%-32%), other (17%-44%).

Source: GAO analysis of responses from agencies surveyed.

Appendixes III and IV further describe the types of taxpayer information received by federal and state and local agencies, respectively; the format in which the information was received; and the frequency with which it was received, categorized by purposes for which the information might be used.

In addition to the taxpayer information received from IRS, many agencies use other sources of information to fulfill their missions. We asked the agencies to indicate, in lieu of taxpayer information, what other sources of data are available that would allow them to accomplish their missions. As shown in table 4, the responses from the federal, state, and local agencies we surveyed generally fell into one of following categories:

- There was no other source of data available to them.
- They used other sources, but these other sources were less reliable than tax information.

- They used other sources, but these other sources were more costly to use than tax information.
- They used other sources in conjunction with the tax information.
- They did not respond to this question.

Table 4: Other Sources of Data Agencies Used in Lieu of Taxpayer Information

	Agencies	
Other sources	**Federal**	**State and local**[a]
No other sources available	47%	71%
Other sources less reliable	28	3
Other sources more costly	16	0
Used other sources as well as tax data	34	44
Did not respond	19	3

Note: Percentages may add to more than 100 because more than one response was possible for an agency due to multiple responses from different components within an agency.

[a]The percentages shown reflect the raw percentages obtained in the sample. The population percentages associated with the 95-percent confidence interval are: no other sources available (56%-83%), other sources less reliable (0%-14%), other sources more costly (0%-9%), and used other sources as well as tax data (30%-59%).

Source: GAO analysis of responses from agencies surveyed.

How Is the Taxpayer Information Being Used?

Under various IRC section 6103 subsections, agencies may receive taxpayer information for one of several reasons, such as to administer state tax programs, assist in the enforcement of child support programs, or verify eligibility and benefits for various welfare and public assistance programs (e.g., food stamps or public housing).[6] Agencies may also receive taxpayer data for use during a criminal investigation, to apprise appropriate officials of criminal activities or emergency circumstances, or to assist in locating fugitives from justice.

One of the most common reasons why agencies said they received taxpayer information was their participation in the tax refund offset program. Pursuant to the IRC, agencies submitted qualifying debts, such as student loans or child support payments, for collection by offsetting the debt against the taxpayer's refund. Seventy-five percent of the federal agencies and 15 percent of the state and local agencies in our sample indicated that they received taxpayer information for this purpose.

Effective January 1, 1999, tax refund offset procedures for collecting qualifying debts were modified. The Department of the Treasury's Financial Management Service was given the responsibility for the Federal Refund Offset Program, which was merged into the centralized administrative offset program known as the Treasury Offset Program. This

[6]See appendix II for a description of the various IRC 6103 subsections.

program commingles tax refund information with other federal financial information (e.g., benefit payments, pensions). If a match is found when an individual has an outstanding debt and is receiving federal money in any form (e.g., tax refund, pension, or vendor payments), the individual is notified that his federal money can be withheld to pay off the debt. The source or sources of any money withheld is not revealed to the agencies, but simply the fact that an offset has been made. This information, then, is no longer identifiable as tax refund information; thus, it is no longer considered taxpayer information.[7]

Because of this change to the offset program, several agencies we surveyed indicated that they no longer needed taxpayer information. Thirty-four percent of the federal and 3 percent of the state and local agencies in our sample indicated that they are participating in the Treasury Offset Program and that they will no longer need to receive taxpayer information from IRS.

We asked the agencies we surveyed to indicate how they use taxpayer information. We grouped their responses into the following categories:

- administering debt collection or offset program;
- administering tax laws;
- determining eligibility for welfare and public assistance programs;
- enforcing child support programs;
- conducting criminal investigations; and
- other purposes, such as statistical and economic research, auditing government programs, or storage of tax returns.

Table 5 shows how the agencies we surveyed responded to our query about how they used the taxpayer information they received in 1997 or 1998. (App. V provides a listing of possible uses of taxpayer information received from IRS.)

[7]To the extent that agencies collect past-due child support payments from tax refund offsets under the Treasury Offset Program, such agencies continue to receive specified taxpayer information as authorized by IRC section 6103 (l)(10).

Table 5: How Taxpayer Information Was Used by Federal, State, and Local Agencies in 1997 or 1998

Category	Agencies: Federal	Agencies: State and local[a]
Debt collection/offset program	75%	15%
Administering tax laws	0	41
Determining eligibility for welfare/public assistance programs	16	32
Enforcement of child support programs	6	29
During criminal investigations	28	3
Other purposes	28	0

Note: Percentages may add to more than 100 percent because agencies can use taxpayer information for multiple purposes.

[a]The percentages shown reflect the raw percentages obtained in the sample. The population percentages associated with the 95-percent confidence interval are: Treasury offsets (6%-28%), administration of tax laws (28%-56%), welfare/public assistance programs (20%-47%), child support enforcement (17%-44%), investigations (0%-14%), and other (0%-9%).

Source: GAO analysis of responses from agencies surveyed.

What Policies and Procedures Are Agencies Required to Follow to Safeguard Taxpayer Information?

Before receiving taxpayer information from IRS, agencies are required to provide IRS with a detailed Safeguard Procedures Report (SPR) that describes the procedures established and used by the agency for ensuring the confidentiality of the information received. The SPR is a record of how the agency processes the federal taxpayer information and protects it from unauthorized disclosure.

IRS Publication 1075 outlines what must be included in an agency's SPR.[8] In addition to requiring that it be submitted on agency letterhead and signed by the head of the agency or the head's delegate, an agency's SPR must contain information about

- responsible officer(s),
- location of the data,
- flow of the data,
- system of records,
- secure storage of the data,
- access to the data,
- disposal of the data,
- computer security, and
- agency's disclosure awareness program.

All federal agencies and the state welfare agencies are to submit their SPRs to IRS' Office of Safeguards, which is to review the reports for completeness and acceptance. State taxing agencies and child support

[8]See appendix VI for a summary of the requirements included in IRS Publication 1075.

enforcement agencies are to submit their SPRs to the IRS District Disclosure Office in their respective states. Agencies are expected to submit a new SPR every 6 years or whenever significant changes occur to their safeguard program.

IRS has taken steps to withhold taxpayer information from agencies if their SPRs did not fulfill the requirements set forth in IRC section 6103. Shown below are some recent examples of IRS notifying agencies that they would not be able to get taxpayer information because their SPRs were incomplete.

- In April 1999, IRS' Office of Safeguards notified the Arizona Department of Economic Security that, since IRS had not received an acceptable SPR, it was recommending to IRS' Office of FedState Relations that federal taxpayer information be withheld until the agency complied with the safeguarding requirements outlined in IRC section 6103. IRS' Office of Safeguards further advised that it would recommend to the Social Security Administration that tax information contained in the Beneficiary Earnings Exchange Record should not be forwarded to the department.
- In May 1999, IRS' Office of Safeguards notified the West Virginia Department of Health and Human Resources that additional information that IRS had requested in an earlier letter had not been provided and that it could not accept the procedures described in the department's draft SPR as adequately protecting federal taxpayer information from unauthorized disclosure.
- In June 1999, IRS' Office of Safeguards notified the Federal Bureau of Investigation that IRS was unable to accept the Bureau's SPR as describing adequate safeguard procedures to protect federal taxpayer information from unauthorized disclosure.

Agencies are also required to file a Safeguard Activity Report (SAR) annually with IRS to advise it of any minor changes to the procedures or safeguards described in their SPR. The SAR is also to advise IRS of future actions that would affect the agency's safeguard procedures—for example, new computer equipment, facilities, or systems or the use of contractors, as permitted by law, to do programming, processing, or administrative services. Moreover, the SAR is to summarize the agency's current efforts to ensure confidentiality and certify that the agency is protecting taxpayer information pursuant to IRC section 6103(p)(4) and the agency's own security requirements.

In addition to the SPRs and annual SARs that are sent to IRS, agencies' OIGs may also review agency programs for safeguarding taxpayer information. For example, a March 1999 Department of Veterans Affairs (VA) OIG report outlined possible inappropriate requests for and subsequent use of taxpayer information by VA's Health Eligibility Center because of erroneous information supplied to them by some VA medical facilities.[9] The OIG found that a large percentage of sampled cases did not have certain required documentation on file and, consequently, should not have been referred for income matching and verification.

Before we notified IRS about the VA OIG report, neither Treasury nor IRS was aware of the report or its findings. After meeting with IRS to discuss the OIG findings, VA agreed to work with IRS on corrective actions. According to IRS, federal agency OIGs are not required to notify IRS of their findings involving tax returns and return information. In July 1999, IRS issued a memorandum to federal agency OIGs asking for their assistance in working with IRS in this area.

How Frequently Is IRS to Monitor Agencies' Adherence to the Safeguarding Requirements?

IRS is supposed to conduct on-site reviews every 3 years to ensure that agencies' safeguard procedures fulfill IRS requirements for protecting taxpayer information. IRS' National Office of Governmental Liaison and Disclosure, Office of Safeguards, has overall responsibility for safeguard reviews to assess whether taxpayer information is properly protected from unauthorized inspection, disclosure, or use as required by the IRC and to assist in reporting to Congress. The Office of Safeguards conducts the on-site reviews for all the federal agencies and state welfare agencies that receive taxpayer information. IRS' District Offices of Disclosure and FedState Relations are responsible for conducting the on-site safeguard reviews at all other state and local agencies that receive taxpayer information. There are 33 district offices, 29 of which have responsibilities for overseeing the safeguard reviews at state and local agencies. As of June 1999, there were 230 professional and 24 support staff assigned to the national and district disclosure offices. (App. VIII shows the staffing levels of these offices.) In addition to overseeing the safeguarding program, the district offices have responsibility for a variety of other disclosure activities, such as responding to requests under the Freedom of Information Act or Privacy Act.

According to IRS, staff from the responsible IRS office visit the agency to review the procedures established and used by the agency to protect taxpayer information from unauthorized disclosure. In addition, they assess the agency's need for, and use of, this information. IRS staff are to meet with agency personnel, review agency records, and visit agency

[9]Report No. 9R1-G01-054, Mar. 15, 1999.

facilities where taxpayer information is kept. They then prepare a report detailing their assessment of the agency's processes and ability to fulfill the requirements of IRC section 6103(p)(4).

In addition to conducting the triennial safeguard reviews, IRS District Disclosure Office staff are to conduct annual "need and use" reviews at all state and local agencies involved in tax administration. These reviews are done to validate the agencies' continued need for and use of the tax information they receive from IRS.

What Are the Results of IRS' Monitoring Efforts?

IRS' safeguard reviews over the last 5 years have identified discrepancies in agency safeguard procedures and made recommendations for corrections. The reviews have uncovered deficiencies with agency safeguarding procedures, ranging from inappropriate access of taxpayer information by contractor staff to administrative matters, such as the failure to properly document the disposal of information. Discrepancies found by IRS during the safeguard reviews generally were procedural deficiencies and did not result in known unauthorized disclosures of taxpayer information. In their responses to the discrepancies found and recommendations made by IRS, agencies indicated that they would institute corrective actions. (App. VII provides examples of the discrepancies found by IRS during its safeguard reviews.)

As noted above, one of the discrepancies that IRS found during safeguard reviews was that some agencies that received taxpayer information were using contractor personnel in a manner that might allow them access to taxpayer information. In its Report on Procedures and Safeguards Established and Utilized by Agencies for the Period January 1 through December 31, 1998, IRS highlighted this problem to Congress. IRS found agencies using contractor personnel in setting up agency computer systems in a manner that permitted the contractors to see taxpayer information. IRS also found agencies using contractor personnel in the disposal of taxpayer information, without having agency personnel observe the process to ensure that contractor personnel did not "access" the information. One of the major changes to IRS Publication 1075 in March 1999 was the inclusion of a section devoted to the appropriateness of, and precautions with, using contractor personnel to assist an agency in fulfilling the part of its mission that requires the use of taxpayer information.

Some types of administrative discrepancies found by IRS staff during safeguard reviews included, among other things, that

- agencies were not properly documenting what information had been destroyed;
- agency recordkeeping systems at field offices did not always meet the statutory requirements for accountability;
- agencies were not properly tracking the shipment of paper documents containing federal taxpayer information; and
- employees were not always aware of the criminal and civil penalties that can be imposed for unauthorized inspection or disclosure.

Agency Comments and Our Evaluation

We requested comments on a draft of this report from the Commissioner of Internal Revenue. Officials representing the Assistant Commissioner for Examination and the Commissioner's Office of Legislative Affairs provided IRS' comments at an August 12, 1999, meeting. IRS also provided written comments in an August 16, 1999, letter, which is reprinted in appendix X.

IRS was in overall agreement with the draft report and said it fairly represented the scope and use of IRC section 6103 provisions regarding safeguarding taxpayer information. IRS also provided some additional information and technical comments. Where appropriate, we made changes to this report on the basis of these comments.

We are sending copies of this report to Senator Fred Thompson, Chairman, and Senator Joseph I. Lieberman, Ranking Minority Member, Senate Committee on Governmental Affairs, and Representative Charles B. Rangel, Ranking Minority Member, House Committee on Ways and Means. We are also sending copies to the Honorable Lawrence H. Summers, Secretary of the Treasury; the Honorable Charles O. Rossotti, Commissioner of Internal Revenue; the Honorable Jacob Lew, Director, Office of Management and Budget; and other interested parties. We will also send copies to those who request them.

If you or your staff have any questions concerning this report, please contact me or Joseph Jozefczyk at (202) 512-9110. Other major contributors to this report are acknowledged in appendix XI.

Cornelia M. Ashby

Cornelia M. Ashby
Associate Director, Tax Policy and
Administration Issues

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Figures

Abbreviations

ATF	Bureau of Alcohol, Tobacco, and Firearms
FMS	Financial Management Services
HCFA	Health Care Financing Administration
IRC	Internal Revenue Code
IRS	Internal Revenue Service
OCSE	Office of Child Support Enforcement
OIG	Office of the Inspector General
OPM	Office of Personnel Management
RRB	Railroad Retirement Board
SSA	Social Security Administration
VA	Department of Veterans Affairs
SAR	Safeguards Activity Report
SPR	Safeguards Procedures Report

Lists of Federal, State, and Local Agencies Receiving Taxpayer Information

The Internal Revenue Service (IRS) provided us with the following list of federal agencies in the Washington, D.C., metropolitan area that received, or maintained records containing, taxpayer data under the authority of Internal Revenue Code (IRC) section 6103.

