SUMMARY OF REPORT IN SUPPORT
OF RECOMMENDATIONS 75-5—75-10
ADMINISTRATIVE PROCEDURES OF THE INTERNAL REVENUE SERVICE*

CHAPTER 1 — THE AUDIT AND SETTLEMENT PROCESSES

Selection of Returns for Examination

Congress has directed the Internal Revenue Service "to the extent . . . practicable . . . to proceed, from time to time, through each internal revenue district and inquire after . . . all persons . . . who may be liable to pay any . . . tax. . . ." The Service is further empowered to review books and records relating to tax returns. For the individual income tax, the Service has heeded the Congressional direction by each year examining some taxpayers' returns for accuracy and demanding substantiation of the entries on the return. Such examinations are called audits.

The Service does not have enough people to audit each of the 80 million individual income tax returns filed each year. Instead only a small percentage is examined. Such audits increase revenue, and also have a major purpose to induce "voluntary compliance" with the tax laws. The program of examinations to achieve this end appears to be based on the assumption that the public will be encouraged to comply if there is a credible possibility that any particular return may be audited.

To carry out these audits, the Internal Revenue Service has separated individual tax returns into seven classes, based on the level and kinds of income shown on the return. These classes are:

Level of Adjusted Gross Income and Other Characteristics	Return Class Designation
$0–$10,000 with only a standard deduction	Low income standard
$0–$10,000 without business income but with itemized deductions	Low income non-business itemized
$10,000–$50,000 without business income (usually with itemized deductions)	Middle income non-business
Over $50,000 without business income	High income non-business
$0–$10,000 with business income	Low income business
$10,000–$30,000 with business income	Middle income business
Over $30,000 with business income	High income business

If any amount of business income is reported, the return is classified as a

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business return. A return with no business income but with very high amounts of investment income, such as dividends and interest, will be classified as a non-business return.

A projection of returns to be audited from each of these classes is determined at the beginning of each fiscal year and is communicated to Service personnel as the Annual Audit Plan. "The Plan" is a management projection developed by the national office with substantial assistance from management personnel at the district and regional offices. It unquestionably is management's most important tool for planning and monitoring the Service's audit activities, and its impact on the auditing process itself is substantial. Accomplishments toward fulfilling the projected goals are collected monthly, quarterly, and annually, and are tabulated by district. District management personnel use such statistics in monitoring the district's success in meeting its assigned objectives, and a desire to "make the plan" is naturally transmitted to and felt by those who do the auditing. What results is a sometimes subtle pressure on the examining officer to increase his productivity as measured by number of audits completed.

The selection of returns for examination begins at the ten IRS Service Centers, where returns are received from the taxpayer and reviewed manually and by machine, for math errors and obvious other errors apparent on the return. If errors (either in favor of or against the taxpayer) are detected, the taxpayer is notified by the Service Center, and the issues so raised are resolved with its personnel if possible. If not, the return may be audited.

The computer at the Service Center also gives every return a score for the tax change that might result from an audit of the return. A high score means there is a correspondingly high probability that an audit would result in either a significant increase or decrease of the tax liability shown on the return ("tax change"). The formula upon which such scoring is based is developed from the results of an intensive survey of sample tax returns known as the Taxpayer Compliance Measurement Program (TCMP).

This program, conducted in periodic cycles, consists of auditing a random sample of all returns filed in a particular year. From this sample, characteristics of returns which have significant tax changes are identified. These characteristics are then built into a formula called the Discriminant Function (DIF) which gives each characteristic and combinations of characteristics on a return a weight related to the amount of tax change found on the sample returns with similar characteristics. The total weight constitutes the DIF score, which purports to indicate the probability of a tax change if the return were audited.

In numerical terms, TCMP examinations are relatively insignificant. About 30,000 returns were examined under this program in the last cycle covering tax year 1971, a small number when compared to the more than 1.6 million taxpayers who were audited under other programs. However, TCMP examinations are exceedingly important to the Service, because they produce the data base from which the DIF formulas, used to select the ordinary tax return for audit, are developed.

Accordingly, to assure the highest degree of accuracy, examiners in TCMP audits are instructed to question every entry on the return and to pursue verification and documentation of each entry, until in the examiner's professional judgment it is accurate. These standards of examination are more stringent than are standards for other audits. TCMP examinations consume much more time than routine audits and put taxpayers to more inconvenience in supplying verification. As a result this audit, done primarily for research purposes, imposes considerable costs in time, money, and frustration on the taxpayer. Furthermore, since the sample is purely a random one, not geared to the potentiality of error, the cost of improving the audit system as a whole is largely borne by those unfortunate and presumably faultless taxpayers who are selected for intensive audit under the TCMP.

Thus, this program, though clearly a valuable one, can be a source of annoyance and irritation for taxpayers who fall into it. While the Service has generally assigned examiners of above average capabilities to conduct these audits, such audits might be further expedited and made less inconvenient to taxpayers if only the most skilled and experienced examiners were assigned to them. For this reason, *it is recommended* that the Service establish units of especially skilled examiners to perform TCMP examinations.

The DIF formulas developed from TCMP audits are applied to each return. The returns with the highest scores for each class of returns are held at the Service Center for delivery to district offices when returns are needed for audit. In the past few years about 60 percent of all returns examined were put into the audit pool by reason of computerized DIF scoring.

The remaining 40 percent enter the audit pool by manual selection under a number of general programs and other criteria. The programs are established by management in the national, regional, or district offices, and are based on return characteristics which are believed to indicate a high likelihood of noncompliance.

While some audits are performed by Service Centers, through correspondence, the majority are performed by one of the district offices, or their branches, scattered throughout the country. When a district office needs returns to audit, it will order returns from the Service Center servicing that particular office. Need is largely determined by the number and type of returns necessary to assure the accomplishment of the objectives prescribed by the Annual Audit Plan. The Service Center sends those returns having the program characteristics specified by the district as necessary for fulfillment of its assigned role in the Annual Audit Plan. Because of the need for further manual screening of returns sent to the district from the audit pool, the number ordered and received by the district is always greater than the number required for auditing under the Plan. The further screening to determine which returns are most suited for audit is manually done by the district's Returns Program Manager (RPM) and his staff. As a result of this review, some returns are judged not to require audit and are returned to the Service Center. When it has been decided that a particular return will be retained for further examination, a classification specialist determines whether its complexity warrants a field audit, by a highly skilled Revenue Agent, or only an office audit, to be performed by a less experienced Tax Auditor, who normally is provided a checklist of issues which he rarely goes beyond.

Once so classified, the return will be forwarded to the personnel who supervise the examining officers. These individuals are known as Group Managers. A Group Manager will screen each return he receives to determine whether he agrees with the RPM that the return is worthy of audit. If he does not, he will return it to the RPM who will then return it to the Service Center unaudited. If the Group Manager determines that a return should be audited, he will assign it to one of the examining officers on his staff who will then be responsible for conducting the audit of the return. This examiner may also independently review the return to ascertain whether it should be examined.

The foregoing has described the fashion in which most returns are chosen for audit; that is, they are routinely forwarded in batches by the Service Center to the district office and ultimately assigned to an examiner. Because several persons along the way consider the suitability of each return for audit, there is only a slight possibility that such Service personnel might abuse their screening power and exercise it maliciously or capriciously.

Other returns are individually selected for examination at the initiative of examiners in the district or branch offices. The examiner's discretion to requisition returns from the Service Center is relatively unchecked, and therefore presents a greater potential for abuse. For example, an examiner may, as a result of findings during an audit, decide that the return of another taxpayer should be examined. The Department of Justice may request that a particular return be examined. Or information suggesting that a taxpayer be audited may be sent to the Service from outside sources. In such cases, individual Service personnel exercise a high degree of discretion in deciding whether the individual returns should be examined. Indeed, the examiner may initiate the requisition entirely for reasons of his own. The examiner need only obtain his immediate supervisor's approval to request a return for audit. The reason for the request is indicated by a two-digit code. For example, if the requested return is said to be related to that of a taxpayer already under examination, the request is known as a "related pick-up," and the corresponding code number is indicated. However, some code categories are extremely broad or vague. The examiner's discretion is further enhanced by the fact supervisors generally seem to consider approval a mere ministerial duty. There exists, then, the danger that a return may be requisitioned for examination by reason of the whim or malice of an examiner. A similar potential for abuse lies in the examining agent's power to earmark the return of a taxpayer he is currently auditing for audit in a future year. Again, approval is perfunctory, and no directives require the supervisor to scrutinize the request for necessity and propriety.

There are several procedures that would discourage if not halt the misuse of such discretion. First, an examiner could be required to give a written explanation of his reason for requisitioning a return for audit. The Group Manager should review the written explanation to see that the request does not proceed from improper motives and is in accordance with established programs or criteria. Accordingly, *it is recommended* that each examining officer's requisition of a return be supported by written reasons, for review by his manager.

Second, if the Service carried out a systematic, ongoing evaluation of the reasons assigned for the selection of returns for audit, improper return selection could be restricted. *It is therefore recommended* that the IRS develop procedures to permit such verification, in a fashion that will simplify review by the Service's Internal Audit Division and facilitate Congressional oversight of the audit selection process. One such procedure was begun during the course of this study.

Third, Service personnel would be further inhibited from improper return selection if they knew that the taxpayer would be told the reason his return was selected for audit. To aid examiners and minimize arbitrariness, the Service should also require as far as possible that the selection of returns for the audit pool be made under programs and criteria established in advance. The Service would be more likely to establish such programs in advance if it is required to publish annual statistics showing the number of returns examined under each program or other criterion in each income class of returns. For these reasons, *it is recommended* that each taxpayer be notified of the reason that his return was selected for audit, that programs and criteria for selection be established in advance to the maximum extent feasible, and that the Service publish annual statistics pertinent to each of its selection programs and criteria.

Since many returns enter the audit pool by machine scoring and since many taxpayers have similar income and deduction patterns each year, the returns of some taxpayers get into the audit pool each year. They may slip through the various screening steps notwithstanding the fact that previous years' audits have resulted in little, if any, change in tax liability. The taxpayer would, perhaps because of some recurring peculiarity in his tax return that causes a high DIF score, undergo audit very often or even for many consecutive years. Taxpayers naturally find such recurring audits annoying. The Service has little reason to audit any particular taxpayer on a repeating basis, especially where only minor tax change is likely to result. Procedures which permit a review of prior audit history could prevent these repetitive audits. Accordingly, *it is recommended* that procedures be adopted which would require review of audit history by the Group Manager and examining officer before conducting a repetitive audit. TCMP audits should not be subject to such a review, however, since the failure to carry out a TCMP audit could impair the validity of the sample.

The Examination

Correspondence audits aim to resolve the simplest of issues by mail from the Service Center. When the examination is performed in the district or branch, returns presenting relatively simple issues receive office audits, conducted in the Service's offices. The more complex returns undergo field audits, performed on the taxpayers' premises where records about business or investment transactions are accessible.

The process of being audited is, for most taxpayers, a frightening and intimidating experience, occurring in a hostile and unfamiliar setting. It is largely the fear of the unknown that arouses such strong anxiety and, at some times, belligerence in the individual taxpayer who has been singled out for audit.

Despite sincere efforts on the part of the Service to lessen these apprehensions, the confrontation between the tax auditor and the taxpayer remains essentially an adversary proceeding. Its adversary nature is heightened by the differing attitudes of examiner and taxpayer. The examiner tends to believe that tax returns in general contain many intentional or careless inaccuracies. As to the particular return before him, he knows that it was probably scientifically selected by a computer. He also knows that the return has been reviewed by the RPM and the examiner's own manager, who is cautioned not to assign the return for audit unless convinced it should be. In the back of the examiner's mind is the knowledge that his failure to find a tax change in a large number of returns may result in a review of his returns or a discussion of his skills, or both. It seems significant that examinations have long been referred to as "enforcement activity." (The 1974 Annual Report, issued as this study was nearing completion, used the word "compliance" in place of "enforcement.") Thus, one may conclude that the average examiner comes to an audit with a disposition to find and assess errors against the taxpayer, whom he will tend to suspect of being careless, dishonest, or unknowledgeable.

Likewise, the taxpayer enters the fray with his own well-established notions and indignation at being called for audit. He also may be resentful about well-publicized tax law preferences, such as real estate tax shelters, or some real or presumed special treatment given to more prominent personalities. His irritation is compounded by the knowledge that the audit experience will cost him time and perhaps money in additional tax assessments or the need to hire professional help.

Further, the average taxpayer is bewildered by the complexity of the tax law and of the auditing procedures, and often learns only then of the degree of verification of items listed on his return that will be required. To reduce this lack of knowledge about the requirement for verification during audit, *it is recommended* that the Service annually include, along with the blank tax forms sent to taxpayers, information telling taxpayers: (1) that all supporting records should be retained for at least three years; (2) that an audit, if there is to be one, is not likely to commence for some time after the return has been filed, and (3) that receipt of a refund does not preclude audit.

Study of Motivations for Compliance

The Service regards the audit process as its primary implement to induce voluntary compliance with the laws requiring the filing of accurate returns and payment of taxes. The audit has generally been viewed by the Service as an "enforcement" function. It is based on the premise that noncompliance can be discouraged by creating the belief that any return may be audited. While this deterrent may operate in many cases, there may be other reasons that some taxpayers do or do not comply with the law. The law is complex, and compliance may elude even those who try carefully and earnestly. There may be techniques other than audit that would encourage greater compliance with the law. The Internal Revenue Service does not really claim to understand the complexities of the taxpayer motivations involved in compliance or noncompliance. Indeed, the Service's tendency to use statistics, relating to the number of returns audited and the resulting increased revenue, as yardsticks for the measurement of its yearly performance (as it often has done in Congressional hearings) raises questions about whether the Service has become too concerned with improved "production," rather than with the ways in which the audit process can best contribute to compliance with the tax laws. The Service has limited resources, and Congress has not to this time provided funds for a study that would evaluate various methods to measure and promote compliance with the tax laws. *It is recommended* that Congress provide funds for such a study.

The Settlement Process

A settlement as described herein encompasses any sort of practical agreement, between a taxpayer and the Service, to terminate factual or legal disputes, that usually have arisen during examination of a tax return. The Service officials' authority to settle, and the settlement procedures, differ with the successive levels of examination and appeal.

Although an examining officer is not supposed to engage in "issue trading" and is bound by the Service's position on questions of law, his fact-finding function necessarily requires him to determine such "ultimate facts" as arise, for example, in disputes over the value of property or the classification of income. This discretion does, in practice, give the examiner certain leeway to close a case by making and obtaining concessions. Many disputes are resolved at this level.

When he cannot reach agreement with the examiner, the taxpayer may pursue resolution through administrative appeals. (In an office audit, he may first seek an immediate informal conference with the examiner's Group Manager, though many taxpayers eschew such a conference because of a lack of preparation and/or representation at this point.) The taxpayer will receive a letter from the District Director notifying him of the proposed adjustments to his tax and informing him of his options. In general, the taxpayer may request a District Conference within 15 days (with further appeal to the Appellate Conference, if necessary), or he may bypass the District Conference and request an Appellate Conference within 30 days. Once the taxpayer exhausts these administrative remedies, or if he does not invoke them within 30 days of the District Director's letter, a statutory notice of deficiency is issued. The taxpayer then has 90 days to assert his right to file a petition with the Tax Court.

If the taxpayer chooses to seek a District Conference, his case will be reviewed by the District Conferee, an experienced examining officer. The District Conferee has full authority to decide factual disputes, but is bound by the Service's position on legal issues. Where that position is unclear, either the conferee or the taxpayer can seek technical advice from the national office. The conferee must generally decide for or against the taxpayer on each issue presented by the examiner's report. Like the examiner, he is supposed to refrain from issue-trading and is prohibited from deciding any "prime issues" (*i.e.*, important unsettled questions of law as listed by the national office). However, the conferee's fact-finding and issue-defining role allows him flexibility to decide issues in a way that the taxpayer will find agreeable as a basis of settlement. In cases involving less than $2,500 for a single year, the conferee is formally delegated the authority to entertain a settlement offer based upon his estimate of the overall hazards of litigation.

If the taxpayer does not settle his case at the District Conference, he may proceed to the regional Appellate Conference. The Appellate Conferee has the authority to settle any question of tax liability (with some exceptions), whether it involves issues of fact, law, or the hazards of litigation. The principal limitations on his decision-making power are that he must consult with the Service's Chief Counsel about prime issues, and must obtain the prior approval of the Chief of the Appellate Conference before he closes a case. If the Chief disagrees, the taxpayer is offered the opportunity for a further conference with the Chief.

If the case is still unagreed after the Appellate Conference, the taxpayer's next level of appeal is outside the Service, in the Tax Court. After a petition to that court is filed, authority to settle a case prior to actual litigation is shared by the Appellate Conference and the Regional Counsel's office. Once the Tax Court convenes the session in which the case is scheduled for trial, however, the Appellate Conference relinquishes settlement authority to the Regional Counsel litigating the case, who may settle, concede, or try the case, as he deems advisable.

Settlement Results and Their Variations

Disputatious taxpayers seem to fare better as they progress up the administrative settlement ladder. In 1971, for example, District Conferees settled for approximately 42 percent of the amount originally assessed by the examiners, whereas Appellate Conferees settled their cases at about 30 percent of the initial claim. Cases settled at the Tax Court level resulted in a 32 percent collection rate, while in cases actually tried by the court the Service collected 41 percent. These disparities are understandable because of the differing settlement standards and strategies employed at each level of the process.

Less understandable, though, are the significant geographical variations in settlement results, both at the District Conference level and the regional Appellate Conference level. In 1971, for instance, the Cincinnati District sustained only 19 percent of the initial assessments while the Newark District sustained 84 percent. Similar variations occurred at the Appellate Conferee stage. Of course some part of these disparities might be explainable by differences in examiner expertise, or by the degree to which different District Directors emphasize the preliminary informal conference procedure, but the extent of such discrepancies raises doubt about whether similarly situated taxpayers have been receiving substantially equivalent treatment in the audit and settlement process. The Service, to its credit, has adopted a number of procedures aimed at encouraging increased consultation and uniformity within and among districts. However, in order better to inform itself as well as the public about settlement variations, *it is recommended* that the Service should annually publish an analysis of a representative sample of District and Appellate Conference settlements. Such a study should provide more than cold statistics, and should develop its analysis from examination of individual settlements involving the most commonly controverted issues. It should analyze the "recovery ratio" with reference to the factors of (a) amounts of tax involved, (b) whether or not the taxpayers were represented, and (c) patterns of geographical variation.

The recommended study ought to shed light on the reasons for the tendency of the Service to settle cases involving large sums of money for a lower percentage of the proposed assessment than cases involving relatively small sums of money. This phenomenon no doubt can be explained in part by the simple observation that the larger assessments will be resisted more tenaciously by the taxpayer, whose threat of appeal and suit is more credible. This tendency undoubtedly is also related to the tendency that the quality of the taxpayer's representation increases as the amount at issue increases.

Qualitative disparities in representation are bound to occur, but the handicaps borne by the wholly unrepresented taxpayer, in both the audit and settlement processes, are more troubling. Although the Service has made efforts to promote objectivity on the part of its examiners and conferees, and has instructed them not to take advantage of the unrepresented, the unrepresented taxpayer is nevertheless at a great disadvantage in the essentially adversary audit and settlement processes. Adversary proceedings work well where the adversaries come to the table with approximately equivalent skills. Clearly, the taxpayer who enters audit with a representative will be the better prepared to refute the examiner's assertions of law and fact. Conferees are drawn from the ranks of examiners, and the written record before a conferee is prepared by the examiner in the case; for a variety of reasons, the record may be tilted against the taxpayer. In addition, the intricacies of the settlement process itself will disadvantage the unrepresented taxpayer who has not mastered the distinctions among the 15-, 30-, and 90-day letters, or among the several levels of settlement authority. He is likely to be wholly unaware of the nuances of negotiation strategies and the prevailing institutional attitudes toward the issues in his case. The unrepresented taxpayer is clearly overmatched.

This imbalance could be at least partially redressed by establishment of an organization to offer advice and representational assistance to some taxpayers. Accordingly, *it is recommended* that Congress establish a Taxpayer Assistance Center, independent of the Department of the Treasury, to offer advice, assistance and representation to certain classes of individual income taxpayers. The Center would advise and represent taxpayers in the preparation for and conduct of audits and appeals therefrom. The Center should be authorized to charge a reasonable and standard fee to taxpayers who have an ability to pay such a fee. For reasons to be mentioned presently, it is suggested that the assistance of the Center be made available to individual income taxpayers who have been notified that they will undergo examination of their returns by means of office or correspondence audits, in contrast to field audits.

Concededly, it would be a difficult task for Congress to draw an appropriate line between those who should have access to such assistance and those who should not. One approach would distinguish the predominant purposes of the service in its application of the audit function to various categories of taxpayers — whether the purpose is primarily to raise additional revenue or is primarily to maintain credibility in enforcement of the tax laws. Where the revenue motive is predominant, and returns in a given category are regularly expected to yield substantial additional revenue, it is also likely to be worthwhile from the standpoint of taxpayers in that category to endure ultimate audit rather than to file returns resolving all doubts in the government's favor. In categories where enforcement through deterrence is the predominant Service motivation, the nature of the returns may be such that the audit experience has no benefits but only burdens for the taxpayers.

One end of the spectrum is exemplified by the large corporate taxpayer. Such a taxpayer will engage in numerous transactions as to which the facts may be unclear and the law ambiguous; the uncertainties will tend to be resolved in favor of the taxpayer by sophisticated tax advisors. Although both audit and subsequent settlement proceedings are virtually inevitable, those proceedings are highly cost-efficient to such taxpayers. The amounts saved by filing returns that invite those proceedings will be expected considerably to exceed the costs of enduring them. Audits of this kind of return are also highly cost-effective to the Service, which realizes its greatest collections per hour of work for such returns. Substantial deficiencies are expected and in fact are assessed. Such returns seem to be audited primarily for revenue purposes rather than for enforcement purposes.

At the other extreme are non-business tax returns showing under $10,000 of income. Although audits of these returns are on the whole cost-efficient to the Service because they raise more revenue than the cost of performing the audits, they are not nearly as remunerative as other audits in higher income brackets. The audit of low income returns is justified by the Service's desire to maintain an enforcement "presence" at each income level, causing all groups to realize that they are subject to audit, and thereby inducing better compliance. But the taxpayer may view himself as the somewhat random victim of an enforcement program. He knows that his return is not likely to be much, if any, more inaccurate than that of his neighbor who was not audited. More important, the audit and appeal system is not cost-effective for this person. For the amounts involved, the cost of commercial or professional assistance in most cases will far exceed the potential saving in taxes. The taxpayer feels he shoulders the burden of audit for no benefit to himself, but merely to contribute to better general enforcement.

The line between giving assistance and not giving assistance would lie somewhere between these extremes. Until that line is authoritatively drawn in some other fashion, a practical division can be made by viewing returns subjected to field audits as generally being examined primarily to raise revenue, and viewing office and correspondence audits as being conducted primarily for enforcement purposes. Under the approach outlined, the latter category would be considered for assistance.

CHAPTER 2 — COLLECTION OF DELINQUENT TAXES

Congress has conferred drastic powers upon the Internal Revenue Service forcibly to collect taxes from delinquent taxpayers. By law, the IRS is authorized without an adjudicatory hearing, summarily to place a lien on, to levy upon, or to seize and sell any or all property and rights to property belonging to a taxpayer with a tax delinquency.

At the same time Congress has provided little guidance on how the IRS should use its collection powers. Nor has there been much judicial direction supplied by the courts. The result is a large body of discretionary authority given to the IRS to collect taxes forcibly. Inevitably, such discretionary power is not uniformly exercised and is open to administrative abuse. As a result, the exercise of the formidable collection powers at times poses troublesome conflicts between the right of the government to exact taxes and the property rights of the individual citizen.

The process leading up to forcible collection commences in the Service Centers in the course of routine handling of taxpayer returns. Although the overwhelming majority of citizens pay their taxes on time and in full, the IRS each year has an inventory of several million cases in which taxpayers either failed properly to assess their tax or to pay any of it or all of it in full. It is usually at the Service Center that tax error or payment omission is first detected, either through mathematical verification or manual sorting of returns.

In 1973, 77.7 million individual tax returns were filed. Slightly less than 3 million of them showed an unpaid balance due. Another 1.6 million revealed a tax deficiency after the Service Center's mathematical check. In all, 4.6 million individual returns indicated that taxpayer contact was necessary to collect the missing revenues.

Once detected, the errors or omissions trigger a series of Service Center computer-printed notices to taxpayers whose accounts show a balance due. As many as four such notices may be mailed to a taxpayer.

Notice and Demand

The initial notice advises the taxpayer of the amount alleged to be due, plus interest and penalties if any, and states that he can square his account within a specified number of days. If there is no response from the taxpayer, a second notice is sent within five weeks, reminding him of the tax due and advising that he "should pay (the tax) within 10 days of the date of this letter. . . ." If there is still no response, a third notice is sent in three more weeks. If there is yet silence on the part of the taxpayer, a so-called "Final Notice Before Seizure" is sent.

It is this Final Notice Before Seizure which, by formal notice of delinquency and demand for payment thereof, lays the legal groundwork for subsequent imposition of the Service's potent summary powers of collection. The present practices of the Service in regard to this notice create the possibility of unfairness and unnecessary irritation for the taxpayer.

No forcible collection action should be initiated against a delinquent taxpayer without actual notice that it may occur. In view of the uncertainties of mail delivery and the treatment commonly given to computer-printed communications, the Service should take reasonable precaution to assure that the taxpayer actually has received such notice and appreciated its significance. To this end, *it is recommended* that the Service experiment with sending its "Final Notice Before Seizure" to the taxpayer by certified mail, return receipt requested, before any forcible collection action is initiated.

Although the Final Notice advises the taxpayer that salary and wages will be levied and any assets, income, or other property may be seized "10 days after the date of this letter," in practice it is usually more than two months before a delinquent taxpayer hears anything more from the IRS. This delay in carrying out a threat raises problems for the Service in future dealings with a delinquent taxpayer. The failure to exercise levy or seizure in the time specified may tend to create indifference, even if the notice is later reinforced by telephone or through personal contact. After passage of the eleventh day, the taxpayer may assume that the time for levy or seizure has passed and consequently be stunned when it does occur as late as two to four months after the Final Notice. When such summary action does indeed occur, the taxpayer predictably may react with anger, surprise, and a feeling that the Service is treating him unjustly. Such potential for aggravation of taxpayers raises serious implications for a tax system that relies heavily on voluntary compliance.

To offset the potential for such negative taxpayer reactions, *it is recommended* that the "Final Notice Before Seizure" be revised to indicate that forcible collection action may be taken *at any time* after the expiration of the 10-day period following the date of the notice, and to *emphasize* that this may be done without further notice to the taxpayer.

If the computer-printed notices do not produce payment, a Service Center automatically will issue a Taxpayer Delinquent Account (TDA) for any deficiency above a specified minimum dollar amount set by the Service. The TDA is forwarded to the District Office, where it is screened by the Office Branch, which attempts to collect the tax from the taxpayer through office interviews, correspondence or limited field contact. Three out of four delinquent taxpayer accounts are settled in the District Office without application of any of the Service's formidable forcible collection powers.

In principle, no Final Notice Before Seizure should be sent to a taxpayer unless it is clear that the circumstances will warrant the application of levy or seizure power. Since these notices are computer-generated by

Service Centers without benefit of the sort of investigation of a taxpayer's circumstances that can be undertaken by the District Office, many Final Notices in response to which the taxpayer does not promptly pay his account will in fact not be followed by a decision to seize the taxpayer's property. Since decisions to seize property are not automated, but made by Service personnel on a case-by-case basis, the timing of the decisions is far from uniform, nor is it as prompt as the Final Notice Before Seizure implies it will be, i.e., 10 days after. The longer the interval between the mailing of the Final Notice and the initiation of forcible action to collect the tax, the greater the possibility of surprise to the taxpayer and resentment by him when forcible action is actually taken. The Service should treat any final Notice as "stale" if, within some period (such as 120 days) after it is received by the taxpayer, no levy or seizure action has been taken to collect the tax due. Thus, *it is recommended* that the Internal Revenue Service arrange for the District Office to provide additional actual notification to the taxpayer that levy or seizure will follow 10 days thereafter in all cases when no such action has been initiated for an unusually long interval, such as 120 days, after the delivery of a Final Notice Before Seizure. Such additional notification might be attempted by telephone or personal contact and failing that by certified mail, return receipt requested.

Liens

In legal theory under the tax code, a lien in favor of the government arises against all taxpayer property and rights to property, whether real or personal, the moment the Internal Revenue Service assesses any tax liability against a taxpayer. The tax code also seems to provide, still as a matter of theory, that the lien attaches the moment, following a demand for payment of the Service-assessed tax liability, when the taxpayer "neglects or refuses to pay the same." For any practical purpose, it appears that a lien, in the amount of the assessed tax liability, only takes priority over the rights of third parties when the Service files for official public record a notice of the lien. When notice of a lien is filed, generally speaking in places prescribed by state law, the lien becomes an encumbrance on the taxpayer's property which very substantially reduces his ability to make legally effective dispositions thereof. The intended effect of filing a notice of lien is to assure that taxpayer property will be available, either from the taxpayer or from a third party transferee, to satisfy the taxpayer's tax liability. However, serious issues are presented which relate to the timing of lien notice and the duration of liens.

The Service intends that notice of a lien should be filed for the record only after reasonable efforts have been made to contact the taxpayer in person to give him a chance to pay what he owes. Even then it should be filed only if it appears that collection of the delinquent tax might be jeopardized by failure to record the lien. When notice of a lien is filed, the public can become aware of the taxpayer's difficulties, and he may, as a result, not only become disabled from raising funds to pay the tax liability, thereby actually impeding collection, but also suffer unintended and unnecessary personal disadvantage. Service guidelines recognize this risk but leave to the almost unfettered discretion of the Revenue Officer the difficult decision as to whether and when to file notice of a lien. Understandably then, there may be wide and inequitable disparity in the practices of Revenue Officers in filing lien notices. Accordingly, to assure greater uniformity in IRS lien notice filing practice and to minimize unnecessary adverse effects on taxpayers, *it is recommended* that the Internal Revenue Service provide specific guidance to make the determination as to whether and when to file notices of liens.

As a matter of legal theory under the tax code, a tax lien continues until the tax liability has been satisfied or has become legally unenforceable; the tax code authorizes release of the lien then or when payment of the tax liability has been secured by a bond. The practical effects of a lien of which notice has been filed in a public record are likely to persist until a certificate of release of the lien has been filed wherever the notice of lien was filed. However, there is no assurance that this will take place. Since the Service has no legal obligation, procedure, or practice to notify a taxpayer when a notice of lien is filed, he may not know it and may, therefore, not seek a formal release certificate — or, if he does, may not know where to file it. Furthermore, nothing mandates the Service to initiate release of a lien, to notify the taxpayer if and when it does so, or to file a certificate of discharge wherever notice of a lien was filed. Nor has the Service adopted a regular and reliable practice of doing any of these things. There can be no possible justification for a taxpayer to have to suffer disadvantage, embarrassment, or other inconvenience due to the persistence of a shadow on his clear interest in property created by a recorded lien that has not been discharged on the record. Accordingly, *it is recommended* that the Internal Revenue Service adopt procedures that will notify a taxpayer whenever notice of a lien is filed against his property in any public record and that will provide, without application by the taxpayer, for the recording of a certificate of discharge of any such lien, upon its release, wherever notice of the lien was filed.

Levies

A more powerful instrument available to the Collection Division of the IRS to collect delinquent taxes is its levy authority.* Although it is imposed in the cases of only a small number of the taxpayers who have

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*In the tax code, the term "levy" is used to include both levy and seizure; in the lexicon of the IRS levy is generally distinguished from seizure. The distinction made by the IRS is followed herein.

failed to meet their tax obligations, those with regard to whom it is imposed frequently suffer severely. In the fiscal year ending June 30, 1974, 582,701 notices of levy were made.

The levy procedure is applied to third parties, such as employers, stock brokers, insurance agents, and bankers holding any asset — usually liquid — owned by the taxpayer. Levies attach to earned salaries and wages, bank accounts, investment accounts, and all accounts receivable. The third-party served with notice of a tax levy is obligated to surrender the property on demand. If he refuses, he is held personally liable for the tax due, interest charges, costs, and penalties, unless he has a reasonable cause for his refusal.

A court judgment or court order is not required before the imposition of a levy, nor is notification of the taxpayer required, beyond the computer-printed Final Notice Before Seizure, except in cases where his salary is to be garnished.

As in most summary actions, the Revenue Officer has enormous discretion in deciding to impose a levy. The Service instructs only that his action be "judicious" in the application of levy. But judiciousness is interpreted differently by different members of the IRS and in some cases in such a manner as to preclude the delinquent taxpayer from paying voluntarily. The Service suggests but does not require that the officer contact the taxpayer to advise him of the possible consequences. One of the few restrictions the officer faces in deciding when to exercise levy is a requirement that he consider the impact his action may have in what the Service refers to as "significant" cases, i.e., those which might cause embarrassment to the Service by adversely affecting large numbers of innocent third parties whose circumstances would be disrupted by levy action. Examples would be levies in case of a hospital, a newspaper, or a large, "viable" business. Avoiding levy in such cases, while perhaps saving the IRS potential embarrassment, does not constitute even-handed treatment of all taxpayers in similar tax-delinquent situations. Accordingly, *it is recommended* that the Internal Revenue Service establish guidelines that will assure judicious and even-handed application of the levy power and that will specify the circumstances constituting a reasonable opportunity for the taxpayer to pay his tax liability to avoid levy on his property.

The Service directs its Revenue Officers that levies should not be used in cases where undue hardship for an individual taxpayer would result. While the Service thus expects a Revenue Officer to consider the impact of his action, it provides no workable definition of what constitutes hardship beyond archaic formulas laid down in pre-inflation times. Lack of direction has left individual Revenue Officers free to make such determinations on a widely varying and arbitrary basis. *It is recommended* that the Internal Revenue Service establish more specific criteria and procedures to make application of the undue hardship principle more uniform. There should be criteria for common necessaries of life, including food, housing, clothing, and transportation, and provision of clear advice to the taxpayer as to what information and documentation are needed for the Service to make a determination of undue hardship. In addition, the Service should allow a minimum subsistence exemption from the initial levy on the salary or wages of a taxpayer being subject to levy for the first time.

Seizure and Sale

The power of the Internal Revenue Service to seize a taxpayer's property for sale is virtually absolute. Seizure may be made to collect taxes, interest, and additions to the tax in the form of penalties.

There are very few seizures of property in comparison with the number of lien notice filings or levies on wages and salaries and other liquid assets. Seizures are imposed in case of well under 1 percent of taxpayer delinquent accounts; they are ordinarily applied to tangible property in the taxpayer's possession. The exercise of seizure power has been delegated to journeymen Revenue Officers. There is no requirement for the Revenue Officer to give specific prior notice of seizure to the taxpayer beyond the general warning contained in the Service Center's computer-printed Final Notice Before Seizure. There is no requirement that the Revenue Officer seek approval of his superior before he seizes property, although he often does so in practice. There is no requirement that seizure of an individual taxpayer's property be made on a last-resort-basis as there is in case of delinquent business taxpayers. Consequently, Revenue Officers have broad and essentially unguided discretion in deciding to exercise this confiscatory power.

From the time property is seized, the Service becomes responsible for the seized property until it is sold and may incur expenses, such as insurance or guards, to protect it. The proceeds of sale of seized property are applied first, to pay the expenses of seizure, protection, and sale of the property, next, to pay any specific unpaid Federal tax liability on the property itself, and finally, to pay the delinquent tax of the taxpayer on account of which the property was seized and sold.