Table I.1: List of Federal Agencies Receiving Taxpayer Information

1	Agency for International Development[a]	14	Department of Transportation
2	Central Intelligence Agency		Federal Aviation Administration
3	Defense Finance and Accounting Service		Office of the Secretary of Transportation, TASC
4	Department of Agriculture		Research and Special Programs
	Farm Service Agency		U.S. Coast Guard
	Food and Nutrition Service	15	Department of the Treasury
	National Finance Center		Financial Management Service
	Office of the Inspector General		Office of the Inspector General
	Risk Management Agency		U.S. Customs Service
	Rural Development		U.S. Secret Service, Financial Management Division
5	Department of Commerce		U.S. Secret Service, Investigative Support Division
	Bureau of Economic Analysis	16	Department of Veterans Affairs
	Economic Planning and Coordination Division		Debt Management Center
	Planning Research and Evaluation Division		Veterans Benefits Administration
	Office of Financial Management	17	Environmental Protection Agency[a]
6	Department of Education	18	Equal Employment Opportunity Commission
7	Department of Energy[a]	19	Federal Emergency Management Agency
8	Department of Health and Human Services	20	General Accounting Office
	Office of Child Support Enforcement	21	General Services Administration
	Program Support Center	22	National Archives and Records Administration
9	Department of Housing and Urban Development		Office of the General Counsel
	Albany Financial Operations Center		Records Center Facilities
	Real Estate Assessment Center	23	National Labor Relations Board
10	Department of the Interior	24	National Science Foundation
11	Department of Justice	25	Office of Independent Counsel
	Antitrust Division	26	Office of Personnel Management
	Civil Division	27	Pension Benefit Guaranty Corporation
	Debt Collection Management	28	Securities and Exchange Commission
	Federal Bureau of Investigation	29	Small Business Administration
	Office of Professional Responsibility	30	Social Security Administration
	Tax Division		Office of the Inspector General
	U.S. Attorneys Offices		Office of Policy, Office of Research, Evaluation, and Statistic
12	Department of Labor		Office of Program Benefits
	Office of the Chief Financial Officer		Office of Systems Requirements
	Office of the Inspector General	31	United States Marine Corps
	Pension and Welfare Benefits Administration	32	U.S. Information Agency
	Plans Benefits Security Division	33	U.S. Peace Corps
13	Department of State	34	U.S. Postal Service
			General Accounting Section
			Postal Inspection Service

[a]In responding to our questionnaire, these agencies indicated that they had not received any taxpayer information in 1997 or 1998.

In addition, IRS identified the following six entities not in the Washington, D.C., metropolitan area that received taxpayer information. These were:

- Army and Air Force Exchange, Dallas, TX
- Department of the Treasury, Bureau of Public Debt, Parkersburg, WV
- Navy Exchange Service Command, Virginia Beach, VA
- Department of the Treasury, U.S. Customs, Indianapolis, IN
- Department of Veteran Affairs, Fort Snelling, MN
- U.S. Railroad Retirement Board, Chicago, IL

As agreed with your office, we did not include these six in our survey because they were located outside the Washington, D.C., metropolitan area.

IRS provided us with the following list of state and local agencies that received, or maintained records containing, taxpayer data under the authority of IRC section 6103.

Table I.2: List of State and Local Agencies Receiving Taxpayer Information

1	Alabama Child Support Enforcement Agency	28	Connecticut Department of Social Services
2	Alabama Department of Human Resources	29	Delaware Child Support Enforcement Agency
3	Alabama Department of Revenue	30	Delaware Department of Transportation
4	Alabama Medicaid Agency	31	Delaware Division of Revenue
5	Alaska Child Support Enforcement Agency	32	Delaware Health & Social Services
6	Alaska Department of Health & Social Services	33	District of Columbia Office of Corporation Counsel
7	Alaska Department of Revenue	34	District of Columbia Department of Human Services
8	American Samoa Department of Treasury	35	District of Columbia Office of Tax & Revenue
9	Arizona Department of Economic Security	36	Florida Department of Children & Family Services
10	Arizona Department of Revenue	37	Florida Department of Revenue
11	Arizona Department of Transportation	38	Georgia Child Support Enforcement Agency
12	Arizona Health Care Cost Containment System	39	Georgia Department of Human Resources
13	Arkansas Department of Finance & Administration Revenue	40	Georgia Department of Labor
14	Arkansas Department of Human Services	41	Georgia Department of Revenue
15	Arkansas Department of Labor	42	Guam Child Support Enforcement Agency
16	Arkansas Office of Child Support Enforcement	43	Guam Department of Revenue & Taxation
17	California State Controller's Office	44	Hawaii Child Support Enforcement Agency
18	California Department of Social Services	45	Hawaii Department of Human Services
19	California Employment Development Department	46	Hawaii Department of Labor & Industrial Relations
20	California Franchise Tax Board	47	Hawaii Department of Taxation
21	California State Board of Equalization	48	Idaho Department of Health & Welfare
22	Colorado Department of Human Services	49	Idaho Department of Labor
23	Colorado Department of Labor & Employment	50	Idaho Department of Revenue
24	Colorado Department of Revenue	51	Idaho State Tax Commission
25	Colorado Department of Social Services	52	Illinois Attorney General's Office
26	Connecticut Bureau of Child Support	53	Illinois Department of Human Services
27	Connecticut Department of Revenue Services	54	Illinois Department of Public Aid

55	Illinois Department of Revenue	105	Missouri–Kansas City Revenue Division
56	Illinois Office of Child Support Enforcement	106	Missouri–City of St. Louis Revenue Department
57	Indiana Family & Social Services Administration	107	Montana Department of Justice
58	Indiana Department of Revenue	108	Montana Department of Public Health & Human Services
59	Indiana Department of Workforce Development	109	Montana Department of Revenue
60	Indiana Office of Child Support Enforcement	110	Montana Department of Social & Rehabilitation Services
61	Iowa Child Support Enforcement Agency	111	Montana Department of Transportation
62	Iowa Department of Human Services	112	Nebraska Child Support Enforcement Agency
63	Iowa Department of Finance & Revenue	113	Nebraska Department of Health & Human Services
64	Iowa Workforce Development	114	Nebraska Department of Labor
65	Kansas Department of Revenue	115	Nebraska Department of Revenue
66	Kansas Department of Social & Rehabilitative Services	116	Nebraska Department of Social Services
67	Kentucky Cabinet for Families & Children	117	Nevada Department of Human Resources
68	Kentucky Revenue Cabinet	118	Nevada Department of Motor Vehicles
69	Kentucky Workforce Development	119	Nevada Department of Taxation
70	Kentucky–Louisville/Jefferson County Revenue Commission	120	Nevada Department of Human Resources
71	Louisiana Child Support Enforcement Agency	121	New Hampshire Child Support Enforcement Agency
72	Louisiana Department of Health & Hospitals	122	New Hampshire Department of Employment
73	Louisiana Department of Revenue	123	New Hampshire Department of Health & Human Services
74	Louisiana Department of Social Services	124	New Hampshire Department of Revenue
75	Louisiana State Police	125	New Hampshire Department of Safety
76	Maine Bureau of Employment	126	New Jersey Department of Human Services
77	Maine Child Support Enforcement Agency	127	New Jersey Department of Labor
78	Maine Department of Human Services	128	New Jersey Division of Taxation
79	Maine Revenue Services	129	New Mexico Human Services Department
80	Maryland Child Support Enforcement Agency	130	New Mexico Department of Labor
81	Maryland Controller of the Treasury	131	New Mexico Taxation & Revenue Department
82	Maryland Department of Human Resources	132	New York Department of Labor
83	Maryland Department of Labor	133	New York Department of Social Services
84	Massachusetts Child Support Enforcement Agency	134	New York Department of Taxation & Finance
85	Massachusetts Department of Employment Services	135	New York City Department of Finance
86	Massachusetts Department of Revenue	136	North Carolina Department of Health & Human Services
87	Massachusetts Department of Transitional Assistance	137	North Carolina Department of Human Resources
88	Massachusetts Division of Medical Assistance	138	North Carolina Department of Revenue
89	Michigan Family Independence Agency	139	North Dakota Department of Human Services
90	Michigan Department of Treasury	140	North Dakota Office of State Tax Commissioner
91	Michigan Office of Child Support Enforcement	141	Ohio Bureau of Employment Services
92	Michigan–City of Detroit Income Tax Bureau	142	Ohio Department of Human Services
93	Minnesota Department of Economic Security	143	Ohio Department of Taxation
94	Minnesota Department of Human Services	144	Ohio–City of Cincinnati Income Tax Bureau
95	Minnesota Department of Revenue	145	Ohio–City of Cleveland Division of Taxation
96	Minnesota Department of Social Services	146	Ohio–City of Columbus Income Tax Division
97	Mississippi Child Support Enforcement Agency	147	Ohio–City of Toledo Division of Taxation
98	Mississippi Department of Human Services	148	Oklahoma Department of Human Services
99	Mississippi Department of Public Safety	149	Oklahoma Tax Commission
100	Mississippi Division of Medicaid	150	Oregon Child Support Enforcement Agency
101	Mississippi State Tax Commission	151	Oregon Department of Human Resources
102	Missouri Department of Revenue	152	Oregon Department of Revenue
103	Missouri Department of Social Services	153	Pennsylvania Department of Public Welfare
104	Missouri Division of Employment Security	154	Pennsylvania Department of Revenue

155 Pennsylvania–City of Philadelphia Department of Revenue	186 Vermont Division of Motor Vehicles
156 Pennsylvania–City of Pittsburgh Department of Finance	187 Virginia Child Support Enforcement Agency
157 Puerto Rico Department of Social Services	188 Virginia Department of Motor Vehicles
158 Puerto Rico Department of the Family	189 Virginia Department of Social Services
159 Puerto Rico Department of the Treasury	190 Virginia Department of Taxation
160 Puerto Rico Department of Welfare	191 Virgin Islands Bureau of Health Insurance & Medical Assistance
161 Puerto Rico Division of Medicaid	192 Virgin Islands Bureau of Internal Revenue
162 Rhode Island Child Support Enforcement Agency	193 Virgin Islands Department of Finance
163 Rhode Island Department of Human Services	194 Virgin Islands Department of Human Services
164 Rhode Island Department of Administration	195 Virgin Islands Department of Justice, Child Support Enforcement
165 South Carolina Department of Revenue	196 Washington Child Support Enforcement Agency
166 South Carolina Department of Social Services	197 Washington Department of Social & Health Services
167 South Carolina Employment Services	198 Washington State Department of Revenue
168 South Dakota Department of Labor	199 Washington Department of Licensing
169 South Dakota Department of Revenue	200 Washington Department of Labor & Industry
170 South Dakota Department of Social Services	201 Washington State Employment Security
171 Tennessee Department of Employment Security	202 West Virginia Child Support Enforcement Agency
172 Tennessee Department of Human Services	203 West Virginia Department of Employment
173 Tennessee Department of Revenue	204 West Virginia Department of Health & Human Services
174 Tennessee–Nashville Metropolitan Police Department	205 West Virginia Department of Tax & Revenue
175 Texas Department of Human Services	206 Wisconsin Child Support Enforcement Agency
176 Texas Disposal Systems	207 Wisconsin Department of Industry & Labor
177 Texas Office of the Attorney General, Child Support Enforcement	208 Wisconsin Department of Revenue
178 Texas Comptroller of Public Accounts	209 Wisconsin Department of Workforce Development
179 Texas Workforce/Employment Commission	210 Wyoming Department of Employment
180 Utah Department of Workforce Services	211 Wyoming Department of Family Services
181 Utah State Tax Commission	212 Wyoming Department of Revenue
182 Vermont Child Support Enforcement Agency	213 Wyoming Department of Social Service
183 Vermont Department of Employment Services	214 Wyoming Department of Transportation
184 Vermont Department of Social Welfare	215 Wyoming State Auditor's Office
185 Vermont Department of Taxes	

IRC Section 6103 Subsections That Authorize IRS to Disclose Taxpayer Information Subject to Safeguarding Requirements

IRC Section 6103

Certain federal, state, and local agencies, and others are authorized under Internal Revenue Code (IRC) section 6103 to receive taxpayer information from the Internal Revenue Service (IRS). The following describes the agencies, bodies, commissions, and other agents authorized by IRC section 6103 subsections to obtain taxpayer information, subject to safeguarding requirements prescribed in IRC section 6103(p)(4).

IRC Section 6103(d)–Disclosures to State Tax Agencies and State and Local Law Enforcement Agencies (Officers and

Disclosures of taxpayer information can be made to state taxing agencies and state and local law enforcement agencies that assist in the administration of state tax laws. Disclosures under this section are to be used only for tax administration purposes, and states must justify the need for this information and must use the data provided.

IRC Section 6103(f)–Disclosures to Committees of Congress

Certain disclosures of taxpayer information can be made to Committees of Congress and their agents upon written request from the Chairman of the House Committee on Ways and Means, the Senate Committee on Finance, or the Joint Committee on Taxation. Taxpayer information that can be associated with, or otherwise identify (directly or indirectly), a particular taxpayer can only be furnished to the Committee when in closed executive session, unless a taxpayer otherwise consents in writing to the disclosure. Agents, such as the General Accounting Office, and certain other Committees may also receive taxpayer information under subsections (f)(3) and (4).

IRC Section 6103(h)–Disclosures to Federal Agencies (Officers and Employees) for Tax Administration Purposes

6103(h)(2)–Disclosures of taxpayer information can be made to the Department of Justice for proceedings involving tax administration before a federal grand jury or any proceedings or investigation that may result in a proceeding before a federal grand jury or federal or state court.

6103(h)(5)–Disclosures of the address and status of a nonresident alien, citizen, or resident of the United States to the Social Security Administration (SSA) and Railroad Retirement Board can be made for purposes of carrying out responsibilities for withholding tax under section 1441 of the Social Security Act for Social Security benefits.

IRC Section 6103(i)-Disclosures to Federal Agencies (Officers and Employees) for Administration of Federal Laws Not Related to Tax Administration

6103(i)(l) and (2)–Disclosures of taxpayer and other information can be made for use in certain criminal investigations.

6103(i)(3)–Disclosures of taxpayer information can be used to apprise appropriate officials of criminal activities or emergency circumstances.

6103(i)(5)–Disclosures of taxpayer information can be made to locate fugitives from justice upon the grant of an ex parte order by a federal district court judge or magistrate.

6103(i)(7)–Disclosures of taxpayer information can be made to officers and employees of the General Accounting Office in conducting audits of IRS; Bureau of Alcohol, Tobacco and Firearms (ATF); and any agency authorized by 6103(p)(6).

IRC Section 6103(j)–Disclosures for Statistical Use

6103(j)(1)–Disclosures of taxpayer information can be made to the Department of Commerce (Census and Bureau of Economic Analysis).

6103(j)(2)–Disclosures of taxpayer information can be made to the Federal Trade Commission for statistical purposes. Only corporate returns can be disclosed for legally authorized economic surveys of corporations. (According to IRS, this section is obsolete because the Federal Trade Commission no longer performs these economic surveys.)