Before a sale, the Revenue Officer must, subject to his Group Manager's approval, fix a minimum sale price for the seized property. This is a difficult decision and an important one for both the Service and the taxpayer. If the highest bid at the sale is less than the minimum price, the property must be bought by the government at the minimum price, which thus becomes the sale proceeds to be applied as explained above. Except in case of property consisting of listed securities, present IRS policy governing the fixing of minimum sale price is confusing and hard to apply. Its aim is to protect both the taxpayer and the government. However, in many cases, it has failed to do one or the other, or both. In any case where the minimum sale price is set too high and no bidder offers as much, the government may end up crediting the taxpayer's delinquent account with more than it can get from resale of the property. Conversely, if the minimum sale price is set too low and no bidder offers as much, the taxpayer may see his property purchased by the government and resold to a third party at much less than it is really worth, with his tax liability reduced by much less than it should have been, given the value of the property. In the first instance, the government is the loser and the taxpayer gains. In the second case, both the government and the taxpayer fail to obtain adequate benefit from ultimate sale of the property.

As might be expected, the present Service guidelines, confusing as they are, lean strongly toward protecting the government. In spite of this, there have been many cases when the proceeds of sales of seized property have not even been sufficient to pay the Service's expenses of seizure, protection, and sale of the property. In any such case, the taxpayer's situation is worsened, with little or no benefit to the government, as a result of the Service's action.

Before a decision to seize property of a delinquent taxpayer is made, and before sale of seized property is carried out, it seems clear that the Service should be certain that the consequence of its actions will be a reduction of the taxpayer's delinquency by an amount that is fair both to the taxpayer and to the government. There should never be a case in which the proceeds of sale do not even cover the Service's expenses of seizure, protection, and sale, including properly accounted for salary and overhead costs which are now not part of the calculus at all. The Service's Internal Audit Division has criticized many seizures because they did not meet these standards and thereby created the appearance of taxpayer harassment.

The risk of imprudent and unfair seizures and sales is especially great when property to be seized is subject to an encumbrance with priority over the Federal tax lien for the delinquency involved. This makes it more difficult to fix a fair minimum sale price and to estimate what the character of bidding at the sale will be. In spite of these difficulties, it seems clear that the Service should never seize or sell a taxpayer's residual (after allowance for any prior encumbrance) interest in property, or "equity [in property] under the lien" as the Service calls it, unless the proceeds of sale will substantially exceed the Service's costs and expenditures.

Because the confiscation of any taxpayer's property can have drastic impact and unnecessarily adverse consequences for the taxpayer, it is vital that the decision to seize property be made with a view to assuring that the taxpayer is injured thereby as little as possible, consistent with the need to collect delinquent taxes. To this end, *it is recommended* that the Internal Revenue Service require that Group Managers, rather than Revenue Officers, make the decision to seize. Furthermore, the Service should require that as a condition to making the decision to seize, the Group Manager should determine, based on adequate evidence, that the proceeds of a sale of the seized property will substantially exceed the anticipated expenses of taking possession of, protecting, and selling the property. And finally, after seizure, the Service's procedures should call for returning promptly to the taxpayer any item of property as to which a determination can reasonably be made that the minimum sale price is unlikely to exceed such expenses.

A serious obstacle to formulating Service guidelines for the making of decisions about when to exercise the power of seizure and sale to collect delinquent tax accounts is the absence of adequate, systematic data about the Service's practices and their consequences. The Service has records of the number of seizures of property which it makes. However, it has no overall records of how many sales ensue, of the gross proceeds of sales, of its expenses of seizure, protection, and sale of property, of the amount of funds obtained from sales applied to reduction of tax liabilities, of the personnel and other overhead costs incurred in seizure and sale proceedings, of the number of or reasons for releases back to taxpayers of seized property. Ad hoc selective studies by the Service's Internal Audit Division have identified serious deficiencies in achieving the Service's own existing policy objectives in relation to seizures and sales. Thus, *it is recommended* that in order better to evaluate and execute its policies and procedures, the Internal Revenue Service should, at least from time to time, collect, tabulate, and analyze data relative to all the matters identified above.

Jeopardy and Termination Assessments

Of all the formidable powers at the disposal of the IRS to force the payment of an individual's delinquent taxes, perhaps none are more harsh than jeopardy and termination assessments.

Under normal circumstances, an additional tax asserted by the IRS, either as a result of return processing by the Service Center or as a result of audit, does not have to be paid by the taxpayer until after he has been issued a Statutory Notice of Deficiency.* For 90 days thereafter, the taxpayer has the right, prior to payment of the tax, to contest the deficiency assessment in the Tax Court. During this period, the Service may not take any formal action to collect the tax.

Under certain exceptional circumstances, when collection of a tax deficiency appears to be in jeopardy, the IRS is empowered by the tax

*Additional tax due on account of purely mathematical error in the return may be assessed and collected without issuance of a Statutory Notice.

code to collect forcibly unpaid taxes through jeopardy or termination assessment procedures, followed by seizure and sale, without any prior notice to the taxpayer. Although these procedures are applied to few tax delinquents, even their infrequent use has had crushing impact upon some taxpayers and has led to numerous charges of misuse of IRS power.

Despite the havoc which can be wrought by jeopardy assessments, the sole criterion specified in the tax code (Section 6861) to determine whether such assessment will be made is a *belief* by the IRS that collection of a tax deficiency "will be jeopardized by delay."

How is a taxpayer actually selected by the Service for jeopardy assessments? Until recently revenue agents, who are likely to be the prime movers in initiating such assessments, have been advised by the Service that "certain conditions and circumstances can properly be considered establishing prima facie cases" in which a jeopardy assessment should be made. These prima facie cases include: present and former major operators in the criminal field; bookies and gamblers; border hoppers; "individuals engaged in other activities generally regarded as illegal"; and taxpayers consistently suffering business or personal losses. Generally speaking, these classifications provide no factual basis for a belief that collection of any particular taxpayer's tax will be jeopardized by delay, and they thereby create a reservoir of discretion to initiate a jeopardy assessement without regard to whether collection of a tax deficiency actually is in jeopardy and to make an assessment which is undesirably large. Jeopardy assessments are supposed to be approved by District Directors who are expected to do so only if it appears that a taxpayer is about to hide himself or his property, to remove himself or his property from the United States, or to become insolvent. Service guidelines also call for jeopardy assessments to be used sparingly and to be made in reasonable amount, i.e., only the amount necessary to protect the government's claim for tax deficiency.

The total number of taxpayers subjected to jeopardy assessment has been small. In fiscal year 1972, for example, there were 375. In the first nine months of fiscal year 1974 there were 479. Nevertheless, the consequences can be disastrous for those individual taxpayers selected and whose assets are seized immediately. In one case a jeopardy assessment of $533,000 was made when the maximum tax liability was probably $58,000. In another case an assessment of $3 million was made after revenue agents had testified in a criminal case that the tax liability did not exceed $300,000. The impact of immediate seizure and inordinately high assessment tends to leave the taxpayer with very little with which to post a bond and in many cases reduces him to penury overnight. The jeopardy assessment may be of such magnitude as to force the individual taxpayer out of his home, destroy his business, and damage his reputation.

Although a jeopardy assessment and consequent seizure can be made without prior notice to the taxpayer, the Service is obliged within 60 days thereafter to send the taxpayer a Statutory Notice of Deficiency. By the time the taxpayer receives this notice it is likely, due to levy and seizure action, that he will not have the wherewithal to pay the asserted deficiency, which he must do as a precondition to contesting the assessment by a suit for refund in the U.S. Court of Claims or a U.S. District Court. However, when he receives the Statutory Notice, he may, without first paying the tax, contest the deficiency in the Tax Court whose jurisdiction is based only on notice of deficiency being given. The Tax Court can abate the assessment if it is excessive, withdraw it altogether if no collection jeopardy is found, and, of course, release any or all assets levied or seized. The impact of the jeopardy assessment may be so crushing as to make it difficult for the taxpayer to take advantage of his right to Tax Court review of the Service's action — but the right exists. The same is not true in the case of termination assessments as will be explained below.

As practiced by the Service, termination assessment is a summary collection tool more dangerously powerful than jeopardy assessment and subject to still greater potential abuse.

Under the tax code, one pre-condition to jeopardy assessment is that there be a tax defficiency. Until a taxpayer has filed (or should have filed) an income tax return, the Service cannot have a basis for finding that there is tax due. Before the end of a taxpayer's taxable year for income tax purposes (ordinarily the calendar year) and the date for filing his return (ordinarily April 15), no tax will be due and hence no tax deficiency could arise. And yet there are instances when the Service may need to act promptly before any tax is due, in order to safeguard from evasive taxpayer conduct its opportunity to collect taxes that will become due in the future. To meet this need, the tax code (Section 6851) empowers the Service without any prior notice, to terminate a taxpayer's taxable year at any time that it finds that the taxpayer "designs quickly to depart from the United States or to remove his property therefrom, or to conceal himself or his property . . ., or to do any other act tending . . ." to frustrate future collection of the current or preceding year's income tax. Termination of the taxable year has the effect of making immediately due and payable income tax for the current (or preceding) year and thereby creating the basis for the Service to assess a tax deficiency and move summarily (by levy or seizure) to collect it.

The tax code provision (Section 6851) authorizing tax-year-termination does not itself contain authority to make an assessment of deficiency. Hence, the Service's lexicon term "termination assessment" is misleading; more strictly speaking, one might say "assessment after termination."

An assessment after termination of tax year is potentially more damaging to a taxpayer than a jeopardy assessment because it may leave him with absolutely no judicial review recourse to contest the tax deficiency, the legality of the assessment (and consequent levy or seizure), or the amount of the assessment. The reason for this is that the Service does not issue a Statutory Notice of Deficiency in connection with a termination assessment. As a consequence, the tax-year-terminated taxpayer, whose opportunity to sue for a refund is as blighted as that of a jeopardy assessee, cannot even have access to the Tax Court.

The issue as to whether the Service is required by the present tax code provisions to give notice of deficiency of a termination assessment may soon be decided by the Supreme Court in two pending cases. Whatever the outcome of the decision, problems may remain, for both the Service and individual income taxpayers, whose solution will entail amendment of the tax code as well as alteration of IRS procedures.

In many cases the size of the assessment has been equal to the value of goods seized in police raids. The obvious conclusion is that its size is the result of pure guesswork. The Service, hence, has used termination assessments as a means of summary, extra-judicial punishment for criminality which neither the tax code nor the agency was established to impose. In any event, the size of the assessment is frequently in excess of the taxpayer's net worth thereby leaving him in a position unable to pay the tax and without access to the courts.

Although the tax code provision for tax-year-termination calls for IRS findings of taxpayer behavior which, if made, constitute presumptive evidence of jeopardy, the Service has given "prima facie" cases, referred to above, the same triggering significance for tax-year-termination as for jeopardy assessment. The availability of this basis for decision-making about both jeopardy and termination may have contributed to the prostitution of these powers to serve goals of criminal law enforcement unrelated, or very marginally related, to the collection of taxes as occurred, for example, in the so-called Narcotics Traffickers Program of the early 1970's. It appears that Commissioner of Internal Revenue Donald C. Alexander put an end to the program in 1974. However, there is no published evidence in IRS guidelines to indicate how the Service's procedures have been altered to help guard against renewed misapplication of IRS summary tax collection powers to some future anti-crime initiative. In order to help assure against improper exercise of these powers, *it is recommended* that the Internal Revenue Service promulgate procedures requiring that no jeopardy or termination assessment be imposed except upon determination made by a District Director, based on substantial evidence, that a tax is due and that its eventual collection is jeopardized.

The so-called Anti-Injunction provision (Section 7421) of the tax code sweepingly limits the power of the courts to issue injunctions against the Service's use of jeopardy and termination assessments. Its purpose is to permit the collection of revenues without interference by the judiciary.

This provision has been extremely effective in limiting taxpayer redress in the courts for jeopardy assessments. The IRS has strained to block any judicial review of termination assessments through this statute but its success in the courts has been mixed in barring relief for taxpayers caught up in termination assessments. Part of the reason for the mixed results in termination assessment court cases is due to taxpayer assertions that they are entitled to receive a Statutory Notice of Deficiency and thus be able to petition the U.S. Tax Court for redetermination of their tax indebtedness. If that position is correct, the Service would be unable, as a general rule, to sell property seized pursuant to the assessment until after the Tax Court rules. Final resolution by the Supreme Court of the question whether Statutory Notice must be given will have significance for taxpayers upon whom termination assessments are imposed.

The scant number of cases decided contesting jeopardy assessments have held that the lack of statutory guidelines against which to test the District Director's decisions precludes judicial review of his determination that jeopardy exists. As a result, taxpayers have found it difficult to derail jeopardy assessments on factual rather than technical grounds.

In order to prevent abuse of the authority to make jeopardy and termination assessments, *it is recommended* that the Internal Revenue Service establish and promulgate new procedures that will enable the taxpayer to contest the necessity and amount of such assessments at the earliest possible time. Additionally, the taxpayer should be furnished with full written explanations of the facts upon which the District Director finds that the collection of tax is or has been jeopardized and upon which the computation of the tax was based.

Alternatives to Forcible Collection

In form, the Internal Revenue Service's approach to collecting taxes from the delinquent taxpayer has an all-or-nothing quality — to demand all the taxes dues, and if they are not paid, to initiate forcible collection procedures. In fact, however, the IRS is not quite that rigid. The question is whether the Service is too rigid in its practices, particularly in a society and an economy that has grown accustomed to meeting obligations through installment payments — whether the Service might not collect more revenues from delinquent taxpayers by adopting more flexible procedures of exacting payments. In examining this question, it is necessary first to examine the magnitude of delinquent payments and the success of the Service in recovering them.

In 1973 at least one delinquent tax notice was mailed to some 7,380,000 individual and business taxpayers. However, only 2,746,000 accounts were subsequently forwarded to District Offices in the form of a Taxpayer Delinquent Account (TDA). While most of the remaining 4.5 million delinquent taxpayers satisfied their outstanding tax obligations in full without the issuance of a TDA, some 817,125 neither paid their bill nor advanced to TDA status. In the latter cases TDA's were not issued because only small tax balances were due. This procedure, known as "deferral" by "dollar tolerance" enables the IRS to concentrate its limited resources on collecting larger delinquencies.

Despite their deferral, however, experience has shown that most of the delinquencies will be collected eventually — either as offsets to future tax refunds, as voluntary payments, or because the addition of subsequent liabilities, accumulated penalties and interest charges raise the amount above the tolerance level, leading to collection action. In the meantime, the taxpayer is reminded at six-month intervals of the outstanding tax. At least six years will pass before the debt is barred by the expiration of the statute of limitations.

Not all small delinquent tax accounts, however, are deferred. IRS employees are exempt from having small delinquencies deferred as are taxpayers with a TDA already outstanding and those who have been coded for "special handling" on the basis of a history of resisting payment or habitual delinquency. Tax returns of resisters and chronic delinquents with a balance due as small as $25 are coded and forwarded to the district office as targets for quickly executed lessons in forcible collection. Service efforts to collect small accounts from chronic delinquents are not cost-justifiable in dollars and may be an inadvertent reflection of excessive concern about tax law enforcement. Collecting small sums from resisters is considered to be an essential policy of the Service.

The tax code, while enumerating a number of methods for forcible collection of delinquent taxes, is silent on the payment of delinquent taxes by installments. This silence is interpreted by the IRS as the denial of a right to pay by such a method. Consequently, Service personnel are directed to request immediate satisfaction of the tax debt. If the taxpayer cannot comply, he is requested to fill out a financial statement. If there are no assets to seize, the Service has no choice but to accept installment payments.

Service reluctance about installment payment agreements is puzzling in view of the fact that so few taxpayers would be eligible for its use. As far as lost revenues are concerned, it would seem that the government is compensated by the collection of penalties and interest on other overdue accounts, particularly in view of the recently approved rates tied to the prime interest rate. With this in mind the IRS should be encouraged to liberalize installment payment procedures, at least to the extent that they involve smaller liabilities.

In 1973, collection efforts were suspended on 313,884 delinquent accounts — representing $397,459,356 — which were reported uncollectible. During the same year, the Service's field offices received nearly 3 million new delinquent accounts representing over $5 billion. Hence, the

Service appears to write off accounts on a grand scale, but the influx of new accounts requires that some limit be placed on efforts to collect old ones.

At some point the cost of collection exceeds the amount to be collected, particularly on small-delinquency accounts. Cost considerations do seem to outweigh any undesirable impact on voluntary compliance which might result from writing off accounts. Despite this, some accounts listed as uncollectible were reported as such merely because the tax debt could not be satisfied immediately. IRS collection personnel commonly indicate that if a balance due can be paid only in installments and the schedule of payments is too long or their size too small, the account will be written off.

The question of fairness arises in writing off delinquent accounts. Is it done too soon? After a review in 1971, the General Accounting Office had no adverse comments. Yet in another review conducted by the IRS Internal Audit Division, of 1,500 cases reported uncollectible in the same year, an error rate of 6.6 percent was found.

Although the majority of accounts marked "uncollectible" are eventually collected, the inventory of such accounts at the end of 1973 stood at $1.3 billion of the $3.1 billion in total outstanding delinquent accounts. The magnitude of the total should impel the Service to consider giving field personnel more guidance in writing off such accounts. It seems plausible that concrete guidelines will reduce the incidence of poor judgment and inconsistency in treatment of taxpayers which was found by the Service's Internal Audit Division.

It is recommended that the Internal Revenue Service should keep collection personnel advised of the minimum acceptable installment payment in order that the costs of processing such payments will not exceed their sum. No payment agreement should be rejected solely because of the length of time it would require to satisfy the debt; however, waiver or extension of the statute of limitations for collection should be obtained if the time needed for payment will extend beyond the limitations period, and the agreement should be subject to at least annual review and adjustment to reflect changes, if any, in the taxpayer's ability to liquidate the unpaid delinquency. Finally, the Service should discontinue any reference to agreements for payment of delinquent taxes in periodic installments as "part payment" agreements, because such terminology fosters the mistaken impression that a portion of the tax debt has been forgiven. The idiom of "part payment agreement" should be supplanted with such terms as "installment agreement," "periodic payments," or others which do not connote that less than the total delinquency is to be paid.