6103(j)(5)–Disclosures of taxpayer information can be made to the Department of Agriculture for the purpose of structuring, preparing, and conducting the census of agriculture pursuant to the Census of Agriculture Act of 1997.

IRC Section 6103(k)(8)–Disclosure for Certain Other Tax Administration Purposes

Disclosures of taxpayer information can be made to the Department of the Treasury's Financial Management Service (FMS) for levies related to any federal debt.

IRC Section 6103(l)–Disclosures for Purposes Other Than Tax Administration

IRC section 6103(l)(1) and (l)(5) allow a specific type of disclosure between IRS and SSA commonly known as the Continuous Work History Sample Program. Under this disclosure, a small sample (approximately 1%) of the U.S. population's Social Security-related data, wage information, and self-employment data is collected and used (1) for various studies to monitor trends that may affect Social Security programs; (2) as a model to assist in determining the effects of proposed program changes, including proposed legislative or administrative changes; and (3) to assess funding requirements related to trust funds and the budget.

6103(l)(1)–Disclosures of taxpayer information can be made to the Social Security Administration and Railroad Retirement Board for the administration of the Social Security Act and the Railroad Retirement Act. The common name for this disclosure is the Administration of the Social Security Act Program. Section 6103(l)(1) is very specific as to what information may be disclosed to SSA, and part of this information may be used by SSA only for purposes of carrying out its responsibility under section 1131 of the Social Security Act.

6103(l)(2)–Disclosures of taxpayer information can be made to the Department of Labor and the Pension Benefit Guaranty Corporation for administration of titles I and IV of the Employee Retirement Income Security Act of 1974.

6103(l)(3)–Disclosures of taxpayer information can be made to any federal agency administering a federal loan program.

6103(l)(5)–Disclosures of taxpayer information can be made to the Social Security Administration for the purposes of (1) carrying out an effective return processing program pursuant to section 232 of the Social Security Act and (2) providing information regarding the mortality status of individuals for epidemiological and similar research in accordance with section 1106(d) of the Social Security Act. The common name for this disclosure is the Annual Wage Reporting Program. Section 6103(l)(5) permits SSA and IRS to work together to process and share certain information. SSA and IRS conduct a number of exchanges to identify whether employee, employer, and wage data are correct and employers are submitting information as legally required.

6103(l)(6)–Disclosures of taxpayer information can be made to federal, state, and local child support enforcement agencies for the purposes of establishing and collecting child support obligations from individuals owing such obligations, including locating such individuals. Under IRC section 6103(p)(2), in conjunction with section 6103(l)(6), IRS has authorized SSA to make disclosures to the Office of Child Support Enforcement, a federal agency that oversees child support enforcement at the federal level and acts as a coordinator for most programs involved with child support enforcement.

6103(l)(7)–Disclosures of taxpayer information can be made to federal, state, and local agencies administering certain benefits programs for the purposes of determining eligibility for, or correct amount of, benefits under such programs. Section 6103(l)(7) states that SSA will provide its return information [obtained under 6103(l)(1) or (5)] to other agencies to assist them with specific welfare programs. The states (and other authorized agencies) provide the names and Social Security numbers of welfare applicants or recipients, and SSA provides the authorized information, such as wages and self-employment (net earnings) and retirement income. This disclosure between SSA and the other agencies is called the Beneficiary and Earnings Data Exchange Program. A similar program, the 1099 Program, involves the disclosure of unearned income information between IRS and federal, state, and local agencies administering these programs.

6103(l)(8)–Disclosures of taxpayer information can be made by SSA to other state and local child support enforcement agencies for the same purposes as 6103(l)(6).[1]

6103(l)(9)–Disclosures of taxpayer information can be made to state administrators of state alcohol laws for use in the administration of such laws. The disclosure is limited to information on alcohol fuel producers only.

6103(l)(10)–Disclosures of specific taxpayer information relating to tax refund offsets can be made to the agency requesting such offsets in order to collect specified debts, such as student loans or child support payments. This disclosure between IRS and other agencies was known as the Tax Refund Offset Program. This program is currently undergoing a "transition." In the past, agencies received pre-offset debtor addresses, debtor identity information, the filing status (if joint), and any payment amount to the spouse of a joint return from IRS. Effective January 1, 1999, Treasury's Financial Management Service assumed complete responsibility for the Treasury Offset Program. Except in the case of tax refund offsets to collect child support debts, agencies are now receiving offset information under the Treasury Offset Program procedures. Tax refund offset will, in general, be blended, or amalgamated, with other Treasury "offsets," such as salary offsets. FMS is to perform the blending and tax information is not to be identified beyond FMS, except for agencies involved in collecting child support debts. When tax refund offset information is blended and

[1] According to IRS data, there are currently no disclosures being made under 6103(8). Section 6103(l)(6) allows IRS to provide the same information to federal, state, and local agencies.

unidentifiable under the Treasury Offset Program procedures, it is no longer considered return information and section 6103(p)(4) safeguarding procedures are not required.

6103(l)(11)–Disclosures of taxpayer information can be made by SSA to the Office of Personnel Management (OPM) for the purpose of administering the federal employees' retirement system (chs. 83 and 84 of title 5, U.S.C.). The common name for this disclosure between SSA and OPM is the Federal Employees' Retirement System Program. It involves a computer match where OPM provides the names and Social Security numbers of federal employees participating in the federal retirement system and SSA provides the wages, self-employment earnings, and retirement income information obtained under IRC sections 6103(l)(1) and (l)(5).

6103(l)(12)–Taxpayer information can be disclosed by IRS to SSA and by SSA to the Health Care Financing Administration (HCFA) to administer the Medicare program. The common name for this type of disclosure is the Medicare Secondary Payer Project. The purpose of this disclosure is to identify the employment status of Medicare beneficiaries to determine if medical care is covered by group health plans. It permits IRS to provide SSA with identity information, filing and marital status, and spouse's name and Social Security number for specific years for any Medicare beneficiary identified by SSA. It also permits SSA to disclose to HCFA the names and Social Security numbers of Medicare beneficiaries receiving wages above a specified amount. Additionally, it permits HCFA to disclose certain return information to qualified employers and group health plans.

6103(1)(13)–Disclosures of taxpayer information can be made to the Department of Education to administer the "Direct Student Loans" program.[2]

6103(l)(14)–Disclosures of taxpayer information can be made to U.S. Customs to audit evaluations of imports and exports, and to take other actions to recover any loss of revenue or collection of duties, taxes, and fees determined to be due and owed as a result of such audits.

6103(1)(16)–Disclosures of taxpayer information can be made by SSA to officers or employees of the Department of the Treasury, a trustee or any

[2]According to IRS, no disclosures have been made under this provision. Instead, the Department of Education has obtained taxpayer information pursuant to taxpayer consents under section 6103(c). Such disclosures are not subject to safeguards.

designated officer, employee, or actuary of a trustee (as defined in the D.C. Retirement Protection Act), for the purpose of determining an individual's eligibility for, or the correct amount of, benefits under the District of Columbia Retirement Protection Act of 1997.

6103(l)(17)–Disclosures of taxpayer information can be made to the National Archives and Records Administration for the purposes of appraisal of records for destruction or retention.

IRC Section 6103(m)–Disclosures of Taxpayer Identity Information

Section 6103 (m)(2), (4), (6), and (7) are not subject to 6103(p)(4) safeguarding requirements unless address and entity information is redisclosed to an agent. If redisclosed to an agent, both the agency and the agent must safeguard the information.

6103(m)(2)–Disclosures of taxpayer information can be made to federal agencies for collection of federal claims under the Federal Claims Collection Act. Section 6103(m)(2) authorizes IRS to provide the mailing addresses of taxpayers to any federal agency to locate taxpayers in an attempt to collect federal claims. The common names for this type of disclosure is Taxpayer Address Request Program or the Recovery and Collection of Overpayment Process. It involves the federal agency providing IRS with a listing of debtors, identified by Social Security number and name, and IRS then providing the agency with the same information and the latest known address.

6103(m)(4)–Disclosures of taxpayer information can be made to the Department of Education for collection of Student Loans.

6103(m)(6)–Disclosures of taxpayer information can be made to officers and employees of the Blood Donor Locator Service in the Department of Health and Human Services for the purpose of locating individuals to inform donors of the possible need for medical care and treatment relating to acquired immune deficiency syndrome.

6103(m)(7)–Disclosures of taxpayers' mailing addresses can be made to SSA for the purpose of mailing the Personal Earnings and Benefit Estimate Statements (Social Security account statements).

IRC Section 6103(n)–Disclosures to Contractors

6103(n)–Disclosures of taxpayer information can be made to contractors to the extent necessary and for the various activities and services related to tax administration. These disclosures can only be made by the Treasury Department, a state tax agency, SSA, and the Department of Justice and in accordance with regulations prescribed by the IRS Commissioner.

IRC Section 6103(o)–Disclosures With Respect to Certain Taxes

6103(o)(1)–Disclosures of taxpayer information can be made to ATF for administering certain taxes on alcohol, tobacco, and firearms.

Tables II.1 and II.2 show, for the agencies we surveyed that received taxpayer information in 1997 or 1998, the authorization under which they received the information.

Table II.1: IRC Authorization for Federal Agencies to Receive Taxpayer Information

	IRC section 6103 subsections								
Federal agency	**6103(d)**	**6103(f)**	**6103(h)**	**6103(i)**	**6103(j)**	**6103(l)**	**6103(m)**	**6103(o)**	**Other**
Central Intelligence Agency						X			
Defense Finance and Accounting Service						X	X		
Department of Agriculture			X	X		X	X		
Department of Commerce					X	X			
Department of Education							X		
Department of Health and Human Services						X			
Department of Housing and Urban Development						X	X		
Department of the Interior							X		
Department of Justice			X	X		X	X	X	
Department of Labor				X		X	X		X
Department of State									X
Department of Transportation				X			X		X
Department of the Treasury			X	X		X	X	X	
Department of Veterans Affairs						X	X		
Equal Employment Opportunity Commission							X		
Federal Emergency Management Agency							X		
General Accounting Office	X	X		X		X			
General Services Administration							X		
National Archives and Records Administration							X		
National Labor Relations Board						X			
National Science Foundation							X		
Office of Independent Counsel			X	X					
Office of Personnel Management						X			
Pension Benefit Guaranty Corporation						X			
Securities and Exchange Commission						X	X		
Small Business Administration						X			
Social Security Administration				X		X	X		
United States Marine Corps							X		
U.S. Information Agency							X		
U.S. Peace Corps			X	X			X		
U.S. Postal Service				X					

Source: IRS' Office of Safeguards and agencies' responses to our survey.

Table II.2: IRC Authorization for State and Local Agencies to Receive Taxpayer Information

State agency	IRC section 6103 subsections								
	6103(d)	6103(f)	6103(h)	6103(i)	6103(j)	6103(l)	6103(m)	6103(o)	Other
Alabama Department of Human Resources						X			
California State Controller's Office	X								
California Department of Social Services						X			
California Franchise Tax Board	X								
Connecticut Department of Social Services						X			
Delaware Department of Health & Social Services						X			
District of Columbia Office of Corporate Counsel								X	
District of Columbia Office of Tax & Revenue	X								
Florida Department of Children & Family Services						X			
Georgia Department of Human Resources						X			
Georgia Department of Revenue	X								
Illinois Department of Human Services						X			
Illinois Department of Public Aid						X			
Kansas Department of Revenue	X								
Kentucky Cabinet for Families & Children, Child Support Enforcement Agency						X			
Kentucky Cabinet for Families & Children, Welfare Division						X			
Louisiana Department of Health & Hospitals						X			
Louisiana Department of Revenue	X								
Massachusetts Department of Transitional Assistance						X			
Mississippi Division of Medicaid						X			
Missouri Department of Revenue	X								X
Montana Department of Revenue	X								
Nebraska Department of Health & Human Services, Child Support Enforcement						X			
New Jersey Department of Human Services						X			
New Mexico Human Services Department						X			
Nevada Department of Human Resources						X			
North Dakota Office of State Tax Commissioner	X								
Rhode Island Department of Administration	X								
Texas Comptroller of Public Accounts	X								
Virginia Department of Social Services, Division of Child Support Enforcement						X			
Virginia Department of Social Services						X			
Vermont Department of Taxes	X								
Wisconsin Department of Revenue	X								
West Virginia Department of Tax and Revenue	X								

Source: Agencies' responses to our survey.

Overview of Information Provided to Federal Agencies Under the Provisions of IRC Section 6103

Internal Revenue Code (IRC) section 6103 allows the Internal Revenue Service (IRS) to disclose taxpayer information to federal agencies and authorized employees of those agencies. Disclosure of taxpayer information is to be used strictly for the purposes outlined by federal statutes and in accordance with IRS policy and procedures.

IRC sections 6103(h) and 6103(i) allow IRS to disclose taxpayer information to the employees and officers of any federal agency for tax administration purposes as well as for the administration of federal laws not related to tax. Under 6103(h), IRS can disclose information to the Department of Justice for federal tax investigations and to the Social Security Administration (SSA) and Railroad Retirement Board (RRB) for purposes of withholding taxes.[1] IRC section 6103(i) allows the disclosure of information for use in federal nontax criminal investigations and other activities not related to tax administration. Table III.1 shows some types of taxpayer information disclosed and the disclosure format and frequency.

Table III.1: Disclosure to Federal Agencies for Tax Administration and the Administration of Federal Laws Not Related to Tax Administration

Taxpayer information provided	Format	Frequency
Criminal tax investigation reports and taxpayer listings	Hard copy	Upon request
Individual and business income tax return information (individual and business master files and return transaction files)	Hard copy	Upon request
Individual and corporate income tax, estate tax, partnership, fiduciary, excise tax, and exempt organization audit reports	Hard copy	Upon request
Payer and payee information from W-2s, K-1s, Form 1099s, and Form 5498	Hard copy	Upon request
Taxpayers' mailing addresses	Hard copy	Upon request

Legend

Form 1099s Interest, dividend, and miscellaneous income statements
Form 5498 Individual Retirement Arrangement Information
K-1s Beneficiary's, partnership's, or shareholder's share of income, deductions, credits, etc.
W-2s Wage and tax statements

Source: IRS' Office of Safeguards.

IRC section 6103(j) allows IRS to disclose taxpayer information to the Departments of Agriculture and Commerce and to officers and employees of the Department of the Treasury for statistical use. Table III.2 shows the types of taxpayer information disclosed and the disclosure format and frequency.

[1]Specifically, section 6103(h)(5) permits the disclosure of taxpayer information to SSA and RRB. According to IRS data, no disclosures have been made under this provision for numerous years.