Employer Tax Delinquents

The timely collection from employers of taxes which have been withheld from employees either as Social Security deductions or as employee income taxes is of vital importance to the daily operation of the Federal Government. Such collections and their subsequent transfer to designated Federal depositories enable the government to have access to a continuous supply of funds without the need to borrow to meet its obligations. Employer tax withholdings constitute the primary means of revenue collection. Additionally, they help assure that wage earners do not become tax delinquents through inability to meet year-end income tax obligations.

As trustees of taxes withheld for the benefit of the Federal Government, employers have a critical duty to meet their tax reporting and payment responsibilities on schedule. If an employer fails to meet these responsibilities, the government is still bound to credit the employees' accounts with the amounts withheld and to determine their current income tax liabilities (and their future Social Security payouts) on the basis of these amounts (and employer and employee Social Security contributions) whether these sums are paid or not.

Federal Tax Deposits (FTDs) consisting of the funds withheld from employees are required to be paid over to designated depository banks within three banking days after they have been withheld. Employer reports of tax withholdings are required on a quarterly basis. Earlier requirements specified that the funds were to be turned over within 14 days. Because any delay in the collection of FTDs increases the government's need to borrow funds, shortening the period has meant substantial savings to the government in borrowing costs. Wage withholding results in the collection of about $150 billion a year. Because of the immensity of this figure, a 10-day reduction in FTD-collection time saves the government as much as $250 million a year in interest costs.

The requirement that withheld taxes not be paid directly by employers to the Service, however, has separated the accounting for receipt of the funds from the Service's processing of the employer quarterly reports. This separation has created problems for the Service, particularly in efforts to detect delinquents quickly. The normal time between payment and posting to the employer's Business Master File at the Service Center is six to eight weeks, but that period may be stretched to 16 weeks by data-processing difficulties. The employer's reporting device, Form 941, is processed on an expedited basis by the Service, and such processing is often completed before the Federal Tax Deposits are processed by the Federal Reserve Bank, which collects the funds from the designated commercial banks and reports to the National Computer Center (NCC). As a consequence some employers claim Federal Tax Deposit credits on their quarterly returns which have not been reported to the NCC until well after the return is filed.

Because of the importance assigned to employer tax withholdings by the IRS, any apparent deficiency is swiftly dealt with. A Taxpayer Deficiency Account (TDA), is issued immediately to permit speedy contact with the delinquent employer. However, a 1974 IRS Collection Division study showed that of all employer TDA's issued in 1973, 28 percent involved withheld taxes which already had been paid.

Quick identification of employer delinquents is vital. In times of high interest rates and a stagnant economy, money owed the government can constitute a source of ready and cheap capital to unscrupulous or financially troubled employers. Until July, 1975, the interest on withholding tax deficiencies was only 6 percent per year. There is a one-time penalty for underpayment of withheld taxes in the amount of 5 percent of the deficiency, and a monthly penalty of 0.5 percent of the unpaid balance limited to a maximum of 25 percent. Starting July 1, 1975, the interest rate on deficiencies was raised to 9 percent, which may curtail, at least for the time being, the tendency of businesses hard-pressed for cash to borrow withheld taxes from the government.

The cheaper cost of "borrowing" from the government resulted in 1973 in 2.3 million "balance due" returns filed by employers. Another 180,000 returns contained errors in arithmetic or preparation which, when corrected, resulted in a balance due to the government. In all, 15 percent of 1973 quarterly returns were not fully paid. While many of these balances were quickly satisfied in response to demands for payment, the Service assigned more than 1.5 million TDA's to local offices for collection of $2.5 billion in overdue withheld taxes. Although there are no accurate statistics available, the consensus is that at least 50 percent of the employers on whom TDA's are issued have been delinquent in the past.

In order to facilitate prompt identification and collection of delinquencies by employers in making their payments of withheld employee income taxes and of Social Security taxes, it is recommended that commercial banks be required to forward records of such payments directly to IRS Service Centers.

The Service has not had as high a success rate in dealing with delinquent employers as it has with individuals in protecting Federal revenues. Part of this failure stems from the reluctance of Revenue Officers to seize assets of a going-business to enforce the government claim. It further appears that the larger the business and the longer it has been established, the less likely it is that the Service will move forcibly. The Service's relatively lighthanded treatment of business delinquents may reflect undue concern about the repercussions that firmer treatment might arouse among their employees and in their communities.

Business taxpayers should be treated even-handedly and firmly where collection of delinquent taxes is involved, except perhaps when it is clear that hasty, forcible collection would result in very serious, long-term damage to the local economy. The Internal Revenue Service does not have authority to decide to go easy on businesses that do not pay taxes in a timely fashion.

Compounding the difficulty of tax collection efforts from delinquent business taxpayers is the reluctance of the judiciary and U.S. Attorneys to deal with business tax enforcement cases generated by the Service. Judicial reluctance is manifested in the light penalties imposed on business officers. This galls the Service because whether they are paid over or not, withheld taxes must be credited to employee accounts. U.S. Attorneys prefer not to handle the cases at all.

New businesses are the most likely to be delinquent in paying over withholding deductions to the government. Yet efforts by the Service to prevent delinquencies among fledgling business enterprises seem only marginal. Despite its recognition that new businesses are the most apt to need guidance, the Service currently merely "invites" their officers to write for a readily available Business Tax Kit, which will be delivered on request. While the Service does have authority to apply a 100 percent penalty on the responsible officers of all delinquent business taxpayers, it is questionable what deterrent effect the penalty can have when in most cases the officers are not advised of its existence until it is applied. Clearly, the Service could do much more.

Consequently, *it is recommended* that the Internal Revenue Service should endeavor, in connection with the assignment of employer identification numbers, to give officers of new businesses written advice of their possible personal liability for payment of withheld employee taxes. The advice given should invite discussion of any questions with a Taxpayer Service Representative. When officers do respond and it is determined that there is a responsibility to pay and file returns of certain taxes, a follow-up contact should be made to ascertain that the responsibilities are understood and followed. Moreover, the Service should work with other Federal agencies to assure that the officers of new employer organizations being established with Federal financial assistance will become familiar with their responsibilities before they commence operations. Similar efforts, with the cooperation of parent organizations, should be made to contact and instruct franchisees and licensees of chain stores, food outlets, oil companies, and the like.

CHAPTER 3 — CIVIL PENALTIES

The Internal Revenue Code contains a complex and in some ways overlapping assortment of civil penalties that the Internal Revenue Service can impose on the taxpayer. Such penalties call for money payments in addition to the tax, as a consequence of culpable conduct, and are regarded as necessary for assuring compliance with the tax laws. The existence of such penalties, routinely utilized and substantial in relation to the amount of tax, is thought to deter intentional violations and to discourage negligence.

There is, though, a lack of information to support the generally held rationale that the civil penalties are an effective method for achieving compliance with the tax laws. The Internal Revenue Service does not possess figures on how many penalties are assessed, the size of the penalties in relation to taxes due, how often the penalties are litigated, or how often penalties are disposed of in the settlement process. Such information obviously is of importance in determining the deterrent value of the penalty system and how effectively and fairly it is working. *It is recommended* that the Internal Revenue Service publish an annual study on the assessment and collection of civil penalties.

There are at least 64 different civil penalties provided for in the Internal Revenue Code. They range from the well-known penalties for filing late tax returns and for fraud or negligence to such exactions as the $50 penalty (recently repealed) for knowingly purchasing any filled cheese which has not been branded or stamped according to law. All the penalties provide for payment of specifically defined sums of money — either absolute sums or percentages of the tax or deficiency. This report focuses on the penalties for filing incorrect or late returns and for late payment of taxes.

Most of the assessed penalties grow out of IRS audits of tax returns. (The audits and settlements procedure, and its application to civil penalties, is described in Chapter 1.) The penalty system gives a compliance force to the audit process that otherwise would be lacking. Without the penalties, a taxpayer who intentionally files an erroneous return might more readily gamble that, even if audited, he would be required to pay only the tax plus interest.

Penalties for Underpayment of Taxes

There is a serious question, however, whether the present system of penalties for underpayment of tax is so structured and administered that it properly fulfills its punitive and deterrent roles. A basic shortcoming in the present system is a lack of gradations in the penalties, with the result that the punishment does not always fit the offense. Too often, for example, conduct amounting to or approaching fraud is penalized as mere negligence. *It is recommended*, therefore, that a more flexible range of penalties be established, to cover intentional violations that may fall short of fraud.

The most serious penalty is for fraud. It is also the most ill-defined and most unevenly applied penalty. The Internal Revenue Code (section 6653 (b)) provides a penalty equal to 50 percent of an underpayment that is due to fraud, but does not define civil fraud. The Internal Revenue Service, in its Internal Revenue Manual, defines civil fraud as requiring only a knowingly false and material representation of fact with the intention that the representation be accepted as truthful. Under this definition, a taxpayer who knowingly pads his charitable contributions by even $5 has committed fraud.

In practice, however, the IRS follows a much narrower definition of civil fraud. In large measure, the Service has been constrained by a line of court opinions holding that civil fraud should be limited to egregious cases of highly culpable conduct, reflecting a pattern of evasion. In civil fraud cases, the Service must carry the burden of proof and must prove fraud by clear and convincing evidence.

As a result, civil fraud has come to mean something different from mere intentional inaccuracy in a tax return. Rather, it has come to be nearly equated with criminal tax evasion, which involves an aggravated willful attempt to evade taxes and carries with it a penalty of imprisonment or fine. But there are administrative distinctions between criminal and civil fraud cases. When fraud is suspected in auditing, the case is immediately referred to the Intelligence Division, the criminal investigative arm of the Service. If criminal prosecution is decided against, the case is returned to the Audit Division, which is still free to determine that there was civil fraud. Within the Service, however, there appears to be a reluctance to press civil fraud. An internal review by the Service last year showed considerable variation in the use of the civil fraud penalty from district to district. The review focussed on cases that were referred back by the Intelligence Division. In the Wilmington District, examining agents assessed civil fraud penalties in 77 percent of the cases, and in the Cincinnati district it was 55 percent. But the figure was only 36 percent in New Orleans, 20 percent in Philadelphia and six percent in Dallas.

Several reasons appear for this uneven use of the civil fraud penalty. Examining agents are under pressure to complete a large volume of agreed cases, and assertion of fraud tends to delay completion of a case. The belief has grown among agents that cases not involving larger dollar amounts will not be pressed by management, and management in turn has come to the conclusion that the courts will limit penalties to situations involving highly flagrant behavior. Consequently, in many districts, the civil fraud penalty is reserved for cases in which criminal fraud is likely to be present.

As a result, there are a multitude of cases involving behavior which would seem to amount to civil fraud but which are not treated as fraud. Such cases tend to be handled as matters of negligence, under the provision for a five percent penalty.

The negligence penalty originally was intended to apply to underpayment of taxes "due to negligence or intentional disregard of rules and regulations (but without intention to defraud)." The Internal Revenue Service defines negligence as an "omission" which "a reasonable and prudent man would not do." In practice, however, the tax negligence provision has been applied to conduct far different from the traditional concept of negligence in tort law. Today the negligence provision is routinely applied to an intentional underpayment of taxes, although, literally, no negligence has occurred. Consequently, in application of the tax laws, the word "negligence" has come to have two distinct meanings: a failure to utilize proper care, and a lesser degree of intentional conduct than is required in practice to sustain a fraud penalty. (Inadvertent mathematical errors are not usually deemed to constitute negligence.)

Consequently, a surprisingly broad range of misconduct is covered by the negligence penalty. Flagrant fraud is often treated with the same level of penalty as is mere inadvertence. Such unequal results are probably not what Congress intended. But judicial and administrative constructions that have broadened the definition of negligence and narrowed the definition of fraud reflect a defect in the tax statutes as they presently are enforced. There is no penalty between the mild five percent penalty for negligence and the 50 percent penalty reserved for highly culpable conduct. However, an immense middle ground exists. There is an endless array of cases which involve reckless or intentional overstatement of deductions or understatements of income where the inaccuracy fails to reach the level of quasi-criminality now required to establish fraud. In effect, there is a vast "excluded middle" in the penalty system.

There are a number of different approaches that might be followed to fill the present gap in the penalty system. One approach would be to raise the negligence penalty to some substantial level, such as 25 percent. Presumably, this higher penalty would provide a substantial deterrent to tax cheating, but would seem excessive for simple negligence where the taxpayer has failed to take reasonable care in keeping records or preparing his return. To raise the level of the negligence penalty to deal with the problem of intentional misconduct would be to reverse the situation in an inequitable fashion. Instead of the cheaters being lumped with the negligent in the present scale of penalties, the negligent would find themselves penalized as cheaters.

Another possibility would be to create a new sliding scale of penalties. Thus, there might be a discretionary penalty ranging from five percent for simple negligence to 25 percent or more for intentional inaccuracies, with the levels in between used for grossly negligent or recklessly prepared returns, keeping the 50 percent penalty for highly culpable tax evasion. Such an approach, however, would confer considerable and presumably unacceptable discretionary power on the IRS to determine the level of punishment, which as applied would yield widely varying results in individual cases. Abuses of such discretionary power would be inevitable and difficult to police.

A third approach, and one *that is recommended*, is creation of a new intermediate penalty of, say, 25 percent. This penalty would apply to conduct more culpable than negligence but less culpable than quasi-criminal fraud or willful evasion. This approach would have the advantage of preserving the small but useful five percent penalty for negligence and the heavy 50 percent for aggravated tax evasion. The new intermediate penalty would be sufficiently severe that a taxpayer would have to weigh it in making any plans to cheat, and, consequently, should enhance the deterrent role of the penalty system. At the same time, a fixed intermediate penalty avoids the problem of granting excessive discretionary authority to the IRS and the courts.

To provide a clear trigger for the proposed new penalty, it would be necessary to redefine and restructure the civil penalties provision (Section 6653) in the Internal Revenue Code. The five percent penalty would be retained for negligence, which would be defined as failure to exercise reasonable care in keeping records or in preparing a tax return. The present five percent penalty for "intentional disregard of rules and regulations (but without intent to defraud)" should be repealed. The 50 percent penalty for civil fraud would be redefined to cover "willful tax evasion," and the confusing term "fraud" would be eliminated. The new intermediate penalty would apply to intentional or reckless inaccuracies where the conduct does not amount to willful tax evasion. Intentional underpayments would be those the taxpayer knew or was substantially certain would occur; reckless underpayment would occur when the taxpayer consciously disregarded a substantial risk of underpayment.

One effect of such a redefinition would be to make clear that the present 50 percent penalty for civil fraud is designed to reach the same kind of conduct (except often less extreme) covered in the criminal laws on tax evasion. This should help clarify the present confusion between civil and criminal fraud and help overcome the reluctance of the IRS to pursue civil fraud charges. The new in-between penalty would clearly cover conduct not serious enough to constitute willful tax evasion under the present civil fraud penalties but more egregious than ordinary carelessness. It would cover both intentionally inaccurate returns and those where the taxpayer proceeded despite his lack of knowledge that the figures on his return were incorrect.

In asserting the new penalty, it would be important to impose the burden of proof on the taxpayer to demonstrate that his conduct was not reckless or intentional. Procedurally, this would help draw a necessary distinction between civil fraud and intentional inaccuracies to be handled under the proposed intermediate penalty. In civil fraud, the burden of proof is placed on the government, reflecting the quasi-criminal nature of the charge. Under court rulings, the government has the additional burden of demonstrating bad faith or intentional wrong-doing, which means establishing the taxpayer's state of mind in preparing a return. Indeed, many rather obvious cases of intentional cheating fail to be treated as fraud under present law because of the onerous burden placed on the IRS of establishing the taxpayer's state of mind. Under the lesser intermediate penalty, the same burden of proof should not be imposed on the government. In effect, the government is waiving charges of civil fraud, which intentional inaccuracies might have amounted to in many cases. In return, the taxpayer should assume the burden of demonstrating that his conduct was not reckless or intentional. There would be a difference, however, in the standards of proof. In civil fraud, the government must prove its case in a clear and convincing fashion. With the proposed intermediate penalty, the taxpayer should only have to prove his case by a preponderance of the evidence. This, however, should not preclude the imposition of a negligence penalty in event the taxpayer should demonstrate that he was not guilty of reckless or intentional misconduct.

Assessment of Penalties for Different Degrees of Culpability

Under present law, the IRS, in assessing fraud penalties, does not distinguish between deficiencies caused by fraud or intentional errors and those caused by negligence or honest mistakes. The practice is to impose the 50 percent penalty for fraud on the entire deficiency even though only part of the deficiency is attributable to fraud.

The result quite frequently is a disproportionate and unfair penalty. For example, a taxpayer may have fraudulently evaded $5,000 in taxes. At the same time he may have another deficiency of $80,000 for claiming excessive depreciation, which occurred because of a good-faith but erroneous use of the wrong method of depreciation, and thus, at most, should be subject to the five percent penalty for negligence. Under present practice, the taxpayer would be required to pay a civil fraud penalty of $42,500 — or 50 percent of the total deficiency of $35,000 — even though only $5,000 of the deficiency was clearly attributable to fraud.

Obviously, this present method of computing penalties also discourages agents from asserting the fraud penalty where the total deficiency is very large but only a small part is attributable to fraud. Thus, the present computation method is contributing to the underutilization of the civil fraud penalty.

It would not be an administrative burden on the IRS to differentiate between the items making up a deficiency. It would seem a modest burden for the IRS to distinguish between the deficiencies caused by willful tax evasion, less flagrant intentional inaccuracies, negligent inaccuracies, non-negligent errors and bona fide disputes of law, just as each distinct item in a deficiency now has to be separately stated and supported in a deficiency notice.

It is therefore recommended that, in imposing any of the penalties for underpayment of tax, each penalty rate should be applied only to that portion of the underpayment as is attributable to conduct that is liable for such rate. The highest marginal tax rate should be applied to that portion of the deficiency attributable to conduct liable for the highest penalty rate, as illustrated in Appendix A to this summary.