Table III.2: Disclosure to Federal Agencies for Statistical Purposes

Taxpayer information provided	Format	Frequency
Information returns master file (SSN, name, address)	Tape	Annually
Individual master file extract (SSN, name, address, marital status, exemptions, dependents, income, and return type)	Tape	Annually
Corporate income tax return information (name, address, EIN, net income or loss, assets, and gross receipts)	Tape	Annually
Employment tax returns records (EIN, total compensation paid, taxable period, number of employees, total taxable wages paid, and tip income)	Tape	Weekly
Business master file entity (EIN, name, address, filing requirements, accounting period, and employment code)	Tape	Monthly, annually[a]
Weekly economic data and economic and agriculture census (SSN, EIN, address, receipts, accounting period, wages, interest, assets, and cost of goods)	Tape	Annually
Information from application for EIN	Tape	Monthly, annually[b]
Statistics of income corporate sample (credits, balance sheet, income statement, and tax items)	Tape	Annually

Legend

EIN Employee identification number
SSN Social Security number

[a]Selected entity data such as EIN, name, address, etc., are disclosed annually. Changes in business status, such as those resulting from births, deaths, etc., are disclosed monthly.

[b]Monthly disclosures are made to SSA, and with IRS approval, SSA can disclose information to Census annually.

Source: IRS' Office of Safeguards.

Under IRC section 6103(l), disclosures can be made to certain federal agencies for purposes other than for tax administration.[2] Disclosure of taxpayer information can be made to any federal agency administering a federal loan program,[3] as well as to those federal agencies administering certain programs under the Social Security Act, the Food Stamp Act of 1977, title 38 U.S.C., or certain other housing assistance and benefits programs. Disclosures can also be made to SSA, RRB, the Pension Benefit Guaranty Corporation, and the Department of Labor for the administration of the Employee Retirement Income Security Act of 1974 and for carrying out a return processing program.

The Veterans Health Administration, Veterans Benefits Administration, and Department of Housing and Urban Development also receive federal taxpayer information from SSA and IRS under the authority of IRC section

[2]Sections 6103(l)(6), (7), and (8) also allow disclosure of taxpayer information to state and local agencies for child support and welfare purposes.

[3]Disclosure is limited to information regarding whether or not an applicant for a loan has a tax delinquent account.

6103(l)(7) for use in administering programs authorized under title 38 and certain housing assistance programs. SSA also receives unearned income information from IRS, which it uses in administering the Supplemental Security Income program.

Additionally, IRC section 6103(l) allows disclosure by SSA to the Health Care Financing Administration and to certain other agencies for determining eligibility for, or the correct amount of, benefits. Table III.3 shows the types of taxpayer information disclosed and the disclosure format and frequency.

Table III.3: Disclosure to Federal Agencies for Purposes Other Than Tax Administration

Taxpayer information provided	Format	Frequency
Form 8300 information	Hard copy	Upon request
Tax liability and delinquency information	Hard copy	Upon request
W-2s and W-3s (wage data submitted by employers)	Electronic, hard copy	Upon request
Unearned income from various Form 1099s	Tape	Monthly
Wages, self-employment earnings and retirement income	Tape, electronic	Monthly, annually
SSN, filing and marital status, taxpayer name, addresses, employee EINs	Tape, electronic	Upon request
Individual income tax return information (SSN, filing status, amount and nature of income, number of dependents)	Tape	Monthly

Legend

EIN Employee identification number
Form 1099s Interest, dividend, and miscellaneous income statements
Form 8300 Report of Cash Payments Over $10,000 Received in a Trade or Business
SSN Social Security number
W-2s and W-3s Wages and tax statements

Note: Data regarding Social Security payments are not considered taxpayer information because they are derived from SSA records. Wage data obtained from W-2s and W-3s and self-employment income and other income data received from IRS are taxpayer information.

Source: IRS' Office of Safeguards.

IRC section 6103(m) allows the disclosure of taxpayer information for collecting federal claims and for locating registered blood donors. All federal agencies can receive the information for collection of claims, such as student loans, under the Federal Claims Collection Act. The Department of Health and Human Services receives the taxpayer information as part of its Blood Locator Service, for the purpose of locating donors. IRC section 6103(o) allows disclosures of the collection of certain taxes on alcohol, tobacco, and firearms. Table III.4 shows the types of taxpayer information disclosed and the disclosure format and frequency.

Table III.4: Disclosure to Federal Agencies for Collecting Certain Federal Claims and Taxes and for Locating Donors

Taxpayer information provided	Format	Frequency
Social Security number, taxpayer name, address	Tape	Weekly
Taxpayer name, address	Electronic	Weekly

Source: IRS' Office of Safeguards.

Overview of Information Provided to State and Local Agencies Under the Provisions of IRC Section 6103

Under the provisions of Internal Revenue Code (IRC) section 6103(d), the Internal Revenue Service (IRS) is authorized to make disclosures for state tax administration purposes to state tax officials and state and local law enforcement agencies. In general, taxpayer information can be disclosed to any state agency, body, or commission, or its legal representative for the administration of state tax laws, including for locating any person who may be entitled to a state income tax refund. Table IV.1 shows some of the types of taxpayer information disclosed and the disclosure format and frequency.

Table IV.1: Disclosure to State Tax Officials and State and Local Law Enforcement Agencies

Taxyer information provided	Format	Frequency
Employment tax audit reports pertaining to Form 940 - Employers Annual Unemployment Tax Return	Hard copy	Quarterly
Audit results and information regarding reclassification of independent contractor to employee status	Hard copy	Quarterly
Individual and corporate income tax, estate tax, partnership, fiduciary, excise tax, and exempt organization audit reports	Hard copy	Monthly
Late-filed income tax returns with a balance due	Hard copy	Quarterly
Criminal tax investigation reports and taxpayer listing	Hard copy	Quarterly
Dyed diesel fuel inspection reports	Hard copy	Quarterly
Business tax return information (master file and return transaction file)	Tape	Annually
Form 1040 information and third-party information returns (underreporter program file)	Tape	Quarterly
Audit and appeals information (audit adjustments and appellate level results)	Tape	Annually
Individual income tax return information (master file and return transaction file)	Tape	Annually
Database of IRS third-party information returns (Form 1099s, W-2s, K-1s)	Tape	Annually
Payer and payee information from W-2s, K-1s, Form 1099s, and Form 5498	Tape	Monthly
Listing of taxpayers who did not itemize on their federal income tax return	Tape	Annually
Information on the taxpaying population of a given state	Tape	Upon request
Taxpayers mailing addresses	Tape	Weekly

Legend

Form 940 Employers Annual Unemployment Tax Return
Form 1040 U.S. Individual Income Tax Return
Form 1099s Interest, dividend, and miscellaneous income statements
Form 5498 Individual Retirement Arrangement Information
K-1s Beneficiary's, partnership's, and shareholder's share of income, deductions, credits, etc.
W-2s Wage and tax statement

Note: Agencies are also authorized to make specific requests for tax information for a taxpayer they are working with. This may include IRS examination and collection files, wage and income information, bankruptcy files, and filing requirements for tax administration purposes.

Source: IRS' Office of Safeguards.

In addition to the types of taxpayer information shown in table IV.1, in some states, the Attorney General's Office receives inheritance tax and estate tax information from IRS, including tax credits and closing letters to taxpayers. This type of taxpayer information is disclosed quarterly on hard copy or magnetic tape.

In certain states, such as Texas, that have no state income tax, the State Comptroller's Office—which is responsible for collecting state sales and inheritance taxes—receives taxpayer information from IRS. The taxpayer information consists of estate and gift tax audit reports and income information, such as Form 1099s, on hard copy or magnetic tape, and transcripts of business returns. This information is received on an ongoing, as well as on a case-by-case, basis. The state of Wyoming also does not have an income tax, but its department of transportation enforces fuel tax laws. IRS provides Wyoming with fuel tax adjustment results on hard copy and only upon specific request.

Some cities, such as St. Louis and Kansas City, levy an income-based tax on their residents and those taxpayers that work in the city. These cities receive income tax audit reports from IRS when adjustments are made to wages or self-employment income. This information is received quarterly on hard copy.

IRC section 6103(l)(6) allows IRS to disclose taxpayer information to state and local child support enforcement agencies.[1] In general, taxpayer information can be disclosed to any state or local child support enforcement agency for establishing and collecting child support obligations, including any procedure for locating individuals owing such obligations.

IRC section 6103(l)(8) permits the Social Security Administration (SSA) to disclose certain taxpayer information to state and local child support enforcement agencies. However, section (l)(6) also permits the disclosure of the same information, and more, to federal, state, and local agencies. Currently, SSA is not making any disclosures of taxpayer information to state and local child support enforcement agencies under 6103 section (l)(8), but is making disclosures to the federal Office of Child Support Enforcement (OCSE) on behalf of IRS. OCSE provides the names and, if known, Social Security numbers. SSA performs computer matches and provides Social Security numbers from SSA records, the last known address from SSA records, and the address of the last known employer

[1]IRC section 6103(l)(6) also permits IRS to disclose certain taxpayer information to federal agencies, such as the Office of Child Support Enforcement—a federal agency that oversees child support enforcement at the federal level and acts as a coordinator for most programs involved with child support enforcement.

from W-2 and W-3 taxpayer information. OCSE then provides the information to the state and local child support enforcement agencies. Table IV.2 shows the other types of taxpayer information disclosed and the disclosure format and frequency.

Table IV.2: Disclosure to State and Local Child Support Enforcement Agencies

Taxpayer information provided	Format	Frequency
Taxpayer addresses	Tape	Weekly
Individual income tax return information (Social Security number, filing status, amount and nature of income, number of dependents)	Tape	Monthly

Source: IRS' Office of Safeguards.

Under IRC section 6103(l)(7), disclosures can be made to state and local agencies administering certain programs under the Social Security Act, the Food Stamp Act of 1977, title 38 U.S.C., or certain other housing assistance and benefits programs. The Deficit Reduction Act of 1984 required state public assistance agencies administering certain programs under the Social Security Act[2] or the Food Stamp Act of 1977[3] to establish an income eligibility verification system. These agencies receive federal taxpayer information under the authority of the IRC 6103(l)(7) from SSA and IRS to be used solely for the purpose of, and to the extent necessary in, determining eligibility for, or the correct amount of benefits,under, the specified programs. The agencies receive wage and self-employment information from SSA through electronic transmissions and unearned income information (Form 1099s) from IRS through magnetic tapes.

Table IV.3 shows the type of information disclosed and the disclosure format and frequency.

Table IV.3: Disclosure to State and Local Welfare Agencies

Taxpayer information provided	Format	Frequency
Taxpayer addresses	Tape	Weekly
Individual income tax return information (Social Security number, filing status, amount and nature of income, number of dependents)	Tape	Monthly

Note: Data from SSA regarding Social Security payments are not considered taxpayer information because they are derived from SSA records. Wages obtained from W-2s/W-3s and self-employment income and other income data received from IRS are taxpayer information.

Source: IRS' Office of Safeguards.

[2] Temporary Assistance for Needy Families and Medicaid are the programs commonly administered by state public assistance agencies.

[3] The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 states that "Notwithstanding any other provision of law, in carrying out the food stamp program, a State agency shall not be required to use an income and eligibility or an immigration status verification system . . . ."

Possible Uses for Federal Taxpayer Data Provided to Federal, State, and Local Agencies

Internal Revenue Code (IRC) section 6103 is very specific about the authorized use of any federal taxpayer data. During our study, Internal Revenue Service (IRS) officials and other federal and state officials indicated that there are many possible authorized uses for tax returns and return information in accordance with IRC section 6103 requirements. Agency officials stated that taxpayer information is used for tax administration and law enforcement purposes, for the administration of federal laws not related to tax administration, for statistical uses, for establishing and collecting child support obligations, and for determining eligibility for benefits. Table V.1 outlines some of the specific uses of federal taxpayer information.

Table V.1: Possible Uses of Taxpayer Information by Federal, State, and Local Agencies

Agency	Possible use
Federal	Tax administration and tax withholding purposes
	Criminal investigation and litigation
	Reporting criminal activities
	Judicial or administrative procedures
	Enforce federal criminal or civil statutes
	Locate fugitives from justice
	Conducting government program audits
	Statistical purposes
	Offsets
	Storing and maintaining data for IRS
	Administration of welfare and public assistance programs
	Collection and enforcement of child support
State and local	Verify taxpayer filed original or amended return and initiate state audit
	Initiate state penalty investigation
	Audit selection
	Provide listing of alleged violators of criminal tax laws
	Verify or update addresses
	Skip tracing
	Sales tax matching
	Identify nonfilers
	Determine discrepancies in reporting of income
	Identify S corporation shareholders who avoid state tax by taking dividends in lieu of wages
	Statistical and revenue forecasting
	Identify payers and employers not reporting to state and determine underreporters
	Identify partnerships with changes in number of partners to detect possible sale of partnership interest
	Compare officers' salaries and total wages paid on corporate returns to withholding tax filed
	Compare federal tax withheld to state tax withheld
	Locate delinquent taxpayers
	Identify out-of-state income

(Continued)

Agency	Possible use
State and local	Motor fuels, estate, and gift tax enforcement
	Unearned income matching
	Provide income information for collection purposes
	Administration of welfare and public assistance programs
	Offsets
	Collection and enforcement of child support
	Civil and criminal investigation and litigation

Source: IRS' Office of Safeguards.

Summary of Tax Information Security Guidelines for Federal, State, and Local Agencies

As a condition of receiving taxpayer information, agencies must show, to the satisfaction of the Internal Revenue Service (IRS), that their policies, practices, controls, and safeguards adequately protect the confidentiality of the taxpayer information they receive from IRS. The agencies must ensure that the information is used only as authorized by statute or regulation and disclosed only to authorized persons. IRS has implemented specific guidelines that all federal, state, and local agencies are to follow to properly safeguard taxpayer information. These guidelines, outlined in IRS Publication 1075, Tax Information Security Guidelines for Federal, State and Local Agencies, are summarized below.

Requesting Taxpayer Information

Federal, state, and local agencies, and other authorized recipients, may request taxpayer information from IRS in the form of a written request signed by the head of the requesting agency or other authorized official. IRS also requires that a formal agreement—a Safeguard Procedures Report—be provided by the agency that specifies the procedures established and used by the agency to prevent unauthorized access and use and describes how the information will be used upon receipt. The Safeguard Procedures Report should be submitted to IRS at least 45 days before the scheduled or requested receipt of taxpayer information.

Any agency that receives taxpayer information for an authorized use under Internal Revenue Code (IRC) section 6103 may not use the information in any manner or for any purpose not consistent with that authorized use. If an agency needs federal tax information for a different authorized use under a different provision of IRC section 6103, a separate request under that provision is necessary. An unauthorized secondary use is specifically prohibited and may result in discontinuation of disclosures to the agency and in the imposition of civil or criminal penalties on the responsible officials.