Publicity of Civil Fraud Penalties

By law and by practice, a distinction is drawn between the publicity given criminal tax convictions and penalties imposed for civil fraud. The IRS publicizes criminal tax convictions, both those arising from guilty pleas as well as those from guilty verdicts. Such publicity obviously is viewed by the IRS as essential if criminal tax law enforcement is to have a deterrent impact upon the taxpaying public.

But the IRS does not publicize the imposition of the 50 percent civil penalty for fraud. If the taxpayer litigates the penalty, his name will appear in a court-reported case, but generally the press and the public would take no notice. If the taxpayer settles his case administratively, there is no publicity at all. One reason given for this secrecy is the bar to disclosure of individual tax return information. It is also argued that there is a difference between criminal tax cases, in which the convicted taxpayer has lost the right to privacy about his tax return, and civil fraud cases. The difference, however, does not seem persuasive in protecting the privacy of the person guilty of civil fraud. Most civil fraud cases are quasi-criminal in nature, characterized by highly blameworthy conduct, much worse than garden-variety tax chiseling. It can be argued that taxpayers who engage in such fraud have forfeited their right to privacy of tax data; that publicity for the penalty would increase its deterrent effect; and moreover, that publicity in itself would be a severe sanction, to many persons worse than any money penalty.

It is recommended, therefore, that the Internal Revenue Service should seek legislative instruction with respect to publicizing the imposition of the 50 percent penalty for fraudulent underpayment of tax (or, as recommended in 3–I above, restated as "willful attempt to evade payment of tax").

Penalties for Delinquencies in Filing Returns and Paying Taxes

The Internal Revenue Code (Section 6651) provides a penalty for failure to file a tax return on time. The penalty is five percent of the amount of the tax in the first month and an additional five percent for each succeeding month, up to a total penalty not exceeding 25 percent of the tax. However, the penalty is not imposed if the taxpayer establishes that his late filing "is due to reasonable cause and not due to willful neglect."

Failure to file is unquestionably a serious infraction, warranting a heavy penalty. There is a question, however, whether the penalty for non-filing does not escalate too quickly and terminate too soon. The five percent penalty for the first month obviously provides an incentive for the taxpayer to get his return in on time. But after the first month, the penalty escalates at an effective annual rate, 60 percent on the entire tax, that would generally be viewed as very steep, particularly so when the penalty for failure to pay a tax shown on a return is at the rate of only ½ of one percent per month or six percent annually. Moreover, the rapid escalation of the penalty seems to create an undesired side effect of encouraging procrastination on the part of the taxpayer after five months. When the maximum penalty has been reached after five months, the penalty creates no additional pressure to file.

It is recommended, therefore, that the penalty be stretched out over a longer period of time, and that after the first month the rate at which the penalty accrues be reduced. The penalty would become less onerous for relatively short-term delinquencies and provide an incentive over a longer period of time for a taxpayer to file his return.

Especially if this change not be made, *it is recommended* that the penalty be prorated after the first month to reflect the half of the month in which a return is finally filed. Under present law, a taxpayer is charged a full month's penalty for a delinquency of only one day of a month. It seems difficult to justify a system which treats a delinquency of one day the same as a delinquency of an entire month. The law as it stands encourages procrastination on the part of the taxpayer.

Administrative and Judicial Review of Late-Filing and Failure-to-Pay Penalties

The taxpayer who is assessed a penalty for late filing (or for failure to pay the full tax with his return) finds himself with little administrative or judicial recourse to overturn what may be an arbitrary decision on the part of the IRS. Such penalties are generated by computers at regional IRS Service Centers.

In principle, the penalty can be abated if the taxpayer can demonstrate that his delinquency is "due to reasonable cause and not due to willful neglect." But the practical opportunities for making such a demonstration are limited. Under IRS procedures, the delinquent taxpayer is supposed to submit a written explanation of his tardiness or failure to pay with his return. If no explanation accompanies the return, or if the processing section at the Service Center fails to accept the written explanation, a computer will send the taxpayer a bill for the penalty. The computer notice contains the telephone number of a local IRS office with which the taxpayer can communicate regarding the bill. The IRS employee at that number has access through a computer terminal to information about the taxpayer's account. If satisfied with the taxpayer's explanation, the employee can revoke or decrease the penalty. Alternatively, the taxpayer can write to the Service Center, where tax examiners consider his explanation and have authority to abate the penalty.

If the taxpayer fails to respond to the computer notice sent by the Service Center, three more letters are sent him, demanding payment of the penalty in increasingly urgent and threatening terms. Finally, the case is declared a Tax Delinquency Account and referred to collection personnel in the taxpayer's district. Employees in the Collection Division generally will contact the taxpayer and give him a final chance to explain the delinquency. If the explanation is not accepted by the responsible revenue officer, or his group manager, the drastic collection process begins against the taxpayer. (For details of the collection process, see Chapter 2.)

Failure-to-file cases may readily present disputable issues of law and fact. Late filing is excused if the taxpayer establishes that his delinquency was "due to reasonable cause and not due to willful neglect." The test is whether the taxpayer exercised ordinary business care and prudence. Needless to say, this sort of test does not lead to clear-cut and indisputable results in many cases, especially where illnesses, or the errors of tax advisers, are involved.

No doubt many of the explanations submitted by taxpayers are accepted by IRS officials. But if an explanation is rejected, the options open to the taxpayer are markedly different and more limited than those available to a taxpayer who has undergone audit. The audit procedures are available for inaccuracy penalties, but not failure-to-file or late payment penalties. If a deficiency is claimed after an audit, an elaborate negotiating procedure is open to the taxpayer before he has to pay the tax (and/or penalty). He can negotiate with the revenue agent's group chief, a district conferee and finally with the appellate division. If the matter is not resolved through negotiations within the IRS, he can file a petition with the Tax Court. Before the case has been heard by the court, he can negotiate further with the regional counsel. Only after the case has been decided against him by the court must he pay the tax and any accompanying penalties.

In contrast, the administrative relief available to a taxpayer before paying a delinquency penalty is very sparse. The taxpayer may send a letter to a tax examiner at the Service Center or speak over the telephone toll-free with an IRS employee. After his account has been declared a Tax Delinquency Account, he can try to convince the collection officers to whom the case has been assigned. But in order to negotiate further with the IRS, he must pay the penalty and file a claim for refund. If his claim is denied, he can litigate only in a Federal district court or the Court of Claims. The Tax Court, with its more informal and less expensive procedures, is not open to him.

In view of the muddiness of many reasonable cause determinations, the administrative and judicial review available to delinquent taxpayers seems most inadequate. It is doubted that a taxpayer (especially an uneducated one) should be expected to present his case in the form of a detailed written statement that will satisfy a harassed tax examiner in the Service Center. If he writes only that he was sick or that his accountant made a mistake, that will probably not be enough. But perhaps he does not know to write more. His alternative opportunity of making telephone contact with a local office may be helpful, though IRS telephone numbers are often busy, and it may prove difficult to explain over the telephone precisely what the excuse was. The employee may seem distant and not take the trouble to ask for additional, necessary details. Yet, if the taxpayer had the opportunity for a face-to-face negotiating session with trained IRS personnel, as under the audit procedure used for inaccuracy penalties, the excuse might be accepted. In order to provide more certainty and awareness for taxpayers of the reasons the Service accepts as excusing lateness in filing a return, *it is recommended* that a listing of such reasons should be officially set forth in the Service's regulations.

Recourse to the Federal district courts or the Court of Claims, after paying the penalties, is not adequate for many taxpayers, particularly those with lower incomes. Apart from the hardship of having to pay the penalty before going to court, the formidable procedural problems of dealing with Federal courts would require virtually every taxpayer to hire an attorney, which would hardly be practicable for cases involving less than some thousands of dollars in penalties. If access to the Tax Court were allowed, the taxpayer could litigate before paying, which may be of critical importance to his financial survival. He also would have the benefit of the relatively simple procedures of the Tax Court, especially those for the small tax case. He could represent himself or have his accountant represent him.

Accordingly, *it is recommended* that the appellate audit and settlement processes of the IRS, and the procedures of the Tax Court, be opened up to taxpayers disputing penalties for late filing or failure to pay with a tax return. Opinions vary as to whether this would place an undue administrative burden on the IRS, or would swamp the Tax Court, diverting it from consideration of more worthy tax disputes. But nobody really knows if that would be the effect. The IRS has no available statistics on how many delinquency penalties are assessed and how many are disputed after being processed by the IRS. In light of the patent inadequacy of the present recourses open to the taxpayer charged with delinquency penalties, it seems clear that more useful avenues of appeal should be opened to him.

APPENDIX A

If the penalties are computed as suggested in the text, the highest-level penalty will always attach to that segment of the income which is infected by the conduct to be penalized, and which is subject to the greatest tax rate which may be attributed to such segment. For example:

	Reported	Actual
Adjusted Gross Income	$47,000	$72,500
Itemized deductions		
Allowable medical expenses	300	—0—
Charitable	1,000	—0—
Other	2,500	2,500
Taxable income	$43,700	$70,000

Assume the following:

(a) $8,000 of underreported income is due to willful tax evasion.

(b) $7,000 of underreported income is due to an intentional inaccuracy which does not rise to willful tax evasion.

(c) The $1,000 charitable deduction was improperly claimed through negligence.

(d) $10,000 of underreported income is due to no fault of the taxpayer for which a penalty would be imposed.

Income	Tax	Tax Difference	Penalty
$70,000	$32,790		
8,000 attributable to tax evasion			
		$5,220 × 50%	$2,610
$62,000	$27,570		
7,000 attributable to intentional inaccuracy			
		$4,280 × 25%	$1,070
$55,000	$23,290		
1,000 attributable to negligence			
		$ 620 × 5%	$ 31
$54,000	$22,670		
10,300 without fault			
		$6,425 × 0	0
$43,700	$16,245		

(a) The tax evasion penalty would attach to the $5,220 difference in tax between the $70,000 and the $62,000 levels, as this difference was due to an $8,000 underreporting due to tax evasion.

(b) The intentional inaccuracy penalty would attach to the $4,280 difference in tax between the $62,000 and the $55,000 levels, as this difference was due to underreporting by reason of an intentional inaccuracy not rising to tax evasion.

(c) The negligence penalty would attach $1,000 difference in tax between the $55,000 and the $54,000 levels, as this difference is due to negligence.

(d) There would be no penalty on the $6,425 balance of the tax due, as it arose from faultless underreporting. This portion of the underreporting also resulted in eliminating the medical deduction, and there should be no penalty for the loss of it. However, had the medical deduction been larger, its elimination due to increased gross income could be attributed to the increased income and any tax liability resulting therefrom should bear the same penalty as the tax on the increase in gross income which eliminated or reduced the medical deduction.

CHAPTER 4 — THE IRS SUMMONS POWER

Among the broad powers given to the IRS to verify the accuracy of taxpayer returns and to collect taxes is its administrative authority to summon any taxpayer, his employer, accountant, banker or any other third party,* to supply relevant books and records and to require that such persons testify under oath.

The power of summons is vested by the IRS in Internal Revenue Agents, Revenue Officers and Special Agents, who are instructed not to use it wantonly or lightly. These IRS officials additionally are cautioned that summonses are to be used as a last resort to obtain information not otherwise available. A summons may be served by any authorized member of the IRS by delivering it into the hands of the summoned person or his authorized representative, or by leaving it at the individual's last known residence. It must permit at least 10 days before the taxpayer's or third party's appearance to permit time to gather the requested material or to prepare objections to the summons.

For all the apparent strengths of the IRS summons power, however, legal constraints are imposed, as there are on the enforcement of all administrative subpoenas. Partly because they are not clearly defined by the IRS, these constraints are likely to be unknown by the average taxpayer, who is apt to believe that his legal obligation to turn over the requested information is immediate and unconditional, and he is likely to assume that any failure to comply with an IRS summons can lead to substantial civil and criminal penalties and perhaps to harassing audits. This is not the case. Where the taxpayer asserts in good faith objections to the summons, he need not comply with the summons until such objections have been ruled on administratively and by a Federal court. Not infrequently a taxpayer may have legitimate reasons for not complying with a summons but is unaware of his right to object. As a consequence, he may comply and turn over information which he could rightfully withhold if properly advised.

For the average taxpayer a summons is a frightening, even intimidating, document inducing compliance. The tax code itself is perplexing on whether the taxpayer is obligated to comply. In one section (7210), it provides for fines and imprisonment for failure to obey a summons; but in another section (7604) it specifies that a summons can be enforced only by a Federal District Court.

As spelled out in a line of court decisions, however, the only immediate obligation of a taxpayer confronted with a summons is to appear before an IRS official to enter his objections to the summons. In the event that the

*The word "taxpayer," as used by itself in this chapter, should be understood to include any third party, unless the context makes it clear that only the taxpayer is being referred to.

official rejects the challenge to the summons, and the taxpayer or his representative or a third party refuses to produce documents or to testify, the IRS must decide whether to pursue enforcement. If the Service decides to seek enforcement, the case is taken to a Federal District Court which holds a hearing and makes a judicial determination as to whether the summons is valid. If the court orders compliance, a taxpayer's failure to obey a summons may subject him to contempt of court proceedings as well as to the civil or criminal penalties for contempt contained in the tax code.

Generally speaking, an IRS summons will not be enforced by the courts if it is vague, ambiguous or deficient; if the individual can establish that he cannot comply with its demands; if the purpose for which it is being used is improper; or if it was issued to harass a taxpayer or force him to settle a dispute. In the latter instance, the burden of proof is on the taxpayer, and courts have been reluctant to find a pattern of harassment and bad faith.

One of the controversial issues regarding the IRS' summons power is its use for criminal investigations. Taxpayers have persistently and strenuously objected to the use of summonses to obtain evidence of criminal tax fraud or evasion. Such use of administrative summonses for criminal investigatory purposes raises obvious problems of potential conflict with the Constitutional protection against self-incrimination.

Without question, the IRS uses its administrative summons power in connection with criminal tax fraud investigations. This is clear from the fact that Special Agents of the Service's Intelligence Division, whose chief function is to investigate criminal violations of the tax laws, are a major source of the summonses.

The courts have not squarely faced up to the question whether a summons may properly be issued to obtain evidence of a criminal tax law violation. In part, this is because the IRS persistently maintains that in addition to the criminal aspects of any case, the issuance of a summons always may lead to evidence of civil violations of the tax laws and facilitate proof and enforcement of tax liability.

In 1971, the Supreme Court, in *Donaldson* v. *U.S.*, approved the Service's use of an administrative summons to obtain evidence in a tax investigation from a taxpayer who was also under investigation for criminal violations of the tax code. The court decision established a two-pronged test, namely, that the summons must be issued prior to an IRS recommendation for criminal prosecution and that the summons be issued in "good faith," meaning for some proper purpose other than obtaining evidence of criminal violation. To establish lack of good faith, it is incumbent upon the individual to demonstrate that the summons was issued solely for criminal investigatory purposes.

The IRS' position is that any information "voluntarily" obtained through use of an administrative summons may be used against the individual even though it is incriminatory. True voluntary compliance, however, must be based on an adequate understanding of the IRS' summons power. If a person complies with a summons because he believes that failure to do so will result in the application of sanctions then his compliance would seem to be compelled by his fear based upon his lack of knowledge.

The use of a summons for criminal investigation thus reinforces the general observation that the IRS has a responsibility to advise those to whom a summons is issued of their rights to contest the request for information. Accordingly, *it is recommended* that the IRS revise its summons form to state expressly the administrative procedures available to the taxpayer for entering objections to supplying the information or testifying, and to indicate more accurately the circumstances in which failure to comply with the summons may subject the taxpayer to punishment.

Some taxpayers have objected that summonses were being used by the IRS for "fishing expeditions" through their records. The IRS acknowledges that there is an element of "fishing" but contends that it is legitimate. In its Handbook for Special Agents, the IRS states that:

> The purpose of a summons is not limited to obtaining records of what the Government already knows, therefore the Government is entitled to indulge in some "fishing."

The limitation established in the Handbook is that "a reasonable basis" must exist for the summons and tax investigators cannot engage in "arbitrary inquiry" or an "inquisition." In principle a summons may only demand production of records and testimony relevant or material in establishing the correctness of a tax return. The courts generally have held that the information sought in a summons was relevant and material, thus giving the IRS some latitude for "fishing."

Third-Party Summonses

The Internal Revenue Service uses its administrative summons power to demand records from banks, employers, accountants and others who have dealings with a taxpayer under investigation. In such cases, the IRS apparently feels under no obligation to notify the taxpayer — the person most directly involved — that a summons has been served on third parties. This raises a serious question whether the IRS has not assumed unduly sweeping authority to conduct fishing expeditions in search of information it can use against a taxpayer.

The third party, of course, does have the right to challenge a summons. And it appears that the courts generally require the IRS to make a greater showing of specificity, need, and relevance of the information in serving summonses on third parties. On occasion, third parties have successfully challenged summonses on the grounds that compliance would be unduly burdensome, that the requested material was not relevant or material to the inquiry, or that the description of the requested material was indefinite. However, the tendency of the courts is to modify, rather than to refuse to enforce, such summonses. Furthermore, many third parties, perhaps because they regard their own relations with the IRS as more important than their relations with a taxpayer under investigation, readily comply with the summonses.

It can be argued that in order to protect the rights of the taxpayer in case of third-party summonses, he should be given notice that a summons has been served on a third party so that he would be in a position to go to court to contest the summons or apply for restraints in compliance with the summons. An opposing argument is that investigations would be unduly hampered if the taxpayer were to receive notice of a summons to a third party. The latter argument unconvincingly puts alleged investigative needs of the IRS ahead of the rights of the individual taxpayer. The only way that the taxpayer's rights to contest or seek modification of a third-party summons can be assured is for him to become aware that the summons has been served against a third party.