Before granting agency officers and employees access to taxpayer information, officers and employees should certify that they understand security procedures and instructions requiring their awareness and compliance. Employees should be required to maintain their authorization to access taxpayer information through annual recertification. As part of the certification and at least annually, employees should be advised of the provisions of IRC 7213(a), 7213A, and 7431.[1] Agencies should make officers and employees aware that disclosure restrictions and the penalties apply even after employment with the agency has ended.

[1] IRC sections that prescribe civil and criminal penalties for unauthorized inspection or disclosure.

Taxpayer information may be obtained by state tax agencies from IRS only to the extent the information is needed, and is reasonably expected to be used, for state tax administration. Some state disclosure statutes and administrative procedures permit access to state tax files by other agencies, organizations, or employees not involved in tax matters. IRC 6103(d) does not permit access to taxpayer information for purposes other than for state tax administration.

State and local tax agencies are not authorized to furnish taxpayer information to other state agencies, tax or nontax, or to political subdivisions, such as cities or counties, for any purpose, including tax administration. State and local tax agencies may not furnish taxpayer information to any other states, even where agreements have been made, informally or formally, for the reciprocal exchange of state tax information. Also, nongovernment organizations, such as universities or public interest organizations performing research, cannot have access to taxpayer information.

Statutes that authorize disclosure of taxpayer information do not authorize further disclosures. Unless IRC section 6103 provides for further disclosures by the agency, the agency cannot make such disclosures. Each agency must have its own exchange agreement with IRS or with the Social Security Administration (SSA). When an agency is receiving data under more than one section 6103 authorization, each exchange or release of taxpayer information must have a separate agreement.

An agency's records of the taxpayer information it requests should include some account of the result of its use or why the information was not used. If an agency receiving taxpayer information on a continuing basis finds it is receiving information that, for any reason, it is unable to utilize, it should contact IRS to modify the request.

Recordkeeping Requirements

Federal, state, and local agencies authorized under IRC section 6103 to receive taxpayer information are required by IRC section 6103 (p)(4)(A) to establish a permanent system of standardized records of requests made by or to them for disclosure of the information. The records are to be maintained for 5 years or for the applicable records control schedule, whichever is longer.

When taxpayer information is received in electronic form, authorized employees of the recipient agency must be responsible for securing magnetic tapes or cartridges before processing and ensuring that the proper acknowledgment form is signed and returned to IRS. Tapes containing federal taxpayer information, any hard-copy printout of a tape, or any file resulting from the processing of a tape is to be recorded in a log that identifies (1) date received; (2) reel or cartridge control number contents; (3) number of records; (4) movement; and (5) if disposed of, the date and method of disposition.

Taxpayer information, other than that in electronic form, must be maintained by (1) taxpayer name; 2) tax year(s); (3) type of tax return or return information; (4) reason for the request; (5) date requested; (6) date received; (7) exact location of the taxpayer information; (8) who has had access to the data; and (9) if disposed of, the date and method of disposition.

If the agency has the authority to make further disclosures, information disclosed outside the agency must be recorded on a separate list that reflects to whom the disclosure was made, what was disclosed, and why and when it was disclosed.

Secure Storage

IRS has categorized taxpayer and privacy information as high-security items. Security for a document, item, or an area may be provided by locked containers of various types, vaults, locked rooms, locked rooms with reinforced perimeters, locked buildings, guards, electronic security systems, fences, identification systems, and control measures. The required security for taxpayer information received depends on the facility, the function of the agency, how the agency is organized, and what equipment is available.

Agencies receiving taxpayer information are required to establish a uniform method of protecting data and items that require safeguarding. The Minimum Protection Standards System, which is utilized by most agencies, has been designed to provide agencies with a basic framework of minimum-security requirements. Since some agencies may require additional security measures, they should analyze their individual circumstances to determine the security needs at their facility.

Care must be taken to deny access to areas containing taxpayer information during normal working hours. This can be accomplished by restricted areas, security rooms, or locked rooms. In addition, taxpayer information in any form (computer printout, photocopies, tapes, notes, etc.) must be protected during nonworking hours. This can be done through a combination of methods, including a secured or locked perimeter or secured area.

When it is necessary to move taxpayer information to another location, plans must be made to properly protect and account for all of the information. Taxpayer information must be in locked cabinets or sealed packing cartons while in transit. Accountability should be maintained to ensure that cabinets or cartons do not become misplaced or lost.

The handling of taxpayer information and tax-related documents must be such that the documents do not become misplaced or available to unauthorized personnel. Only those employees who have a need to know and to whom disclosures may be made under the provisions of the statute should be permitted access to information.

In the event that taxpayer information is hand-carried by an individual in connection with a trip or in the course of daily activities, it must be kept with that individual and protected from unauthorized disclosure.

Data stored and processed by computers and magnetic media should be physically secured and controlled in a restricted access area. If the confidentiality of the taxpayer information can be adequately protected, alternative work sites, such as employees' homes or other nontraditional work sites, can be used. Despite location, taxpayer information remains subject to the same safeguard requirements and the highest level of attainable security.

Restricting Access to Taxpayer Information

Agencies are required by IRC 6103(p)(4)(C) to restrict access to taxpayer information only to persons whose duties or responsibilities require access. Taxpayer information should be clearly labeled "federal tax information" and handled in such a manner that it does not become misplaced or available to unauthorized personnel.

Access to taxpayer information must be strictly on a need-to-know basis. Information must never be indiscriminately disseminated, even within the recipient agency. Agencies must evaluate the need for taxpayer information before the data are requested or disseminated.

An employee's background and security clearance should be considered when designating authorized personnel. No person should be given more taxpayer information than is needed to perform his or her duties.

To avoid inadvertent disclosures, it is recommended that taxpayer information be kept separate from other information to the maximum extent possible. In situations where physical separation is impractical, the file should be clearly labeled to indicate the taxpayer information is included and the file should be safeguarded. Any commingling of data on tapes should be avoided.

Processing of taxpayer information in magnetic media format, microfilms, photo impressions, or other formats should be performed by agency-owned and -operated facilities, or contractor or agency shared facilities.

All systems that process taxpayer information must meet the provisions of OMB Circular A-130, appendix III and Treasury Directive Policy 71-10. The Department of Defense Trusted Computer System Evaluation Criteria (DOD 5200.28-STD), commonly called the "Orange Book," should be used as the basis for establishing systems that process taxpayer information.

All computer systems processing, storing, and transmitting taxpayer information must have computer access protection controls (controlled access protection level C-2). To meet C-2 requirements, the operating security features of the system must have (1) a security policy, (2) accountability, (3) assurance, and (4) documentation. Agencies should assign overall responsibility to an individual (security officer) who is knowledge about information technology and applications. This individual should be familiar with technical controls used to protect the system from unauthorized entry.

The two acceptable methods of transmitting taxpayer information over telecommunications devices are encryption and the use of guided media. Encryption involves the altering of data objects in a way that the objects become unreadable until deciphered. Guided media involves the use of protected microwave transmissions or the use of end-to-end fiber optics.

Connecting the agency's computer system to the Internet will require "firewall" protection to reduce the threat of intruders accessing data files containing taxpayer information.

Agencies receiving taxpayer information from IRS are also required to conduct internal inspections. The purpose of these inspections is to ensure that adequate safeguard and security measures are maintained. Agencies should submit copies of these inspections to IRS with their annual Safeguard Activity Report.

Safeguard Reporting and Review Requirements

IRC section 6103 (p)(4)(E) requires agencies receiving taxpayer information to file a report that describes the procedures established and used by the agency for ensuring the confidentiality of the information received from IRS. The Safeguard Procedures Report is a record of how taxpayer information is to be processed and protected from unauthorized disclosure. Agencies should submit a new Safeguard Procedures Report every 6 years or whenever significant changes occur in their safeguard program.

Agencies must file an annual Safeguard Activity Report, which advises IRS of changes to the procedures or safeguards described in the Safeguard Procedures Report. The Safeguard Activity Report also (1) advises IRS of any future actions that will affect the agency's safeguard procedures, (2) summarizes the agency's current efforts to ensure the confidentiality of the taxpayer information, and (3) certifies that the agency is protecting taxpayer information in accordance with IRC section 6103 requirements and the agency's own security requirements.

A safeguard review is an on-site evaluation of the use of federal tax information received from IRS and the measures used by the receiving agency to protect that data. IRS conducts on-site reviews of agency safeguards regularly. Reviews of state and local agencies are conducted by IRS District Disclosure personnel. Reviews of federal agencies and state welfare agencies are conducted by the IRS Office of Governmental Liaison and Disclosure, Office of Safeguards.

IRS safeguard reviews cover the six requirements of IRC section 6103(p)(4), which are (1) recordkeeping, (2) secure storage, (3) restricting access, (4) other safeguards, (5) reporting requirements, and (6) disposal.

Disposal of Taxpayer Information

Agencies are required by IRC section 6103(p)(4)(F) to take certain actions upon completion of their use of taxpayer information in order to protect its confidentiality. Agency officials and employees should either return the information, and any copies, or make the information "undisclosable" and include in the agency's annual report a description of the procedures used. If the agency elects to return the information, a receipt process should be used. Taxpayer information should never be provided to agents or contractors for disposal unless authorized by the IRC.

Examples of Deficiencies Found During IRS' Reviews of Agencies' Safeguarding Procedures

The Internal Revenue Service (IRS) routinely conducts on-site reviews of agencies' safeguard procedures to ensure that the procedures fulfill IRS requirements for protecting taxpayer information from unauthorized disclosure. After completing the review, IRS prepares a report of its findings and recommendations and sends the report to the agency for comment. Upon receiving the agency's comments, IRS annotates its report to indicate whether it accepts responses as correcting any discrepancies reported.

Case Examples

The following excerpts are examples of the findings, discussions, recommendations, agency responses, and IRS comments found in recent IRS reports of safeguard reviews.

Case One

Finding

The agency permitted a number of contractors to have access to return information. Some of the contractors are authorized to have access, while others are not. Also, when contractor access was authorized, the agency was not always including "safeguarding" clauses in all contracts.

Discussion

The agency uses hundreds of contractors. Internal Revenue Code (IRC) section 6103 generally does not authorize contractors to have access to federal taxpayer information. Certain exceptions exist, such as section 6103(n), which permits contracts for tax administration purposes, and section 6103(m)(2) and (7), which permit disclosures for the collection of federal debt and for the mailing of personal earnings and benefits estimate statements, respectively. However, there is not an exception for the purposes of administering the agency responsibilities under the act, nor for most other IRC section 6103 authorized disclosures.

The agency uses contractors for the printing of the personal earnings and benefits estimate statements and has included a "safeguarding" clause, which requires that the contractor's employees be made aware of the taxpayer information, its restricted access and use, and the penalty provisions for unauthorized access or use. The agency also uses a contractor for developing microfilm with taxpayer information. This contractor is authorized access, but the contract does not contain "safeguarding" language relating to taxpayer information. It does have confidential clauses relating to the Privacy Act provisions.

The agency has also contracted out for the disposal of the paper Form W-2s and W-3s received. An earlier contract allowed for the contractor to shred the material to 2-inch strips or less, which does not meet the IRS required standard of 5/16-inch or less for shredding. The current contract states that all material will be totally destroyed beyond legibility or reconstruction through shredding, maceration, or pulping. However, a visit to the contractor's site revealed that the contractor is shredding material, but not always to the original 2-inch requirement. The required "safeguarding" clauses are not in the contract, and the employer is not advising his employees of the confidentiality and penalties associated with accessing taxpayer information.

Many other storage, retrieval, and disposal activities are contracted out by the agency. Two units of the agency use contractors to conduct most of the activities at their facilities, where beneficiary files (with taxpayer information) are stored in open boxes. This is also true of the records center that the agency contracts with to store, dispose of, and retrieve millions of beneficiary files. Other units of the agency are also contracting out for disposition of information. IRC section 6103 does not authorize these contractors to have access to taxpayer information, which they do.

Recommendation

In order to comply with IRC section 6103 and with IRS standards, the agency needs to review its use of contractors. When contractors are authorized to have access to taxpayer information, the agency needs to ensure that "safeguarding" clauses are included in the contracts. When contractors are not authorized access to this information, the agency needs to ensure that it is not permitting such access. Specific examples include

- adding the safeguarding clauses to the microfilm development contract;
- adding the safeguarding clauses to the contract for the disposal of paper return information, mainly W-2s and W-3s;
- ensuring that disposal methods meet IRS standards;
- developing policies and procedures to ensure that contractors who are not authorized to have access do not have access; and
- making units and field offices aware of "unauthorized access" by contractors.

Agency Response

The agency agreed that safeguarding clauses need to be included in contracts when contractors are authorized to have access to taxpayer information and that contractors should not have access unless authorized.

IRS Comment

IRS was still being reviewing this agency's safeguard report and had not finalized its comments at the time we prepared our report.

Case Two

Finding

The recordkeeping system at the agency's field offices does not meet all of the statutory requirements for tax information accountability.

Discussion

When federal tax returns or return information are received, agencies are required to maintain a record of

- taxpayer name,
- tax year(s),
- type of information,
- reason for request,
- date requested,
- date received,
- exact location of data, and
- who has had access to the data.

Further, if and when the data are disposed of, agencies are required to maintain a record of the date and method of disposition.

Agency field offices maintain a system of records for tracking documents and evidence obtained during a criminal investigation. Returns and return information are generally placed in an evidence envelope and associated with the case files, which are kept in the office's filing area. The envelope is annotated as to contents and any additional descriptive information the case agent may write down. The agency's system of standardized records contained many of the required items listed above, but not all of them. Further, tax documents controlled by the agency's seizure team unit may not necessarily show who has had access to the information.

Recommendation

Since information used to track returns and return information is dependent upon information furnished by the case agent, the agency should ensure that the agents are aware of the elements required to meet the statutory requirements for tracking federal tax data. Also, the seizure team unit may wish to consider using some type of "charge-out" form to record accesses to tax information.

Agency Response

The agency uses a central recordkeeping system for maintaining all investigative files. The system is outlined in the Federal Register. During IRS' review, access to information by the IRS team was limited to the federal tax return and return information contained in the evidence envelope, and not to the entire file. Information regarding the taxpayer name, tax year(s), reasons for request, and data requested is contained in the case file and supplied to IRS during the request for the information. The date received and type of information is maintained in the evidence log. Access to case information is restricted based on the need-to-know and to individuals having a file on the case. Agency procedures used for controlling access to federal tax return and return information within the seizure team unit are the same procedures used for investigative information. Information is restricted to individuals with a role in the asset forfeiture.

IRS Comment

Along with the agency's response, the appropriate Federal Register cite was provided. The agency's response was accepted.

Case Three

Finding

Agency employees that have access to federal tax data are not aware of the criminal and civil penalties that can be imposed for unauthorized disclosure of the data.