Even when informed that a third-party summons has been served, a taxpayer faces considerable difficulties in the courts in blocking the summons. In its decision in *Reisman* v. *Caplin* in 1964, the Supreme Court indicated that a taxpayer or any affected person could be heard to challenge the enforcement of a third-party summons. Subsequently, intervention by the taxpayer was often liberally granted by the courts. In 1971 in the *Donaldson* case, however, the Supreme Court restricted the situations in which courts may permit intervention or restraints against third-party summons. The court held that a taxpayer has no absolute right to intervene or to prevent third-party compliance. Rather, the taxpayer must demonstrate that he has a "significantly protectable interest" in the records being sought. The taxpayer must establish that: (1) he has a proprietary interest in the books or papers summoned; (2) the summons was issued for an improper purpose; (3) the material is protected by some form of privilege; or (4) the material is the work product of his attorney. Even then, any restraint on compliance with the summons is in the court's discretion and may not be granted.

Recent court decisions add urgency to the desirability of adjusting the balance between the convenience of the Service and the rights of taxpayers in the use of third-party summonses. The IRS is amply protected by court decisions in asserting its authority to issue third-party summonses and in obtaining compliance with them. At the very least, the taxpayer should be put in a position where he can assert whatever rights he may have to contest a third-party summons, and to seek restraint on its enforcement, by being informed that the IRS is seeking to compel disclosure of information about him from a third party. Accordingly, *it is recommended* that at the time a summons is served on a third party, requesting testimony or production of documents concerning a taxpayer, or as soon after such service as feasible — and certainly before the return date of the summons — the Internal Revenue Service should deliver a copy of the summons to the taxpayer.

"John Doe" Summonses

Usually the IRS exercises its summons power when it suspects a specific individual may have a tax liability. On occasion, however, the Service uses a "John Doe" summons demanding records or information without stating the identity of the person under tax investigation.

The use of "John Doe" summonses involves the striking of a difficult balance that all too easily can tip toward unwarranted "fishing expeditions" on the part of the Government. On the one side is the legitimate interest of the IRS in conducting an investigation in a case where it suspects a tax may be due. An example, in an action upheld by the Supreme Court in *U.S.* v. *Bisceglia*, was a case where the Federal Reserve Bank of Cleveland received $40,000 in old $100 bills from a local Kentucky bank. This was unusual and caused the IRS to suspect that the money might relate to a transaction which had not been reported for tax purposes. The IRS issued a "John Doe" summons to an officer of the bank requesting extensive books and records which would disclose the identity of the depositor.

On the other side, however, is the possibility that "John Doe" summonses will be used by the IRS to rummage through the files of a financial institution or some other organization in the hope of discovering adverse information against unsuspected individuals. Indeed, at times the IRS seems to use its summons authority under Section 7602 of the Internal Revenue Code to enforce its general authority under Section 7601 to conduct canvasses of internal revenue districts to determine whether there are persons owing taxes.

The courts have been troubled by the use of broad, open-ended summonses by the IRS. In general, the courts are likely to uphold a "John Doe" summons if the IRS is engaged in an investigation of a suspected tax liability, even though the identity of the suspect is not immediately known. On the other hand, the courts seem less likely to enforce a "John Doe" summons to support a generalized inquiry.

The Commissioner of Internal Revenue has recently directed that "John Doe" summonses may not be issued without the prior approval of the District Chief of the IRS functional activity desiring to issue such a summons and a pre-issuance legal review by the IRS Regional Counsel's Office. The purpose of these new controls was explained to be "to ensure that the IRS does not become involved in 'fishing expeditions' that are merely an invasion of taxpayer's privacy" and uses its summons authority "only in limited and justifiable circumstances." Depending on the criteria that are formulated to govern approval of the issuance of "John Doe" summonses, it can be hoped that the new control procedures will have a salutary effect on the Service's use of such summonses.

Management of the Use of Summonses

The Internal Revenue Service compiles no systematic data about the issuance of summonses by its officials and employees. It has no records of how many summonses are issued, by whom, or for what purposes. Nor has it any records of experience arising from the issuance of summonses, e.g., the extent of voluntary compliance, the frequency and reasons for challenges by taxpayers, and the extent of efforts to obtain judicial enforcement and the results thereof. Without any systematic procedures for keeping track of how the summons power is exercised and what the consequences are, it is hard to see how the management of the Service can know whether the summons power is being properly exercised. Accordingly, *it is recommended* that the Internal Revenue Service prepare and maintain statistics and analyses designed to assure better oversight of the use of the summons by its officials and employees.

CHAPTER 5 — TAXPAYER SERVICES AND COMPLAINTS

Taxpayer Services.

The bewildering complexity of the nation's tax laws creates confusion and problems for individual taxpayers. In recognition of this, the Internal Revenue Service has long assumed an obligation to assist and advise the taxpayer in meeting his tax responsibilities.

To perform this assistance function IRS has created a Taxpayer Service Division, with more than 2,000 full time permanent employees. During the peak filing season, January to April 15, this corps is supplemented by hundreds of temporary, part-time or detailed-in employees. The overall budget for providing taxpayer services is approximately $100 million annually — an enormous figure in the absolute, but not so significant when compared to the total $1.6 billion budget of the Internal Revenue Service.

Initially, all taxpayer services were provided on a first come-first served basis in local offices. Today most of the assistance is provided by telephone. Thus, in 1955, 10 million taxpayers were assisted in IRS offices, while 4.7 million were served by telephone, but in 1974, 9.5 million were served on a walk-in basis and 24.7 million by phone. Not only do these figures show the increased reliance on telephone advice, but they show the growth in numbers seeking advice as well. These services are provided on a year round basis at all district and local offices, and during the filing season in special mobile and satellite offices in an effort to reach as many taxpayers needing aid as possible. The IRS has developed assistance programs aimed at reaching particular groups, such as the Spanish speaking, senior citizens and low income persons. It has developed services such as Volunteer Income Tax Assistance, in which taxpayers are trained to aid other taxpayers. It has additionally devised educational programs for high school and adult education classes, and special training programs for tax practitioners. It makes its staff available to deliver speeches. Special programs have been adopted, expanded, and refocused from year to year to meet new and changing needs.

The principal contact within the IRS for dealing with taxpayer requests is the Taxpayer Service Representative (TSR), whose exposure and training make him the most responsive person in the Service to taxpayer problems. Because of this exposure and their basically sympathetic approach to the taxpayer, Taxpayer Service Representatives are becoming a major public relations adjunct of the Internal Revenue Service.

The TSR position has been upgraded recently by the Service, which now requires that a candidate have at least six semester hours of college level accounting and a college degree or equivalent work experience. Before June, 1975 TSR's needed only two years of education beyond high school, or two years work experience which demonstrated an aptitude for meeting and dealing with people, plus an ability to understand a body of rules and to apply them to specific cases. Upon entering the Service, TSR's are required to undergo 11 weeks of training encompassing complex issues such as investment credits, and such technical matters as Automatic Data Processing and the Integrated Data Retrieval System.

Supplementing the permanent TSR's during the filing season are other personnel, including part-time and temporary TSR's and personnel detailed from the Audit and Collection Divisions. These divisional employees for the most part are relatively new personnel, whose training has been in their designated areas.

The Service provides three basic kinds of assistance: (1) tax return assistance and preparation; (2) resolution of problems stemming from IRS notices, communications, and failures to understand either, or from the IRS' bureaucratic structure; and (3) education of individuals or groups on their tax responsibilities.

The Service has no breakdown about the respective quantities of these services it does provide or the resources applied to each. Nevertheless, it seems likely that the bulk of services supplied in direct taxpayer contact are in the return assistance and preparation category, particularly since two-thirds of all taxpayer contacts occur during the peak filing season. After April 15 at least half the inquiries involve requests for aid in IRS procedural matters, such as delayed refund checks, computer notices, and conflicts with the bureaucracy.

To offset this lack of information, *it is recommended* that the Service compile data on all manpower and funds allocated for each type of taxpayer service performed.

Taxpayer assistance in substantive tax law is designed by the IRS to be on a basis that will enable the taxpayer to prepare his own return through the ready availability of clear and comprehensive information. Taxpayer Service Representatives are present in local and district offices to provide personalized service in explaining the forms, and in a limited number of cases to prepare returns for taxpayers.

Procedural assistance covers a wide range of activities, from the routine handling of requests for extension of filing time to problems emanating from IRS' heavy reliance on computers in processing taxpayer returns. This type of assistance may be of more significance to the taxpayer than return preparation, because there is no low-priced commercially available alternative assistance for coping with procedural problems, while there is for return preparation. Yet most taxpayers polled in a recent survey expressed a desire for more IRS help in return preparation.

TSR's are the most responsive employees of the IRS to taxpayer inquiries and problems. They have the ability to explain notices, to trace payments, and to initiate freezes on further notices in confused account situations. Through their knowledge of and access to IRS' computed information, they are capable of resolving taxpayer problems rapidly. There are, however, limits on the TSR's problem solving capabilities. For example, a TSR cannot delay, stop or interfere with an audit, nor can he initiate a freeze on a tangled taxpayer account after it has been referred for collection. And he is not equipped to deal effectively with taxpayer complaints emanating from taxpayer contact with an auditor or collection agent. In most circumstances such complaints are ignored, leaving the taxpayer with little opportunity to air or redress his grievance. The Taxpayer Contact Units in Service Centers are also critical cogs in resolving taxpayers' post filing procedural problems, which largely stem from confusing computer-generated notices. This unit has the ability to unsnare complicated account problems, which TSR's in district offices are generally unable to do.

The public measures the quality of service provided by the Taxpayer Services Division in terms of aid given in the preparation of tax returns rather than in procedural matters. Based on taxpayer polls of those who had used the service, the overwhelming majority of respondents gave high marks to the quality of assistance received. The taxpayer consumers found generally that the service was clear, complete, and courteous, and they stated that they would use it again. Whether this confidence is justified or not is open to some question.

Surveys of the quality of walk-in assistance conducted by several newspapers and by the Tax Reform Research Group between 1972 and 1974 showed a significant amount of error by IRS return preparers, although in no instance was the sample tax case complicated. Particularly troublesome for the IRS assistors was computing the allowable deduction for the expense of offices maintained by taxpayers in their homes. There were procedural and mathematical errors as well. In the survey conducted by the tax reform group, two IRS personnel substantially increased the tax liability by advising the use of the standard deduction. IRS' own surveys of the quality of telephone assistance have yielded error rates of 20% or more.

Given the poor quality found in the surveys it is apparent that there is a need for more comprehensive training of TSR's. The training problem, in turn, could be more effectively attacked if the Service systematically developed more precise information regarding the needs of users of taxpayer assistance, such as relative frequency of various categories of inquiry. Compounding the problem of inadequate training is the enormous staffing crisis the Service faces during the filing season when demand for services reaches a peak. To meet the increased workload, the Service has customarily tapped employees and former employees with varying levels of skills and experience and given them a little refresher training. It has also detailed to taxpayer assistance functions employees from Collection and Audit. Collection personnel are by outlook and training ill-suited for taxpayer assistance roles. Audit personnel, on the other hand, represent a valuable asset in taxpayer services because they are among the most highly skilled and experienced personnel in the Service, although not as likely as TSR's to advise the taxpayer in areas where substantial legal conflicts arise.

Since the seasonal nature of the taxpayer assistance program inevitably requires the assignment to this function of personnel of uneven qualifications and training, the quality of taxpayer service would be upgraded significantly if there were an approved mechanism to funnel complicated questions to more experienced technicians. To achieve this desired improvement, *it is recommended* that such a referral system be established, that it be supplemented by expanded and specific personnel training geared to ascertained taxpayer needs, and that expansion of the TSR workforce during the filing season should include as many personnel from the ranks of its most experienced and knowledgeable employees as possible.

Although IRS advice, whether given in response to telephone or walk-in inquiries, frequently proves inaccurate, the IRS has consistently refused to accept responsibility for errors in returns prepared by its employees or in reliance on its advice. Consequently, if IRS advice is incorrect the taxpayer is held responsible and must pay any deficiency, penalty or interest assessed as the result of its error. We conclude that this policy is appropriate because communication between the TSR and taxpayer may not always enable the TSR to accurately obtain all pertinent facts. Establishing the facts correctly would impose such heavy burdens the tax service structure might be in danger of collapse if assurance of complete accuracy were required. Additionally, the complexity of the law is such that it is impossible for tax law experts to agree on a uniform application of law to a given set of facts. Finally, since the advice generally relates to treatment of completed transactions, the taxpayer is ordinarily not worse off having to pay a deficiency than if he had paid the correct tax in the first place.

However, the Service should adopt procedures to avoid taxpayer misunderstanding regarding the nature of the advice and the reliance which may be placed on it. Accordingly, *it is recommended* that the Service inform taxpayers that answers given are based on the TSR's comprehension of the facts; that the Service is not bound by the answers given; and that the answers are based on the Service's interpretation of the law but that there may be authority for a different approach.

Taxpayer Complaints.

About 80 million individual income tax returns are filed and processed each year. Even in the best of situations the handling of so many accounts would not be an easy task. But the tax world is not the best. Its substantive rules and its procedures are complex, and the relationship of tax collector and taxpayer is inherently an adversary one. From such a relationship, so fraught with possibilities for misunderstanding and abrasive contact, some conflicts must be expected.

Some of these disputes involve only issues affecting tax liability. But others arise largely from a real or perceived abuse of authority, lack of response or over-reaction to the situation by one of the parties. These conflicts rarely reach the courts, and those taxpayers who may wish to pursue the matter administratively often look in vain for an effective mechanism for processing their complaints.

While a taxpayer who disagrees with a Service representative over a question of tax liability has open to him well marked routes of administrative and judicial review, and the Taxpayer Service Division provides adequate treatment for those complaints addressed to systemic dysfunctions, such as erroneous bills, unintelligible notices, and computer errors, those complaints which are addressed to the conduct or misconduct of Service personnel are subject to only an informal and largely *ad hoc* system of review, which varies with the organizational unit in which the complaint arises or in which it is received. The present system for handling such complaints lacks credibility because of its very formlessness and because it frequently involves review of complaints by those with direct supervisory responsibility for the action or personnel complained of.

In our judgment there is need for a new organizational mechanism within IRS with the function of receiving, evaluating and responding to taxpayer complaints. The Service's duties might be more easily discharged, and both its image and public awareness of its problems would likely be improved by a responsive taxpayer complaint-handling device. We believe that a procedure can be created which will fit within the existing system and will not adversely affect the basic responsibility of the Service for collecting the revenue.

The collection responsibility is indeed a most crucial one and the Service's effectiveness in this role must not be undermined. It is important that any device chosen not be one which lends itself to use by taxpayers in "beating the system." On the other hand, the effective collection of taxes would be enhanced rather than undermined by the presence of competent and understanding persons available to correct misunderstandings and unreasonable attitudes or to help avoid hardship.

A mechanism for the handling of taxpayer complaints should be (1) independent; (2) expert within its sphere of competence; (3) widely available; (4) highly visible; (5) client-centered; and (6) capable of developing general recommendations for the improvement of complaint-producing situations.

Therefore, *it is recommended* that the Service establish regular procedures for receiving, processing and resolving taxpayer complaints about the conduct of individual IRS employees. This complaint handling function might be placed in any of several existing organizational units of IRS, but its personnel should be independent of the line organizations where the complaints are likely to arise. The procedures should be well publicized, and they should be designed and operated to provide for line management the information necessary for taking corrective action with respect to the particular complaint and the more general problem areas.

CHAPTER 6 — CONFIDENTIALITY OF TAX RETURNS

The individual taxpayer expects that his income tax return will be treated as confidential by his government. It is a reasonable expectation since the taxpayer, under pain of financial penalties or even imprisonment, is required to provide information on his tax return that provides a skeletal yet revealing profile of his personal and financial life.

To a large though decreasing degree, the expectation is fulfilled. Information contained in tax returns is not made available to the general public. In fact, there have long been penalties under the tax code against unauthorized disclosure of information in tax returns by Federal or state employees. Since information on tax returns generally has not been available to the public, there is a widespread impression that tax returns are confidential documents. Indeed, public figures have contributed to this impression by consistently referring to tax returns as if they were documents locked away in the Internal Revenue Service's vaults. Increasingly over the past half century, however, this public impression has been more myth than reality.

Beginning about 1920, without a change in the tax code, there has been a gradual administrative erosion of the confidentiality of tax returns. The government continues to maintain their confidentiality so far as the general public is concerned. Within the government, however, the returns more and more have come to be viewed as a general resource available for purposes going far beyond the administration of the tax laws. Tax returns have become readily available sources of information, used by the government to study the population in general and to investigate individuals in particular.

As a result, within the government there has been a dissemination of tax returns going far beyond the Internal Revenue Service. Federal agencies, such as the Census Bureau, receive "raw" tax data from tax returns in the form of IRS computer tapes for use in a host of business and economic studies and analyses. States receive tax return information to help in the administration of their tax laws. Committees of Congress, including those not involved in the writing of tax laws, can and do obtain tax return information. The Department of Justice systematically obtains returns for use in civil cases as well as for use in developing criminal charges that do not involve violation of the tax laws. The White House and other Executive agencies routinely obtain "tax check" reports on persons under consideration for government jobs. In the wake of the Watergate affair, there also are questions as to whether the White House has not obtained access to tax returns for political purposes.

One of the striking features of the broadening dissemination of tax returns within the government is that it has occurred largely through regulations prepared only by the Executive branch rather than as a result of laws passed by Congress. Certainly, a practice that is based on largely unpublicized administrative decisions and which departs significantly from concepts of confidentiality commonly held by the public and Congress is open to question and needs basic reexamination.

Disclosure of Tax Returns to Other Executive Agencies

The extent to which tax returns should be available for legitimate functions of the Federal government apart from collection of taxes is a question fraught with deep and difficult philosophical and legal issues. At least in principle, a strong case can be made that tax returns should be an instrument for administering the tax laws and nothing more. Certainly, the opportunity for invasion of citizen privacy increases when a tax return escapes the grasp of the Internal Revenue Service. On the other side, an argument can be made that non-revenue use of tax returns can frequently serve a meritorious social purpose. Some uses would seem more meritorious and less intrusive than others. For example, some would see little harm in the use by the Census Bureau of computerized tax return information to distill purely statistical data about the population in general, but would shudder at the thought of the Department of Justice "fishing" through individual tax returns to develop leads in non-tax criminal cases. Others, however, might consider it the duty as well as the right of the government to use all information available to it, including tax returns, in the drive against organized crime.

Legal and constitutional issues also abound, stretching from the individual citizen to the presidency. For example, after the Watergate experience, many consider it highly important to place restrictions on the availability of tax return information to the President. Considering, however, the broad constitutional authority that the President has over any officer of an Executive agency, there may be a problem in establishing viable restrictions over his access to data in the hands of the Internal Revenue Service. On the individual level, the prosecutorial use by the Justice Department of information obtained from tax returns, which taxpayers are required to prepare fully and truthfully under penalty of law, must be balanced against the individual's protection under the Fifth Amendment against self-incrimination.

The dichotomy between tax returns being viewed as confidential documents and as governmental assets is embodied in the tax code itself. Section 6103, which is the basic policy provision in the code dealing with confidentiality, states that tax returns "shall constitute public records" and "shall be open to inspection only upon orders of the President and under rules and regulations prescribed by the Secretary [of the Treasury] or his delegate and approved by the President." The result is an outwardly contradictory and confusing concept that tax returns are to be "public" records but are to be made available only at the order of the

President. By interpretation and practice, "public" has come to mean records belonging to the government rather than the general public.

The dichotomy has its historical antecedents in the first income tax laws passed during the Civil War. From the start there was a debate over whether tax returns should be generally available to the public or should be confidential documents available only to the government. The furor over publicity of tax returns, interestingly, was one of the central causes of the early demise of the income tax as a revenue-raising instrument after the Civil War. By 1909 and 1910, when an excise tax was imposed on corporations, the weight of Congressional opinion had come down on the side of confidentiality, built around the concept that has persisted until today that tax returns were "public records" with access to them controlled by the President and the Secretary of the Treasury.

The 1913 Act that imposed an income tax upon individuals perpetuated this somewhat ill-defined confidentiality concept. Embodied in this concept was the embryonic notion that tax returns were generalized government assets — a notion that was to flourish as the government became infiltrated first by statisticians and later by computers. Under regulations carrying out the 1913 law, inspection of individual tax returns was denied to anyone not an employee of the Treasury Department. Release of returns was allowed only in legal proceedings to which the United States was a party.

By 1920, however, the regulations were relaxed. Government agencies other than the Treasury Department were permitted, at the discretion of the Secretary of the Treasury, to inspect both corporate and individual income tax returns. At the same time, the Executive branch repealed a regulation, dating back to the 1909 law, permitting public access to certain corporate returns. Thereafter, the public would be denied unrestricted access to any returns, but governmental access to returns would be broadened. State tax officials were added in 1921 to the governmental group permitted access to returns. In 1930, President Hoover set a significant precedent by approving a regulation authorizing the Department of Commerce to inspect returns for statistical purposes. In 1933, President Roosevelt approved a regulation permitting a special Senate Committee investigating air mail contracts to examine returns, and in 1935 the examination rights were extended to another non-tax-writing Congressional committee. These precedents were but the first drops of a gentle rain which nearly became a downpour, with later presidents issuing at least 110 Executive orders permitting various Congressional committees to inspect tax returns.

A broad overhaul of the regulations in 1938 greatly facilitated access to returns by United States Attorneys and attorneys of the Justice Department for use in cases not involving tax violations. Later the same year, the regulations were amended to permit any government agency to obtain tax return information for evidentiary use in proceedings conducted by or before it and to which the United States was a party. The 1940's, 1950's, and 1960's were marked by almost unrestrained growth in the access to tax returns by government agencies, largely for statistical purposes.

The early 1970's saw the first steps to stem, if not yet reverse, this tide toward ever greater governmental access to tax returns. The processing of requests by U.S. Attorneys, or by attorneys of the Department of Justice, for returns to be used in non-tax litigation, or for use in grand jury proceedings, was shifted from District Directors of the Internal Revenue Service to the National Office of IRS. Regulations were amended to deny to Justice Department attorneys access to tax returns for examining prospective jurors. After Congressional protests, a proposed regulation authorizing the Agriculture Department access to tax returns of farmers for a proposed economic study of the farming industry was withdrawn. More detailed rules for White House access to tax returns were developed. And finally, the definition of "return" was broadened to include any information related to the return "or other written statements filed on behalf of the taxpayer." It was provided that these internal documents relating to a taxpayer's return would be available "only in the discretion of the Secretary [of the Treasury] or the Commissioner [of Internal Revenue] or the delegate of either."

The growth of governmental access to tax returns has been based on a somewhat ambiguous statute which, in all significant respects, has been unchanged since 1910. Thus, the story is one of exercise by the Executive Branch of discretion granted by a Congress unwilling to define precisely the policy to be followed. Having granted such discretion, Congress should not be surprised that the Executive Branch has exercised that discretion.

Despite the growth in governmental access, the thought persists in Congress, and among the public as well, that tax returns are generally confidential. There seems to be little public awareness that the principle of confidentiality has been progressively eroded by administrative process. For all its ambiguity, the current statutory language is more consistent with the concept of confidentiality than with present governmental practices. Given this fact, and the public assumption that tax returns are confidential, there seems little to justify the exploitation of tax returns for investigative purposes, particularly on a dragnet basis, as is now done by the Justice Department. There is no use of tax returns more in conflict with the principle of confidentiality than their use for investigative purposes. Information on tax returns which most people assume is confidential, and which is obtained under compulsion, is being used by the government to investigate crimes unrelated to the tax laws.

There are basically two methods by which government agencies obtain tax returns from the IRS. One is under a so-called "catchall" regulation which permits an agency to have its executive head request inspection by an agency employee in connection with a matter officially before the agency. The request must be in writing, signed by the agency head, and must set forth the name and address of the taxpayer, the type of tax, the period covered by the return, and the reason for the inspection. Nominally, the Secretary of the Treasury or the Commissioner of Internal Revenue retain discretion to deny inspection. In practice, however, such discretion is rarely exercised, although the Commissioner may request clarification of the request or seek to limit inspection to information clearly pertinent to the request. In principle, the agency head must specify why inspection of a tax return is necessary but in practice many of the requests are vague and indefinite, frequently stating only, for example, that an investigation is underway in a certain area and that the return is needed. As a result, the requirement for a statement of reasons for inspection, which was supposed to provide a discretionary restraint, has become largely a charade.

The second method to obtain tax returns is through the existence of so-called "blanket" authority, approved by the President, for an agency to inspect returns. The regulations providing for "blanket" authority generally state the circumstances under which inspection will be permitted and do not impose the procedural requirements of naming a taxpayer, giving an address, stating the type of tax and return period. While the language of such regulations state that the Treasury Department "may" furnish the requested information, this has not generally been interpreted as giving the Department discretionary authority to refuse the information.

By and large, requests under the "catchall" provision are for investigative purposes. On the other hand, the majority of returns requested under the "blanket" regulations are for the purpose of gathering statistical data. The "blanket" regulations, thus, are designed for large-volume users of tax returns who have general rather than specific reasons for their use and are interested in the returns of classes or groups of taxpayers rather than in those of specific individuals.

The inspection of tax returns by Justice Department attorneys and U.S. Attorneys is governed by a separate set of special "investigative" regulations. These provide that a "return . . . shall be open to inspection by a United States Attorney or by an attorney of the Department of Justice where necessary in the performance of his duties." Under these regulations, the request must be signed by either the Attorney General, Deputy Attorney General or an Assistant Attorney General if the information is needed by a Justice Department attorney, or by a United States Attorney if the return is needed by him. The regulations specify that the request must state "the reason why inspection is desired," but most of the requests do not make precisely clear why access to a tax return is needed. Another "investigative" provision provides that a United States Attorney, or an attorney of the Department of Justice, may obtain tax returns "for official use in proceedings, before a United States grand jury, or in litigation in any court, if the United States is interested in the result, or for use in preparation for such proceedings."

Prior to 1970 the Service kept only sketchy statistics on requests by government agencies for tax returns. Since that time, however, it has made a semi-annual report to the Congressional Joint Committee on Internal Revenue Taxation setting forth the number and types of tax return requests as well as a summary of the reasons given by the agencies for requesting the information. The semi-annual report for the first half of 1974 shows the following data concerning requests for tax returns by various federal agencies:

Requests pursuant to blanket regulations:

Agency	No. of Returns
Department of Health, Education & Welfare	3,895
Department of Commerce	20,000,000
Renegotiation Board	867
Federal Trade Commission	58,729

Requests pursuant to catchall and investigative regulations:

Agency	No. of Requests	No. of Taxpayers	No. of Returns
Department of Agriculture	1	3	3
Department of Commerce	1	5	5
U.S. Customs Service	1	3	12
Federal Deposit Ins. Corp.	1	12	12
Federal Home Loan Bank Board	2	28	112
General Accounting Office	1	342	342
Interstate Commerce Commission	2	9	45
Department of Justice (other than U.S. Attorneys)	226	2,087	6,114
United States Attorneys	852	2,635	9,570
Department of Labor	1	2	6
Securities and Exchange Comm.	10	55	238
Renegotiation Board	1	11	21
	1,099	5,192	16,480

The tax information supplied by the IRS varies considerably, depending upon whether it is requested under the "catchall" or "blanket" regulations. In the "catchall," investigative request, the IRS tends to turn over the actual return of a taxpayer. Under the "blanket" authority, most agencies do not get the return itself but only data taken from the return. The Bureau of Census, for example, frequently gets only entity data — such as name, address, and social security number. It may also obtain financial data in the form of a computer tape containing information which is limited to amount and type of income, and information relating to deductions.

What information is made available by the IRS under an investigative request is complicated by the Service's bifurcated definition of what constitutes a "return." A return is first defined as including "information returns, schedules, lists and other written statements filed by or on behalf of the taxpayer" as well as audit reports, claims for refund, and notices of over-assessment or adjustments. Under the "catchall" regulations, a Federal agency is entitled to obtain all information falling within these categories. There is, however, a second grouping of information, embracing, for the most part, material prepared within the Service, such as work papers of examiners, cover letters, reports of special agents, and inter-office communications. This latter material (which embraces information obtained from third parties, including voluntary informants, IRS investigative reports, and data obtained by third-party summonses) is not available as a matter of right to the requesting agency but "only in the discretion" of the Secretary of Treasury or the Commissioner of Internal Revenue. In response to investigative requests, however, the Service usually will produce both the documents filed by the taxpayer as well as most material prepared inside the IRS, including conferences' and revenue agents' reports. Some information, such as work papers of examiners, cover letters, reports of special agents, and inter-office communications, may be obtained only with the express authorization of the Assistant Commissioner for Compliance.

The problem of defining the information to be covered by a "return" has been further complicated by a 1972 amendment to the regulations redefining the nature and coverage of a "return." Instead of providing, as in the past, that internal IRS documents could, in the Commissioner's discretion, be made part of the return, the 1972 change provides that all such internal documents are considered part of the return.

While the Service and the Treasury Department deny the suggestion, some observers believe that the reason for the 1972 change was to sweep internal IRS documents into the definition of a return, thus preventing their disclosure under the Freedom of Information Act which came into force in 1967. The IRS has contended that the objective of the 1972 change was to extend the basic policy of confidentiality to "every item in our computers, to every memorandum, report or document." At the same time the Commissioner of Internal Revenue has sought to maintain discretion over the release of the "associated" internal documents. Whether this effort to retain discretion will be successful is open to question. The Service has now defined the associated documents as part of the return, and there are numerous regulations that require disclosure of returns. There is therefore an apparent inconsistency between the mandatory disclosure of returns and the IRS effort to retain some discretion over release of the "associated" documents.

Agency Use of Tax Information

The principal, most consistent users of tax return information have been the Department of Justice, the various United States Attorneys, the Bureaus of the Census and of Economic Analysis of the Department of Commerce, the Social Security Administration, and the Federal Trade Commission. In addition, over the years, such tax information has been used by more than two dozen other departments and agencies, largely for investigative purposes. The purposes have ranged from investigation of profits on charter flights by the Civil Aeronautics Board to alleged kick-backs by a borrower from the Rural Electrification Administration.

By far the biggest user of income tax return information is the Department of Commerce. Almost all of the Commerce Department's use of tax information is by the Bureau of the Census and the Bureau of Economic Analysis. For business surveys during the first half of 1973, the Commerce Department requested, under its "blanket" regulation, information appearing on 75,000 partnership tax returns, 1,042,000 corporate income tax returns and 6,705,000 proprietorship returns. The Department also received information on 78,216,000 individual returns for use in updating the Population Migration Study and Revenue Sharing Estimates.

The Census Bureau first began using tax return data in 1944 and by 1950 had concluded they constitute a very economical, accurate basis for making economic and social surveys. Four types of census and survey activities are performed by the Bureau utilizing tax return data. One is the Economic Census which covers manufacturing, mining, retail and wholesale trade, service industries, construction, and transportation. This census, conducted every five years, provides a primary source of facts about the structure and functioning of the nation's economy. A second is the Census of Agriculture, also quinquennial, which provides data concerning farm size, type, tenure, form of organization, and market value of products. A third survey conducted by the Census Bureau with use of tax data is the compilation of Current Economic Indicators, a broad series of weekly, monthly, quarterly and annual surveys of trends in trades and industries. Finally, the Bureau conducts a Survey of Minority-Owned Business Enterprises to develop data on the extent and growth of minority participation in private enterprise.

Aside from these four surveys, the Census Bureau conducts a Demographic Statistics Program to furnish population and per capita income estimates on which to base allocation of revenue-sharing funds to state and local governments. Tax information also permits the Bureau to obtain data on migratory patterns within the national population.

The Bureau of Economic Analysis makes much more limited use of tax return information, deriving most of the tax information it needs from the Statistics of Income, an annual publication of statistical material derived from tax returns. Other agencies making use of tax return information for statistical surveys are the Federal Trade Commission and the Renegotiation Board.

Most statistical uses of income tax information are for compiling what are regarded as essential economic data for government planning. In many cases, the tax return information serves the purpose of identifying further sources of information. In other instances, the return information itself is converted into statistical information. Most of the tax return information is transmitted by the IRS in a form that makes identification of the individual taxpayer either difficult or impossible. Not only is the anonymity of taxpayers preserved, but also the material is handled by department and agency offices and bureaus having no power to take actions affecting directly the taxpayers whose returns are furnished. Hence, this type of disclosure of tax information would seem the least offensive of all as an infringement upon the complete confidentiality of tax returns. Whatever small infringement may exist, it appears to be far outweighed by the benefits of obtaining objective information on which to base national government economic and social policies.

To the concern of the Census Bureau, the Service recently has adopted new procedures which may reduce the availability of tax data for statistical purposes. The Service apparently has concluded that income tax data should be available for statistical purposes only if (1) the data are absolutely essential and (2) no satisfactory substitute can be found. The revised procedures apparently reflect a new policy emphasis by the IRS upon protecting the confidentiality of tax returns.

Another potential restriction on the dissemination of tax return information is presented by the Privacy Act enacted in 1974. One of the principal purposes of the Act is to restrict the use by Federal agencies of information about individuals to the purposes for which it was obtained. In principle, this objective conflicts directly with the use of tax returns for statistical or non-tax-related investigative purposes. In a key provision, the Act provides that no agency shall disclose any individual's record to another agency except with the written consent of the individual to whom the record pertains. The provision, however, contains exceptions, pertinent to the use of tax returns, stating that consent is not required for either "routine use" of the record or for "civil or criminal law enforcement activity." Privacy Act guidelines issued by the Office of Management and Budget to implement the law appear to take the position that disclosures to other Federal agencies by IRS of individual tax returns to be used for statistical or investigative purposes may be described as "routine use," thus exempting tax returns from the restrictions on disclosure of the law.

Aside from statistical purposes, the largest use of tax return information by government agencies is for investigating possible violations of laws other than the tax code by the Justice Department, United States

Attorneys and the Securities and Exchange Commission.

The majority of the returns requested by the Justice Department are for criminal investigations, particularly by "strike forces," the interagency task force created some 15 years ago to provide a coordinated attack on organized crime. The strike force concept has become inextricably linked to the use of tax returns for the investigative purposes. Service representatives from the Audit and Intelligence Divisions have been assigned to the strike forces to help single out individuals for investigation. In addition, the Service has placed itself in the position of volunteering tax information to the Justice Department, particularly when it desires to have a taxpayer selected as a strike force target. The IRS engages in this act of voluntary disclosure by sending the name of a suspected law violator to the Justice Department with the notation that the Service may have information on the taxpayer which Justice may find useful. Under the appropriate regulation, the Justice Department then requests and obtains the information from the IRS. To do this, the IRS has had to make a dubious interpretation of a provision in the tax code (Section 7213) which prohibits disclosure of tax returns by IRS personnel. The IRS rationale is that the prohibitions apply to information in the tax return and not to the name of the taxpayer. From June 1, 1973, through October 31, 1974, 240 taxpayers were so "voluntarily" identified to the Justice Department by the IRS.

Among U.S. Attorneys there has been a growing demand for tax returns for investigative purposes as they have adopted the task force approach toward crime. Disclosure of tax return information to U.S. Attorneys poses a particular problem in protecting the confidentiality of such information. U.S. Attorneys are political appointees who very often harbor political ambitions. Placing confidential material in their hands raises a potential for political abuse.

The use of tax returns for investigative purposes generally raises a multitude of legal and administrative problems. By far the most serious problem is whether the disclosure of information, provided by the individual taxpayer on his tax return, for use in prosecution for non-tax crimes, violates the Fifth Amendment protection against self-incrimination. The preparation and filing of truthful and accurate tax returns is compelled for reasons unrelated to criminal law. Subsequent use of the information from tax returns for prosecutorial purposes in a non-tax proceeding raises difficult questions about the scope of the protection against self-incrimination in a mandatory, self-assessment taxation system. Until recently, no court had squarely faced the issues presented by the use of a taxpayer's return in non-tax criminal cases. The issues have now been raised in the case of *Garner* v. *United States*, which was heard by the Supreme Court on November 3, 1975. Garner was prosecuted and convicted for Federal gambling violations. The principal items of evidence were his tax returns, which revealed that almost all of his income was derived from wagering.