Discussion

IRS Publication 1075 requires that, as part of an agency's employee awareness program, each employee that has access to federal tax data should receive copies of IRC sections 7213(a) and 7431, which describe the criminal and civil penalties applicable to the unauthorized disclosure of federal tax data. In addition, employees must be advised at least annually of these provisions. Personnel that IRS' review team talked with could not recall receiving copies of the IRC penalty provisions. Employees receive periodic reminders about protecting sensitive information; however, they are not specifically reminded of the provisions of IRC sections 7213(a) and 7431.

Recommendation

All employees that are authorized to have access to federal tax data should receive a copy of IRC section 7213(a) and 7431, and they should be reminded at least annually of the criminal and civil penalties that can be imposed under the IRC for the unauthorized disclosure of federal tax data.

Agency Response

Although employees were not specifically aware of the penalties for unauthorized disclosure of federal tax data as contained in the IRC, agency employees knew about the penalties for unauthorized disclosure of information contained in investigative files.

IRS Comment

The revised IRS Publication 1075 now contains penalty provisions in exhibits 3 and 4. Along with the agency response, IRS received a copy of Security Bulletin 96-03 with attachments A-2 and A-3, with instructions that the information in the document be reviewed annually by all personnel who have access to tax return and return information provided to the agency by IRS. Observance of Security Bulletin 96-03 will satisfy the IRS requirement.

Case Four

Finding

The last Safeguard Activity Report for this agency was dated June 29, 1995—2 years before the review. Also, the report did not contain the information as required in IRS Publication 1075. Additionally, IRS records showed the last Safeguard Procedures Report was submitted in 1988.

Discussion

The statute requires reports to be furnished to IRS describing the procedures established and utilized to ensure the confidentiality of tax data received from IRS. After the submission of the Safeguard Procedures Report, a written Safeguard Activity Report is to be submitted annually to give information regarding the agency's safeguard program. The Safeguard Procedures Report should be updated as changes occur, and a new report submitted when warranted.

Recommendation

A Safeguard Activity Report must be submitted to IRS no later than January 31 each year. The report must contain the required information as shown in IRS Publication 1075. Because of changes within the agency since 1988, a current Safeguard Procedures Report was requested.

Agency Response

The agency responded that it would comply with all reporting requirements. It assigned its internal audit unit the annual inspection as required by IRS Publication 1075 and planned to submit the Safeguard Activity Report. The agency submitted an updated Safeguard Procedures Report.

IRS Comment

IRS accepted the response, but explained to the agency that the Safeguard Procedures Report was not a "one-time" report and that it should be updated as changes occur and a new one submitted when warranted. IRS requested that a revised version be submitted reflecting changes made as a result of IRS' review.

Case Five

Finding

The agency's records did not list some employees who were receiving and using taxpayer information to determine Medicaid eligibility.

Discussion

The Deficit Reduction Act of 1984 requires states to have an income and eligibility verification system for use in administering certain benefits programs. State welfare agencies are required to obtain and use unearned income data from IRS and other wage and income data from SSA in the verification process of these benefits programs. Accordingly, IRC section 6103 authorizes the disclosure of taxpayer information to federal, state, and local agencies by IRS or SSA for use in the administration of these benefits programs. As a condition of receiving taxpayer information, state welfare agencies are required to maintain a permanent system of standardized records that documents all requests for, receipt of, and disclosures of taxpayer information made to or by the agencies.

During its review of this agency, IRS found that, while some employees acknowledged using taxpayer information, the agency's records did not list the employees as having received taxpayer information. IRS found that taxpayer information, in the form of a printout, was being disclosed to Medicaid technicians who are stationed at various state hospitals. The technicians receive the information to determine Medicaid eligibility for applicants who were hospitalized. Upon receipt from the agency's mailroom, the printout is accompanied by an acknowledgment form that employees must sign, indicating receipt of taxpayer information. IRS found that technicians were properly signing the acknowledgment form and returning it to the mailroom to indicate receipt of the information. However, the agency's records did not reflect that taxpayer information was being disclosed from the agency to its employees located at these various state hospitals.

Recommendation

The state hospitals that get taxpayer information should be included so that the agency's records reflect a complete and accurate listing of all requests, receipts, and disclosures of taxpayer information.

Agency Response

The Medicaid technicians are stationed at the state hospitals at various times. For this reason, any disclosure of taxpayer information to these hospitals will be managed by an agency coordinator. To improve recordkeeping, the coordinator will provide a listing of the disclosures, and this list, along with the agency acknowledgment forms, will be maintained in the standardized records. The General Services Mail and Distribution Manager will ensure that the records are received.

IRS Comment

Agency's response was acceptable.

Other Deficiencies

Table VII.1 summarizes some of the other deficiencies found during IRS' on-site safeguard reviews of federal, state, and local agencies.

Table VII.1: Examples of Agency Deficiencies Found During IRS' Safeguard Reviews

General category	Specific deficiency noted
Maintaining system of standardized records	No system exists for ensuring that all keys to secure areas are accounted for or that access to keys is restricted.
	No records exist of when taxpayer information was received and destroyed, or of how the information was destroyed.
Maintaining secure storage	Taxpayer information locked in the supervisor's office, but not in locked containers or file cabinets, which would properly protect the information from inadvertent or unauthorized disclosure.
	Agency mailroom not secure during nonduty hours, and employees are leaving taxpayer information unsecured, in unlocked containers.
	No reconciliation of transmittal documents to actual receipts and shipments of federal return information.
	There was not adequate protection for tax information. There was no agency requirement that containers be locked, and some containers cannot be locked.
	There was not a specific individual responsible for physical security.
Restricting/limiting access	Ground floor entrances were not locked during office hours, and there was a need for "Employee Only" signs.
	IRS tapes and income and eligibility verification system documents were transported via unsecured courier service.
	Tax information was combined with nontax information and accessible by other employees not directly involved in program.
	Several federal tax documents were found that were not labeled as such.
	Agency was sharing taxpayer information with other state agencies and contractors that are not authorized to receive information.
Disposal of taxpayer information	Agency was using an unauthorized method of destroying taxpayer information.
	Existing procedures for repairs to equipment do not appear to address removal of federal return information before repairs are made.
	Agency was not utilizing proper destruction procedures for taxpayer information that is no longer being used.
Computer security	Computer systems containing tax information do not display warning banners reminding employees of safeguarding requirements and associated penalties.
	Agency was not promptly removing from the system employees that no longer needed access to taxpayer information.
	Taxpayer data was not transmitted through secure communication lines to prevent unauthorized use or access.
	Unsecured dial-in modems were being used for taxpayer information on agency systems, and information on the mainframe was not adequately restricted.
Other safeguards	Employees were not properly trained on all aspects of safeguarding tax information. Some were not aware of the civil and criminal penalties associated with unauthorized disclosure or of the Taxpayer Browsing Act.
	Internal security inspections were not conducted, or the results were not documented. There was no documentation of corrective actions, if any were taken.
	The agency needs to post signs and send memos to remind employees of their responsibility to safeguard federal tax information.

Source: IRS Office of Safeguards.

Staffing Levels for IRS' Office of Safeguards

Listed below are the staffing levels, as of June 1999, for IRS' national and district offices that are responsible for IRS' safeguarding program. In addition to overseeing the safeguarding program, the district offices have responsibilities for a variety of other disclosure activities. These activities include, among other things, conducting disclosure awareness seminars for state and local agency personnel, processing Freedom of Information Act and Privacy Act requests, processing ex parte orders for grand jury or federal criminal investigations, testifying in federal court to certify that certain documents are true copies of tax return information, and reviewing subpoenas served to IRS personnel to advise them of what they can and cannot disclose in court.

		Number of staff		
	Office	**Professional**	**Support**	**Total**
	National Office of Safeguards	12		**12**
I	**Midstates Region**	3		**3**
1	Arkansas-Oklahoma District	4	1	**5**
2	Houston District[a]	5		**5**
3	Illinois District	9	2	**11**
4	Kansas-Missouri District	7	1	**8**
5	Midwest District	11	2	**13**
6	North Central District	8		**8**
7	North Texas District[a]	6	1	**7**
8	South Texas District	5	1	**6**
	Regional subtotal	**58**	**8**	**66**
II	**Northeast Region**	3		**3**
9	Brooklyn District[a]	4		**4**
10	Connecticut-Rhode Island District	4		**4**
11	Manhattan District	3	1	**4**
12	Michigan District	5		**5**
13	New England District	9		**9**
14	New Jersey District	4	1	**5**
15	Ohio District	5		**5**
16	Pennsylvania District	6	1	**7**
17	Upstate New York District	4	1	**5**
	Regional subtotal	**47**	**4**	**51**
III	**Southeast Region**	4		**4**
18	Delaware-Maryland District	7	1	**8**
19	Georgia District	5	1	**6**
20	Gulf Coast District	8	1	**9**
21	Indiana District	4		**4**
22	Kentucky-Tennessee District	6	1	**7**
23	North Florida District	5		**5**
24	North-South Carolina District	5	1	**6**
25	South Florida District[a]	4	1	**5**
26	Virginia-West Virginia District	5		**5**
	Regional subtotal	**53**	**6**	**59**
				(Continued)

	Office	Number of staff: Professional	Support	Total
IV	**Western Region**	3		**3**
27	Central California District	6	1	**7**
28	Los Angeles District	6	1	**7**
29	Northern California District	11	2	**13**
30	Pacific-Northwest District	10	1	**11**
31	Rocky Mountain District	9	1	**10**
32	Southern California District	8		**8**
33	Southwest District	7		**7**
	Regional subtotal	**60**	**6**	**66**
	Total	**230**	**24**	**254**

[a]Not responsible for any safeguard review activities.

Source: IRS' Office of Safeguards.

Questionnaires Used to Survey Federal, State, and Local Agencies Receiving Taxpayer Information

Figure IX.1: Survey of Federal Agencies Receiving Taxpayer Data

1. Agency

2. Department/Unit

	3. IRC 6103 authorization under which tax data is received/used (Check all that apply. Also, see page 3 for definitions)									**4. Format of data received** (Check all that apply)				**5. Frequency of data received** (Check one)				
Year	6103 (d)	6103 (f)	6103 (h)	6103 (i)	6103 (j)	6103 (l)	6103 (m)	6103 (o)	Other	Paper copy	Database	Tape extracts	Other	Once a year	Quarterly	Monthly	Weekly	Other
1998																		
1997																		

Explanations of "Other" category:	
Authorization:	
Format of data:	
Freq. received:	

6. Please descibe specifically how and for what purposes your department/unit uses the taxpayer data received from IRS.

7. In lieu of using taxpayer data, what other source(s) of data are available which would allow you to accomplish the same purposes? Please explain.

8. Have you researched other possible data sources that you could use? Please explain.

9. If your department/unit did not receive any taxpayer data in 1998 or 1997, when was the last time you did receive such data?	**Year**

10. Date of last Safeguard Procedures Rpt.	**11. Date of last Safeguard Activity Report**	**12. Safeguard reviews by IRS**			
		Date of last on-site visit	**Date of draft report**	**Date of final report**	**Next review scheduled**

13. Date of previous safeguard review by IRS (before the one noted in Q. 12 above)	**Date of last on-site visit**	**Date of final report**

14. Please describe any safeguard discrepencies or violations that have been noted during inspections (either internal or external) over the last three years and what was done to correct these problems.

	Yes	**No**
15. Has your unit been given all of the taxpayer data necessary for it to carry out its responsibilities?		
If, no, please explain what other taxpayer data is needed that you have not been given.		

	Yes	**No**
16. Has your unit had a need for all of the taxpayer data that it has been given?		
If no, please explain what taxpayer data you have been given that is not used by your unit.		

Name and phone number of contact if clarification is needed:	
Name:	
Title:	
Phone No.:	

Thank you very much for completing this survey. Please fax it to Tim Outlaw at (202) 512-9096 or (202) 512-3497.

61-878 00 - 13

Figure IX.2: Survey of State and Local Agencies Receiving Taxpayer Data

1. Agency	
2. Department/Unit	

	3. IRC 6103 authorization under which tax data is received/used (Check all that apply. Also, see page 3 for definitions)									**4. Format of data received** (Check all that apply)				**5. Frequency of data received** (Check one)				
Year	6103 (d)	6103 (f)	6103 (h)	6103 (i)	6103 (j)	6103 (l)	6103 (m)	6103 (o)	Other	Paper copy	Database	Tape extracts	Other	Once a year	Quarterly	Monthly	Weekly	Other
1998																		
1997																		

Explanations of "Other" category:	
Authorization:	
Format of data:	
Freq. received:	

6. Please descibe specifically how and for what purposes your department/unit uses the taxpayer data received from IRS.

7. In lieu of using taxpayer data, what other source(s) of data are available which would allow you to accomplish the same purposes? Please explain.

8. Have you researched other possible data sources that you could use? Please explain.

9. If your department/unit did not receive any taxpayer data in 1998 or 1997, when was the last time you did receive such data?	Year

10. Date of last Safeguard Procedures Rpt.	11. Date of last Safeguard Activity Report	12. Safeguard reviews by IRS			
		Date of last on-site visit	Date of draft report	Date of final report	Next review scheduled

13. Date of previous safeguard review by IRS (before the one noted in Q. 12 above)	
Date of last on-site visit	Date of final report

14. Need and use reviews by IRS	
Date of last on-site	Date of final report

15. Please describe any safeguard discrepencies or violations that have been noted during inspections (either internal or external) over the last three years and what was done to correct these problems.

	Yes	No
16. Has your unit been given all of the taxpayer data necessary for it to carry out its responsibilities?		

If, no, please explain what other taxpayer data is needed that you have not been given.

	Yes	No
17. Has your unit had a need for all of the taxpayer data that it has been given?		

If no, please explain what taxpayer data you have been given that is not used by your unit.

Name and phone number of contact if clarification is needed:

Name:	
Title:	
Phone No.:	

Thank you very much for completing this survey. Please fax it to Tim Outlaw at (202) 512-9096 or (202) 512-3497.

Comments From the Internal Revenue Service

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

CHIEF OPERATIONS OFFICER

August 16, 1999

Ms. Cornelia M. Ashby
Associate Director, Tax Policy and Administration Issues
United States General Accounting Office
Washington, D.C. 20548

Dear Ms. Ashby:

Thank you for the opportunity to review and comment on your recent draft report entitled "Taxpayer Confidentiality: Federal, State, and Local Agencies Receiving Taxpayer Information." We are pleased to have worked with your staff as the study progressed. This includes not only your sharing of information during your data gathering but also allowing us to review advanced sections of the report for technical accuracy. The result of this partnering approach is a report that provides valuable information on the Internal Revenue Service's (IRS) administration of disclosure practices and safeguards of taxpayer information.

At the closeout conference, we had the opportunity to provide your staff with our technical comments. We appreciate your consideration of these points.

We fully support the General Accounting Office as they work to produce information required by both the Joint Committee on Taxation and the Secretary of the Treasury as they undertake a study of the scope and use of section 6103 provisions regarding taxpayer confidentiality. We believe that this study, a requirement of section 3802 of the IRS Restructuring and Reform Act of 1998, will show that the IRS has taken quite seriously its mandate to provide tax information where authorized and to assure the confidentiality of that information as required by the provisions of Internal Revenue Code 6103.

If you have any questions, please call me at (202) 622-6860 or Tom Wilson, Assistant Commissioner (Examination), at (202) 622-4400.

Sincerely,

John M. Dalrymple

GAO Contacts and Staff Acknowledgments

GAO Contacts

Cornelia Ashby, (202) 512-9110

Joseph Jozefczyk, (202) 512-9110

Acknowledgments

In addition to those named above, Michelle Bowsky, John Gates, Tim Outlaw, Anne Rhodes-Kline, Kirsten Thomas, and Carrie Watkins made key contributions to this report.

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United States General Accounting Office

GAO

Report to the Joint Committee on Taxation

August 1999

TAX ADMINISTRATION

Few State and Local Governments Publicly Disclose Delinquent Taxpayers

GAO

Accountability * Integrity * Reliability

GAO/GGD-99-165

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Accountability * Integrity * Reliability

United States General Accounting Office
Washington, D.C. 20548

General Government Division

B-282522

August 24, 1999

The Honorable Bill Archer
Chairman
The Honorable William V. Roth, Jr.
Vice Chairman
Joint Committee on Taxation

The Internal Revenue Service Restructuring and Reform Act of 1998 required the Joint Committee on Taxation to study whether greater levels of compliance might be achieved by publicly disclosing taxpayers who have not filed their required federal tax returns. This report provides the information about state and local public disclosure programs that you requested to assist you in your study. Specifically, our objectives were to determine (1) which state and local governments are operating programs to publicly disclose the names of taxpayers that are delinquent in paying the income taxes they owe or do not file income tax returns, (2) the differences, if any, among these programs, and (3) state and local revenue office officials' views on whether their disclosure programs are improving compliance. Because of your interest in the individual programs, we are also providing a description of those programs that we identified in appendix I.

Consistent with your request, in this report we define public disclosure as a process for proactively publicizing the names and other identifying information about taxpayers that are delinquent or do not file returns.[1] Such programs represent a departure from historical practice. As described later in this report, federal and state confidentiality statutes generally prohibit the disclosure of taxpayer information.

Results in Brief

Of the state and local governments we surveyed, only four states—Connecticut, Illinois, Montana, and New Jersey—and the District of Columbia are operating programs to publicly disclose the names and other information about individuals or businesses that are delinquent in paying income taxes. None of the programs include specific provisions for disclosing the names of taxpayers that simply fail to file their required tax returns. Instead, compliance employees are to assess taxes owed by nonfilers they have identified and then process nonfiler accounts in the

[1] As such, these proactive programs can be distinguished from other disclosures, such as a public notice pursuant to a legal action (e.g., when a lien is placed on a taxpayer's property).

same manner as other taxpayers' accounts. In the event that such nonfilers are found to be delinquent, they also become subject to public disclosure.

The five public disclosure programs differ in regard to their legal authority and operations. Like the federal government, the four states and the District of Columbia have tax provisions that protect the confidentiality of taxpayer information. Two states—Connecticut and Illinois—and the District have enacted legislation providing explicit statutory authority for their programs, notwithstanding confidentiality safeguards. The two other states—Montana and New Jersey—have not. Officials from these two states said that they do not need additional statutory authority to implement public disclosure because a tax delinquency is a matter of public record after certain legal action has been taken, such as filing a certification of debt in superior court, which is entered into a judgment docket. The programs also operate differently, varying as to the procedures leading up to disclosure, the media through which disclosure is made, the type of information disclosed, and how often that information is updated.

Revenue office officials from the four states and the District of Columbia believe that their programs have improved or will improve compliance. However, officials are unable to isolate the gain in revenue collections directly attributable to their programs. As they explained, public disclosure is one of many tools that revenue offices use to gain compliance. Some revenue office officials also noted that factors outside the control of their offices—notably, the economy—affect compliance.

Background

Like the Internal Revenue Service, state and local revenue offices have authority to collect taxes from taxpayers that they believe have not paid the taxes they owe, including taxpayers that are delinquent or have not filed their returns. The collection process followed by most revenue offices is phased and generally begins with an assessment of taxes owed. Thereafter, the office has a number of collection tools it can use to obtain compliance, including mailing notices to inform the taxpayer of the taxes that have been assessed and the procedures available for resolving the delinquency.

In the case of taxpayers that do not respond, the revenue office also has other tools at its disposal. These include telephone calls and in-person visits, the placement of a lien on the taxpayer's property, levying the taxpayer's bank accounts, and ultimately the seizure and sale of the taxpayer's property. To resolve delinquencies not resolved using traditional collection tools, revenue offices have experimented with other less traditional tools, including public disclosure programs as defined in this report.

Scope and Methodology

To accomplish our three objectives, we used a combination of surveys and interviews with state and local revenue office officials. Initially, to determine which state and local governments are operating public disclosure programs, we developed a short survey and sent it to all 50 states. We asked officials from revenue offices in each state whether they had such a program or knew of any local governments operating a disclosure program in their state. Because these officials identified no local governments with public disclosure programs, we used the 1998 State Tax Guide to identify cities and counties that had a local personal or corporate income tax, and thus potentially might be operating a program.

As agreed with the Committee, we used this information to select no more than five cities and five counties per state, using population size—starting with the largest—as our criterion. The group included 24 cities and 8 counties in 12 states and the District of Columbia.[2]

Appendix II provides a list of the cities and counties we surveyed. We then sent surveys, which were virtually identical to the ones sent to states, to these governments. The response rate for surveys of states, cities, and counties was 100 percent.

To determine the differences among the programs and the views of state and local officials on whether the programs are improving compliance, we conducted structured interviews by phone or in-person with officials from revenue offices in the jurisdictions that reported having public disclosure programs. To provide the most complete information possible, we also interviewed officials from jurisdictions reporting that they had discontinued or were planning to adopt a program.

We did not verify the survey responses provided by the state and local revenue offices. The results of our survey of cities and counties may not be representative because we used a judgmental sample, focusing on the largest cities and counties. Also, as requested by the committee, we are not making any recommendations in this report.

[2]We eliminated cities and counties, such as Baltimore, Maryland, that had a piggyback tax, i.e., income tax collected by the state and distributed to local governments. We also eliminated cities and counties that have authority to levy an income tax but did not, including cities and counties in Arkansas, Georgia, and Virginia.

We requested and received comments on the descriptions of each state and the District of Columbia's disclosure program from cognizant revenue office officials, and we incorporated their comments where appropriate.

We did our review from March 1999 to July 1999 in accordance with generally accepted government auditing standards.

Public Disclosure Programs Are in Four States and the District of Columbia

As of June 1999, only four states—Connecticut, Illinois, Montana, and New Jersey—and the District of Columbia had programs operating to publicly disclose the names and other information about individuals or businesses that were delinquent in paying income taxes. All of the programs are relatively new. Connecticut's program, the first to be implemented, began disclosing on the Internet in January 1997. The District of Columbia, Montana, New Jersey, and Illinois programs began disclosing on the Internet in October 1997,April 1998, May 1999, and September 1999, respectively.[3] None of the other state and local governments we surveyed had a public disclosure program.

None of the programs publicly disclose the names of taxpayers that fail to file their required tax returns. Instead, revenue office employees assess nonfilers the taxes they owe and process their accounts in the same manner as delinquent taxpayers should the nonfilers be determined to owe taxes. Generally, revenue office employees in the four states and the District of Columbia compare federal and state income tax returns to identify individuals that did not file their state income tax return. Identified individuals are then to be assessed an estimated amount and notified through traditional billing and collections procedures. Should the individual then fail to pay or resolve the assessment, the account is to be processed in the same manner as a delinquent taxpayer's account, which ultimately may include public disclosure.

In response to our survey, officials from Wisconsin and Minnesota reported that public disclosure programs were either being developed or considered. All of the states and the District of Columbia that have or are planning programs told us that they used Connecticut's program as a

[3]The dates shown are when the governments began or planned to begin using the Internet or press releases to proactively disclose the names of delinquent taxpayers. Connecticut had begun preparing a list of delinquent taxpayers beginning in September 1996, which was open for public inspection at the revenue office.

model. Also, Connecticut's tax commissioner told us that 24 other states and five cities had requested information about the state's program.[4]

Officials from North Dakota reported that in September 1995, the state's Department of Revenue published a list of approximately 4,000 taxpayers with unsatisfied liens dating back to 1982. However, they said that this effort was discontinued in January 1997 because of publicity about its many errors, such as including taxpayers that had resolved their liens. Also, North Dakota's newly elected commissioner told us he believed that the disclosure unnecessarily embarrassed taxpayers.

Programs' Legal Authority and Operations Differ

Three of the programs we identified are operating under explicit statutory authority, and two are not. Connecticut, Illinois and the District of Columbia have statutes that explicitly authorize public disclosure of delinquent taxpayers. Connecticut's statute requires tax officials to maintain, and make available for public inspection, a list of delinquent taxpayers. Illinois' statute explicitly states that tax officials may disclose taxpayers that are delinquent in the payment of tax liabilities. Similarly, the District of Columbia's statute grants authority for tax officials to publicly disclose delinquent taxpayers.

New Jersey and Montana do not operate their programs under specific statutory authority. Like the other three jurisdictions, New Jersey and Montana have statutes designed to safeguard the confidentiality of taxpayer information.

For example, New Jersey's confidentiality statute explicitly provides that taxpayer records and files shall be confidential and may not be disclosed. However, according to state officials, another provision allows tax officials to file a certificate of debt in superior court against a taxpayer, which is entered into the judgment docket, thereby making the delinquency a matter of public record. Since the certificate of debt is a public record, revenue office officials said that they have the necessary authority to publicly disclose the information included therein with regard to delinquent taxpayers.

Montana's confidentiality statutes also prohibit the disclosure of taxpayer information. Montana officials told us that another provision provides that after a warrant is filed with the clerk of the district court and included in

[4]These states were Arizona, California, Colorado, Florida, Georgia, Idaho, Indiana, Louisiana, Michigan, Nebraska, Nevada, New Mexico, North Carolina, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Utah, Virginia, Washington, West Virginia, and Wyoming. The cities were Birmingham, AL; Boston, MA; Juneau, AK; Milwaukee, WI; and New York, NY.

the judgment docket, the information becomes a matter of public record and subject to public disclosure on the Internet, newspapers, or any other medium the state may choose.

The programs also operate differently. As shown in table 1, they differ with respect to the procedures leading up to disclosure, the media through which the disclosure is made, the type of information disclosed, and the frequency with which information is updated.

As table I also shows, four of the programs include provisions to send letters to delinquent taxpayers, warning them of impending disclosure if they do not resolve their delinquency.[5] Additionally, the length of time to respond to the warning varies from 10 business days to 60 calendar days; all 5 governments use the Internet, while 3 also use press releases to disclose delinquent taxpayers; the number of taxpayers listed varies from 50 to all that qualify, and the frequency of updates varies from monthly to periodically, as new information becomes available.

Table 1: Differences in Program Operations

	Programs				
Program procedure	**Connecticut**	**District of Columbia**	**Illinois**	**Montana**	**New Jersey**
Warning letter of impending disclosure sent	Yes	Yes	Yes	No	Yes
Days for taxpayers to respond to warning	10 (business)	30 (calendar)	60 (calendar)	Not applicable	14 (business)
Medium of disclosure	Internet, press release and newspaper	Internet	Internet and press release	Internet and press release	Internet
Number of taxpayers disclosed on delinquency list	100	All that qualify	All that qualify	50	200
Disclosure of mailing address	Yes	No	Yes	No	No
Disclosure of court docket number	No	No	No	No	Yes
Disclosure of type of tax	Yes	No	Yes	Yes	No
Disclosure of year(s) of tax liability	No	No	Yes	No	Yes
Frequency of update of delinquency list	Monthly	Periodically	Periodically	Monthly	Monthly

Source: GAO surveys and structured interviews of state and local revenue office officials.

[5]The programs provide that taxpayers can resolve their delinquencies by paying in full or negotiating payment agreements. Taxpayers may also provide evidence that the liability is an error or demonstrate that bankruptcy procedures are in process.

Revenue Office Officials Believe Their Public Disclosure Programs Improve Compliance

Revenue office officials believe that their public disclosure programs improve compliance. They base their views mostly on anecdotal evidence from statistics on accounts receivable and collections. Montana reported that as of June 1999, numerous accounts receivable had been resolved since the program's inception in April 1998. Specifically, Montana said that 18 payment plans had been set up, 23 accounts had been paid in full, and 23 taxpayers had filed their returns. During this time, approximately 150 taxpayers had been disclosed on the Internet. The District of Columbia reported that as of June 1999, it had collected $669,912 from seven taxpayers after they had received warning letters that their names would be disclosed on the Internet. As of June 1999, approximately 150 warning letters had been sent to delinquent taxpayers. Additionally, revenue office officials from Connecticut and the District of Columbia added that they believe public disclosure had a salutary effect on voluntary compliance.

However, the state and District revenue office officials recognized that such statistics were not good indicators of program impact because they do not isolate the effect of public disclosure on accounts receivable and collections. As they explained, public disclosure is one of many tools that revenue offices use to gain compliance. For example, Montana officials noted that at about the same time the first list of delinquent taxpayers was published on the Internet, the state implemented an automatic phone system (the predictive dialer), which enabled collectors to contact a significantly greater number of taxpayers than they were previously able to contact. The collectors were able to contact more taxpayers because the automated phone system makes multiple calls, screening out nonreponses, busy signals, and answering machines, and then directs calls that are answered by the taxpayer to available collectors.

While District of Columbia officials were able to identify payments from taxpayers that had been warned that their names would be published on the Internet if they did not resolve their tax liabilities, they recognized that other factors could have influenced the taxpayers' decision to pay.

None of the revenue offices had undertaken a thorough evaluation of their program. Such an evaluation would be expensive and, as our prior work has shown, isolating the impact of such programs would be difficult.[6] Moreover, revenue office officials from New Jersey and Connecticut said that factors outside of tax administration—notably, the economy—also affect compliance.

[6] Budget Process: Issues Concerning the 1990 Reconciliation Act (GAO/AIMD-95-3, Oct. 1994).

We are sending copies of this report to Representative Charles B. Rangel, Ranking Minority Member, Joint Committee on Taxation, and Senator Daniel P. Moynihan, Ranking Minority Member, Senate Committee on Finance. We are also sending copies to the Honorable Lawrence H. Summers, Secretary of the Treasury; the Honorable Charles O. Rossotti, Commissioner of Internal Revenue; and the Honorable Jacob Lew, Director, Office of Management and Budget; and other interested parties. We will also send copies to those who request them.

If you or your staff have any questions concerning this report, please contact me at (202) 512-9110 or A. Carl Harris, Assistant Director, at (404) 679-1900. Other major contributors to this report are acknowledged in appendix III.

Margaret T. Wrightson

Margaret T. Wrightson
Associate Director, Tax Policy and
Administration Issues

Contents

Profiles of State and Local Governments With Public Disclosure Programs

In this appendix, we describe each of the five public disclosure programs. All the information provided in this appendix was reported by state and local revenue office officials. Other than clarifying this information with the appropriate officials, we did not attempt to validate its accuracy.

Connecticut

In January 1997, the Connecticut Department of Revenue Services began publicly disclosing on the Internet (http://www.state.ct.us/drs/delinq/mart100.html), newspapers, and press releases, the names of Connecticut's top 100 delinquent taxpayers, including businesses and individuals.

Legal Authority

In 1986, section 12-7a of the Connecticut Tax Code was amended to require the tax commissioner to prepare a list of delinquent taxpayers and make it available for public inspection.

Impetus

Revenue office officials told us that the public disclosure program was initiated as a means of applying "social" pressure to encourage people to pay the taxes they owe.

Operating Procedures

Certified letters, return receipt requested, are sent each month to the top 200 delinquent taxpayers (those with the largest accounts that were delinquent for more than 90 days), warning them of impending disclosure on the Internet if they do not resolve their delinquencies within 10 business days. Meanwhile, officials screen the list for taxpayers whose names should not be published.[1] When 10 days have elapsed, officials have 5 days to finalize and narrow the list to the top 100. The information disclosed includes the taxpayer's name, address, amount owed (including penalties and interest), and type of tax owed. It is updated monthly.

Disclosure is discontinued for any of the following reasons:

- taxpayer pays, negotiates a payment agreement, or otherwise resolves the account;
- taxpayer's account has appeared on the Web site for 3 or more consecutive months, and the revenue office has verified that:
  - certified letters have been undeliverable for 3 consecutive months, but not "refused" by the addressee or
  - the account is not collectible for statutory or regulation-based reasons; or

[1] Officials screen taxpayers' names for those who may have voluntarily paid or are in the process of resolving their delinquency, yet such transactions are not yet in the computer system.

- taxpayer's account has appeared on the Web site for 4-6 consecutive months, and revenue officials have verified that bankruptcy proceedings have occurred.

Nonfilers can be included on the list after an assessment is made and the account becomes delinquent. Their accounts are then processed in the same manner as other delinquent accounts and are not identified as nonfilers.

Problems/Complaints

Revenue office officials reported that they have not had any inaccurate disclosures, complaints from taxpayers, or opposition from taxpayers or interest groups.

Effect on Compliance

Revenue office officials told us that since the program's inception, the revenue office had collected $52 million in overdue tax revenues and entered payment agreements totaling $12 million. Revenue office officials said that they could not determine the extent to which public disclosure affected collections because other collection tools could have influenced taxpayers' decisions to pay. Revenue office officials also stated that factors outside the control of their offices, such as the economy, also affect compliance.

Other Tools for Improving Compliance

Revenue office officials reported that they use several tools to gain compliance, such as letters, liens, levies, and seizures. Additionally, Connecticut has used other tools, such as a Tax Amnesty Program, a Voluntary Disclosure Program, and the Nexus Project.[2]

District of Columbia

In October 1997, the District of Columbia's Office of Tax and Revenue began publicly disclosing on the Internet (http://www.dccfo.com/TAXPAYER2.htm) the names of selected uncooperative delinquent taxpayers, including businesses and individuals, who owe more than $10,000.[3]

Legal Authority

In 1947, section 47-1805.4 of the District of Columbia Code was enacted, granting the District authority to disclose delinquent taxpayers.

[2]The Tax Amnesty Program allowed nonfilers to come forth and pay their taxes without penalty. The Voluntary Disclosure Project offers noncompliant taxpayers favorable terms to pay their back taxes. The Nexus Project is an effort to identify and collect the taxes owed by nonresident taxpayers.

[3]In May 1999, 94 taxpayers were listed. This represented all delinquent taxpayers that had been processed to disclosure. The list included two taxpayers who owed less than $10,000, $9,743.48 and $9,749.69, respectively.

Impetus

Revenue office officials told us that the public disclosure program was initiated as another tool to encourage taxpayers to pay the taxes they owe. They also told us that they were impressed with Connecticut's public disclosure program.

Operating Procedures

When an account is delinquent for at least 90 days, a certified letter is sent, warning the taxpayer that failure to work with the Office of Tax and Revenue within 30 days to resolve the delinquency could result in public disclosure. After the disclosure, a copy of the Internet screen is mailed to the delinquent taxpayer. The information disclosed includes the taxpayer's name (including the responsible officer(s) for businesses) and the amount owed. The delinquency list is updated periodically as new information becomes available.

Disclosure is not made (or discontinued if already made) for any of the following reasons:

- taxpayer makes payment arrangements,
- revenue office determines that a mistake was made in calculating the tax,
- taxpayer enters bankruptcy proceedings, or
- taxpayer provides evidence that he is not the responsible officer of a business.

Nonfilers can be included on the list after an assessment is made and their accounts become delinquent. Their accounts are then processed in the same manner as other delinquent accounts and are not identified as nonfilers.

Additionally, the Office of Tax and Revenue publishes a separate list on the Internet of taxpayers it is unable to locate after exhaustive investigation. The public is invited to advise the Office of Tax and Revenue of the whereabouts of these taxpayers.

Effect on Compliance

Revenue office officials told us that they have not conducted an overall evaluation of their disclosure program because of staff limitations. They told us that in fiscal year 1999,[4] the revenue office collected $669,912 after sending warning letters and $70,587 after disclosure on the Internet. However, revenue office officials recognized that other factors could have influenced the taxpayers' decisions to pay.

[4]As of June 1999.

Problems/Complaints

Revenue office officials reported that they were aware of only one instance where inaccurate information was disclosed on their Web site. In this case, an individual was inappropriately identified as the responsible officer of a business. After providing information proving that he was not the responsible officer, the revenue office corrected the mistake. Officials said that they had not received any complaints about the public disclosure program or any opposition from interest groups.

Other Tools for Improving Compliance

The disclosure program is one of many tools the District uses to improve compliance and collect unpaid taxes. Other tools include telephone contacts, letters, liens, and seizures.

Illinois

In September 1999, the Illinois Department of Revenue plans to disclose on the Internet (http://www.revenue.state.il.us/) and through press releases, the names of all delinquent taxpayers, including businesses and individuals, who have final liabilities greater than $10,000 for longer than a period of 6 months.

Legal Authority

Section 39b54 of the Illinois Civil Administration Code, enacted in August 1998, with an effective date of January 1999, provides Illinois' authority for its public disclosure program.

Impetus

Revenue office officials told us that the public disclosure program was initiated to decrease the amount of accounts receivable. The revenue office was also influenced by Connecticut's public disclosure program.

Operating Procedures

Certified letters are sent to those taxpayers with delinquent accounts of at least 6 months, warning them that their names will be published on the Internet if they do not make payment arrangements or resolve their accounts. Taxpayers have 60 days to respond. The information to be disclosed includes the taxpayer's name; amount owed; mailing address; type of tax owed; tax period; and for corporations, the president's name. While the legislation stipulates an annual list, the program administrator said that names will be removed periodically, as accounts are paid, and that new names will be placed on the list only once a year.

Disclosure may be discontinued for any of the following reasons:

- account is paid in full,
- payment arrangements are made,
- old payment agreements are brought into compliance, or
- legal proceedings (i.e., administrative hearings, civil court, or bankruptcy) are under way.

Nonfilers can be included on the list after an assessment is made and their accounts become delinquent. Their accounts are then processed in the same manner as other delinquent accounts and are not identified as nonfilers.

Effect on Compliance

Revenue office officials told us that it is too early to determine the full impact of the program. However, they reported that after sending warning letters to 5,200 delinquent taxpayers since March 1999, $2.9 million had been collected, $918,000 in payment agreements had been made, and $453,000 in accounts receivable were resolved (i.e., the taxpayer demonstrated that amount was not owed).[5]

Problems/Complaints

Revenue office officials reported that they have not had any opposition from interest groups. They have received some letters of complaint from businesses with the same or similar names as delinquent taxpayers.

Other Tools for Improving Compliance

Revenue office officials reported that they use other tools to gain compliance, such as letters, liens, levies, and seizures. Other tools include denying the issuance or renewal of licenses and utilizing private collection agencies.

Montana

In April 1998, the Montana Department of Revenue began publicly disclosing on the Internet (http://www.state.mt.us/revenue/del._tax_accts.html) and through press releases, the names of Montana's top 50 delinquent taxpayer accounts, including businesses and individuals.

Legal Authority

Montana does not have a statute that specifically addresses public disclosure. However, according to Montana officials, section 15-1-704 of Montana's Tax Code allows the department of revenue to file a warrant with the district court to be included in the judgment docket, which makes the delinquency a matter of public record.

Impetus

The public disclosure program was initiated in an effort to improve compliance. Also, revenue office officials told us that they were impressed by Connecticut's public disclosure program.

Operating Procedures

If taxpayers do not pay their taxes within 30 days of the due date, the Department of Revenue notifies the delinquent taxpayer, either by telephone or mail, that unless payment is received within 30 days of the date of the notice, a warrant of distraint may be issued and filed in the district court. The filing of warrants with the clerk of the district court to

[5] As of May 21, 1999.

be included in its judgment docket is the basis of Montana's disclosure program; as such, legal action renders a delinquency a matter of public record. The information disclosed includes the taxpayer's name, city and state of residence, tax type, and amount owed. The information is to be updated monthly.[6]

Public disclosure is discontinued for any of the following reasons:

- payment plan is established,
- return is filed,
- revenue office accepts an offer-in-compromise,
- taxpayer files for bankruptcy, or
- taxpayer is on the list for 6 months.

Nonfilers can be included on the list after an assessment is made and their accounts become delinquent. Their accounts are then processed in the same manner as other delinquent accounts and are not identified as nonfilers.

Effect on Compliance

Since the program's inception, revenue office officials reported that as of June 1999,

- 23 taxpayers paid in full,
- 18 negotiated payment plans,
- 23 filed outstanding returns, and
- 2 filed amended returns.

The revenue office officials told us that they had collected $367,839 as a result of these actions. They recognized that other factors may have contributed to the taxpayers' decisions to pay or resolve their delinquencies. For example, Montana officials noted that at about the same time the first list of delinquent taxpayers was published on the Internet, the state implemented an automatic phone system (the predictive dialer), which enabled collectors to contact a significantly greater number of taxpayers.

Problems/Complaints

Revenue office officials stated that in one instance, inaccurate information was disclosed on the Internet. In that case, the amount of taxes owed was overstated because the tax rate was applied incorrectly. The state has received few complaints from taxpayers and no opposition from interest

[6] The March 1999 listing had not been updated as of July 15, 1999. According to the program administrator, failure to update the Internet listing was an oversight.

groups. One local attorney tried to organize citizens in opposition to the Internet program, but he was unable to gain much support, according to revenue office officials.

Other Tools for Improving Compliance

Revenue office officials reported that they use other tools to gain compliance, including telephone contacts, letters, warrants of distraint (liens), levies, and offers-in-compromise.

New Jersey

In May 1999, the New Jersey Division of Taxation began publicly disclosing on the Internet (http://www.state.nj.us/treasury/taxation/jdgdiscl.htm), the names of New Jersey's 100 businesses and 100 individuals that owe the most.

Legal Authority

New Jersey does not have a provision that expressly authorizes a public disclosure program. According to New Jersey officials, the filing of a certificate of debt under section 54:49-12 forms the basis of New Jersey's public disclosure program. When the clerk files the certificate in the judgment docket, the information contained therein becomes public record.

Impetus

Revenue office officials told us that the public disclosure program was initiated in an effort to collect outstanding tax liabilities. Also, they were influenced by the reported success of Connecticut's public disclosure program.

Operating Procedures

The public disclosure program is not initiated until after standard collection tools are used, including sending the taxpayers a statement of account, bill, notice of assessment, and a letter warning that failure to resolve their delinquency in 30 or 90 days[7] will result in the filing of a certificate of debt. After the certificate of debt is filed, taxpayers may be subject to actions, such as levy, seizure, and/or referral to the Attorney General. Finally, delinquent taxpayers are warned, through certified mail, that failure to resolve their delinquency within 14 days may result in the disclosure of their certificate of debt information on the Internet. The 100 individuals and 100 businesses that owe the most are disclosed. The information disclosed includes the taxpayer's name; trade name (if a business); city; date and amount of the certificate of debt; and the court docket number. The information is updated monthly.

[7]Businesses are given 30 days, while individuals are given 90.

Disclosure is discontinued if the taxpayer

- shows proof of bankruptcy proceedings,
- enters into a deferred payment arrangement or closing agreement, or
- pays all tax liabilities.

Also, taxpayers that have not paid outstanding liabilities or entered into a deferred payment arrangement or closing agreement may be removed to make room for the posting of new names. Such taxpayers may be re-posted at any time until the delinquencies are resolved.

Nonfilers can be included on the list after an estimated assessment is made and a certificate of debt is filed. Their accounts are then processed in the same manner as other delinquent accounts and are not identified as nonfilers.

Effect on Compliance

A revenue office official told us $695,991 had been collected as of July 27, 1999. However, he also stated that it is too soon to quantify the full effects of the program.

Problems/Complaints

Officials reported that they had received no complaints from taxpayers or opposition from interest groups.

Other Tools for Improving Compliance

Revenue office officials told us that the disclosure program is only one of many tools the state uses to improve compliance and collect unpaid taxes. Other tools include project letters, field investigations, certificates of debt, levies, seizures, and office and field audit programs. The revenue office has also used private collection agencies and a special project group that focuses upon noncompliants in the cash economy, as less traditional tools.

Cities and Counties We Surveyed

State	City	County
Alabama	Birmingham	
California	Los Angeles	
	San Francisco	
	District of Columbia	
Delaware	Wilmington	
Indiana		Allen
		Elkhart
		Marion
		St. Joseph
		Vanderburgh
Kentucky	Lexington	
	Louisville	
		Fayettte
		Jefferson
Michigan	Detroit	
	Flint	
	Grand Rapids	
	Pontiac	
	Warren	
Missouri	Kansas City	
	St. Louis	
New Jersey	Newark	
New York	New York	
	Yonkers	
Ohio	Akron	
	Cincinnati	
	Cleveland	
	Columbus	
	Toledo	
Oregon	Portland	
		Multnomah
Pennsylvania	Philadelphia	
	Pittsburgh	

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