Administratively, the IRS's close involvement in criminal law enforcement raises the serious problem that the Service may be diverting resources and energies away from its primary job of collecting taxes and enforcing the tax laws and in the process acquiring a punitive public image as a law enforcement agency. It was a possibility recognized by Commissioner of Internal Revenue Donald C. Alexander, who in a 1974 speech warned that the emphasis on non-tax criminal law enforcement could "be jeopardizing our traditional tax administration processes, both from the standpoint of the most effective use of our resources and from the standpoint of the public's faith in an impartial, non-political tax system." In announcing that the Service would withdraw the Audit Division representative from Strike Force teams, Mr. Alexander said, "The overall emphasis of our criminal enforcement activities has been shifted away from special enforcement programs, such as narcotics traffickers and strike forces, and has been aimed more directly toward the taxpaying public in general."

The most general and perhaps most fundamental recommendation growing out of this report is that disclosures of income tax returns and tax return information (as covered by the Service's present definition of "return") of individuals and decedents, by the Internal Revenue Service to any persons or officials outside the Service should be made only as permitted by express statutory authorization designating the persons to whom and the purposes for which disclosure may be made, the procedures governing such disclosure, and limitations on use or redisclosure that shall govern such disclosure. The execution of this recommendation would entail the enactment of legislation establishing the foregoing principle and repealing the authority now provided in Section 6103(a) of the tax code for inspection or disclosure of tax returns upon order of the President and under presidentially approved rules and regulations of the Secretary of the Treasury or his delegate.

The purpose of this recommendation is to lodge exclusively in the Congress the responsibility for determining what uses and disclosures of tax returns, pertaining to individuals and decedents, may be made for purposes other than those necessary for the administration of the Federal revenue laws by the Internal Revenue Service. Execution of this recommendation should serve to stanch once and for all the flows of such tax returns resulting from purely administrative action, taken with little or no publicity, and for reasons of administrative efficiency or convenience. The intent of requiring that the Congress determine each type of disclosure of individual tax returns to be made for any purpose unrelated to administration of the tax laws is to maximize the likelihood that members of the taxpaying public will have knowledge of any proposal for such disclosures and opportunity to influence the determination to be made by the Congress; it is expected that in this way there will be a careful balancing of conflicting interests at stake in the determination, including, on the one hand, those of effective tax administration and personal privacy and, on the other hand, enhanced convenience or efficiency in prosecuting various governmental or societal purposes.

Another principal recommendation growing out of this report is to constrain the authority of the Internal Revenue Service to transfer tax return data pertaining to individuals and decedents to other Executive agencies. The Service should be prohibited from disclosing individual and decedent tax return and associated information to another government agency for use in criminal or civil investigations unrelated to administration of the tax laws. Pursuant to the recommendation, each tax return could still be turned over to the Justice Department or a U.S. Attorney for use in civil or criminal litigation involving the tax laws. Returns also could be provided to the Treasury Department for tax policy-making, to the Commerce Department's Bureaus of the Census and of Economic Analysis for statistical studies, to the Social Security Administration for administering the Social Security Act, and to the Labor Department and the Pension Benefit Guaranty Corporation for administering the Employee Retirement Income Security Act. Any Federal department or agency authorized to receive individual tax returns in a form permitting identification of a taxpayer should only be able to do so if it has legally binding procedures acceptable to the IRS to insure that the returns may not be used or redisclosed for any purpose other than for which the returns were provided.

Another approach to limiting disclosure of tax returns by the Service which deserves consideration has been proposed by Senator Joseph Montoya as Chairman of the Senate Appropriations Subcommittee overseeing the IRS. The Montoya Bill (S.1511) would provide that a Federal or state agency could inspect a tax return in non-tax cases only if it obtained a court order showing that the information in the return was necessary for the investigation and that no alternative source of information was reasonably available.

White House Access to Tax Returns

In recent decades there has been a lingering suspicion that given the awesome power of the presidency over the bureaucracy, the White House had undue access to tax returns and was perhaps using them for political purposes. The suspicions seemed to be confirmed by events in recent presidencies. Early in the Kennedy Administration, Carmine S. Bellino, a special consultant to the President, entered into arrangements with the IRS to inspect tax returns and associated documents. Similarly, in the Nixon Administration, Clark R. Mollenhoff, Deputy Counsel to the

President, reached an understanding with the Commissioner of Internal Revenue concerning the inspection of tax returns. So far as is known, neither individual had an actual presidential order to inspect tax returns. They merely exercised the influence of the White House to obtain access to tax information. In the course of the Watergate investigations, further evidence was developed that tax return information was improperly transmitted to the White House.

The Watergate experience made it clear that the unfettered ability of White House employees to obtain tax return information presents distinct potential for abuse. This was acknowledged by President Ford, who, a few weeks after assuming the presidency, issued an Executive order designed to control White House access to tax information. The Ford order had three key provisions: 1) returns "shall be delivered to or open to inspection by the President only upon written request signed by the President personally;" 2) any such request for tax return data shall be addressed to the Secretary of the Treasury and shall state the name and address of the taxpayer, the kind of tax, and the taxable periods involved, and 3) the President "may designate an employee or employees of the White House office who are authorized on behalf of the President to receive any such return . . ." Interestingly, the order does not require that the President specify why a tax return is needed although such a requirement is generally placed on executive agencies seeking tax information from the Service.

If reform is needed in this area — and it seems agreed that it is — the question is whether it should take the form of administrative change, such as that ordered by President Ford, or statutory change by Congress in the basic law. Statutory change has the advantage of relative permanency. An Executive order, on the other hand, is subject to modification at the discretion, or even the whim, of a President. While it is difficult to imagine a President having the temerity to alter the general approach of the Ford Executive order in the foreseeable future, a change could well be made once public concern over the problem has subsided. Relaxation of legislatively imposed standards would come far less easily and presumably would attract public scrutiny.

Statutory restrictions may raise a question as to whether Congress would be unduly curbing the President's constitutional authority to see that the laws are faithfully executed. If the President is to carry out this authority, he must in principle have access to information within the Executive branch. Such a constitutional issue, however, does not seem insurmountable, particularly if the statutory restrictions stop short of a complete prohibition on the disclosure of tax return information to the President.

A statutory change which falls short of a complete restriction would still constitute a considerable improvement over present law and practice. Accordingly, *it is recommended* that legislation be enacted restricting the availability of tax returns to the Executive Office of the President. If such legislation is to be effective, it must incorporate certain safeguards. First, the request for tax data should be signed by the President personally. Second, the request should designate, by name, the White House employee or employees to whom the tax data may properly be furnished by the IRS. Third, the presidential request should state in a full and complete manner why the tax return information is desired. Fourth, some procedures should be required to control dissemination of the information once it is obtained by the White House and to provide for its eventual return to the Internal Revenue Service. Fifth, an outside group, such as the Congressional committees having jurisdiction over tax matters, should periodically be informed by the Service of the instances in which the White House has requested tax information.

Of these proposed safeguards, two are of critical importance to the prevention of political misuse of tax return information by the White House. One is the requirement that the President state in full his reasons for wanting to see a tax return. The other is the provision for periodic review of the Presidential requests by appropriate Congressional committees. If the reasons for a request must be stated fully and accurately, it is less likely that a President would attempt to obtain tax return information for political purposes. The possibility would be lessened further if a President realized that his requests would be reviewed by Congressional committees.

Another questionable tax practice initiated by the White House and now widely followed within the Executive branch is the somewhat secretive check on the tax status of individuals under consideration of appointment to Federal jobs. Since 1961, the so-called "tax checks" have become part of the "character investigations" of prospective appointees conducted by the Federal Bureau of Investigation. Upon a request by the FBI, the Service furnishes information on whether the individual has paid income taxes, liens, criminal tax investigations or civil penalties for fraud and negligence. Tax checks are an example of how a practice, which started out as a device to check on a few high-level presidential appointees, can be copied and spread throughout the Executive branch. The White House requests tax checks concerning all its own appointees — from gardeners to cabinet ministers. Other departments of the Executive branch usually reserve the tax checks for high level positions.

During the recent years, the White House and other Executive agencies have requested total numbers of tax checks as shown in the following table:

	1966	1967	1968	1969	1970	1971	1972	1973	1974
White House	547	583	880	1263	868	1134	915	1081	1045
Department of Justice	547	495	517	1424	1162	1274	772	999	335
Department of Treasury	91	240	89	258	412	233	393	397	775
Department of State	242	16	9	5	4	76	105	113	148
Department of Commerce	75	67	74	113	133	94	114	121	106
Department of Agriculture	0	0	0	69	183	72	—	—	—
Export-Import Bank	0	0	0	0	16	17	9	13	15

Apparently there are two rationalizations for the tax check. The first is that the tax status information has some relevance to the competence or fitness of the individual for a public job. The second is to spare the President the embarrassment of appointing someone with serious recent or current tax trouble. Both justifications sidestep the possibility that the prospective employee could be required to furnish copies of his tax returns or alternatively, as would now seem to be required under the Privacy Act, could give his written consent to inspection of his tax returns. Such directness, however, would frequently undercut the secret manner in which individuals are considered for Federal positions.

Some procedural steps have been taken by the Service to lessen the likelihood of abuse, such as requiring that there be a written request for a tax check and that the President designate the individuals authorized to receive the tax information. Even with such improvement, the procedure may be open to abuse, but at least, as Commissioner of Internal Revenue Alexander put it, the creation of a "paper trail" on a tax check should permit "rights . . . (to) be better protected in the event that anyone should try to abuse this particular procedure."

Access to Tax Information by Congressional Committees

Three Congressional committees — the House Committee on Ways and Means, the Senate Committee on Finance and the Joint Committee on Internal Revenue Taxation — are specifically authorized under the tax code to receive and inspect tax returns. Such inspection presumably is needed either as part of their tax oversight function or as an aid in the drafting of tax legislation.

Other Congressional committees, to obtain access to tax returns, must request a Presidential Executive order, the request stating the general purpose of the inspection. Since the 1930's, it has been the general practice of the White House to comply with such requests from Congressional committees. Surveys show, however, that the number of tax returns requested by the committees are relatively few in number. It is estimated that no more than a half-dozen requests for income tax returns have been made by the three tax law writing committees in the last ten years. Other Congressional committees authorized by executive orders to obtain tax returns also have used the authority sparingly.

While Congressional examination of individual tax returns may serve a legislative purpose, quite obviously there is a thin dividing line between obtaining tax information for purposes of legislating and obtaining such information for purely investigative purposes. It would appear that some committees use tax data for the purpose of developing investigative leads. To the extent that such information is used for public hearings or is forwarded to prosecutorial agencies, the Congressional practice of using income tax returns for investigative purposes would seem to raise the same problems of infringement upon confidentiality presented by the Justice Department's access to tax returns. Furthermore, with tax returns in the hands of Congressional investigators, there is an obvious potential for political abuse.

In order to help assure explicit, deliberate, and responsible Congressional attention to the use made by its members and committees of individual tax returns, *it is recommended* that the existing statutory authority (Section 6103(d) of the tax code) for disclosure by the Internal Revenue Service to the House Committee on Ways and Means, the Senate Committee on Finance, and the Joint Committee on Internal Revenue Taxation, be continued. Disclosure of tax returns by the Service to any other committee of the House or Senate, or joint committee of the Congress, should by statute be permitted only in accordance with specific authorization for such disclosure by a resolution of the House or Senate, or both.

Inspection of Tax Returns by State and Local Governments

Since 1935, the tax code has permitted inspection of Federal tax returns by state tax administrators (Section 6103(b)). Returns may be inspected only for state tax purposes or to obtain information to be furnished local tax authorities. Eleven states have chosen to make this inspection by examining and copying returns in an office of the Service. Another 38 states carry out inspection by obtaining computer tapes drawn from the IRS Individual Master File, which contains enough information to compute taxable income but not enough to reproduce the return of a taxpayer.

The release of Federal tax information to state officials raises an obvious concern over maintaining the confidentiality of the tax returns once they are in state hands. To a large extent, this concern is now met through so-called Agreements on Coordination of Tax Administration entered into between the Federal government and the individual states. All states except Texas and Nevada have entered into such agreements. The agreements spell out the mutual obligations in handling the tax returns and usually require the states to make available certain tax information to the Federal government. Recently the agreement has been tightened by imposing additional requirements for safeguarding tax information.

Basically, the agreement is a representation by a state that it will adhere to certain standards and procedures for protecting the confidentiality of tax returns. State employees also are covered by the provision in the Federal tax code (Section 7213) that imposes a criminal penalty on unauthorized disclosure of income tax information. Some uncertainties develop, however, in applying this provision to state officials since the information disclosed may have come from state individual tax records and not have been acquired directly from inspection of Federal tax returns. In some states the taxpayer submits schedules or other information to the state identical to what he has prepared for his Federal return.

If a state fails to live up to the standards required in the agreement, the Service may terminate the agreement for exchange of tax information. The Commissioner of Internal Revenue, however, lacks clear authority to pass judgment on the safeguard procedures of the individual states. *It is recommended*, therefore, to provide by statute that the Commissioner has not only the authority to review state confidentiality safeguards but also the authority to suspend a state's access to Federal tax returns if the Service finds its procedures are unsatisfactory. Furthermore, through changes in the tax code, it should be made clear that establishment of adequate laws and procedures safeguarding Federal tax return information in the hands of state tax agencies — whether the information was obtained from the Internal Revenue Service or from the taxpayer himself — is a necessary prerequisite to a state obtaining Federal tax returns.

Unauthorized Access to Returns by IRS Employees

With the multitude of records that exists in numerous forms in Service files, there obviously is a potential problem that a taxpayer's right to confidentiality may be violated by unauthorized examination or improper use of tax return information by employees of the Service. Abuse of tax returns by Service employees may be motivated by any number of reasons. During the Watergate investigation, instances were uncovered of employee access to tax returns solely for political purposes.

Every year, IRS employees make about 18 million requests for tax return information on file in Federal Record Centers. The objective of course is to make sure that all of these requests are legitimate. Information stored on computer tapes seems to be fairly well guarded against unauthorized access, but the Service's procedures for guarding hard copies of returns appear somewhat casual. In the millions of requests processed by the Federal Records Centers, a permanent record of who requested the return is maintained in only about two-thirds of the cases. If no action is taken on a requested return, the return is refiled and the requisitioning document identifying the Service employee is destroyed. In such "no action" cases, abuses obviously could arise with a photocopy quickly made of a return, which would then be returned to the file with no record showing that it had even been removed.

Partly as a result of the disclosures in the Watergate investigations, the Service is now moving to improve and strengthen its internal procedures for protecting returns against unauthorized access. As steps in that direction, *it is recommended* that the Internal Revenue Service adopt procedures that would provide for periodic monitoring of returns requisitioning by Service employees; establishment of statistical records designed to reveal patterns of frequency in, and reasons for, requisitioning returns; and preservation of return-requisitioning documents as part of the permanent file of every return.

Notice to the Public About Tax Return Disclosures

To maximize citizens' awareness of the ways in which their tax return information may be used, *it is recommended* that the Internal Revenue Service place on tax return forms a concise statement describing the disclosure, for uses unrelated to the administration of Federal tax laws, that may be made of information supplied in such returns. The statement should include reference to a public document, prepared and disseminated by the Service, that identifies the governmental agencies and other persons to which disclosures of tax returns are made and the purposes for such disclosures, and fully describes the procedures followed by the Service with respect to such disclosures.

MEMORANDUM IN SUPPORT OF PROPOSED AMENDMENT TO RECOMMENDATION 75-8

*Sheldon S. Cohen**

At its Thirteenth Plenary session, held December 11 and 12, 1975, the Administrative Conference adopted, among others all pertaining to procedures of the Internal Revenue Service, a set of recommendations grouped under the title, Tax Return Confidentiality (Recommendation No. 75–8) 41 Fed. Reg. 3985–6 (January 27, 1976). The declared purpose of this set of recommendations is "to narrow the authority of the Service to disclose to other governmental agencies tax returns pertaining to the tax liability of individuals and decedents. . . ."

Paragraph (a)(2) of these recommendations states that the term "tax return" as used therein means

> (i) the return itself together with any schedule, list, and other written statement filed by or on behalf of the taxpayer with the Internal Revenue Service which is designed to be supplemental to or become a part of the return, and (ii) other records, reports, information received orally or in writing, factual data, documents, papers, abstracts, memoranda, or evidence taken, or any portion thereof, relating to the items included in paragraph (a)(2)(i) of this section.

A footnote to paragraph (a)(2) states as follows:

> This definition is taken from Treasury Regulation § 301.6103(a)–1(a)(3)(i). In considering any legislation in this area, Congress should consider the adequacy of this definition, since some technical problems may exist under the present regulation.

The first of the set of Tax Return Confidentiality recommendations adopted by the Conference provides as follows:

> (b) *General.* Legislation should be enacted which would permit the disclosure of tax returns by the Internal Revenue Service only as authorized by express statute designating the persons to whom and the purposes for which disclosure may be made, the procedures governing such disclosure, and limitations on use or redisclosure that shall govern such disclosure.

The chief purpose of this recommendation, which is the most general and the most fundamental of all the Conference's Tax Return Confidentiality recommendations, is to assure that disclosure of tax returns be made by the Internal Revenue Service only on the basis of express statutory authorization that specifies for any authorized disclosure (i) the persons to whom disclosure may be made, (ii) the purposes for which disclosure may be made, (iii) the procedures governing such disclosure, and (iv) limitations on use or redisclosure to govern such disclosure.

The Steering Committee for the Conference's Internal Revenue Service Project, which proposed the foregoing recommendation, intended that three additional purposes be achieved by this recommendation.

*Chairman, Steering Committee for IRS Project

Although these additional purposes were implicit in the Steering Committee's address to the issue of tax return confidentiality, and doubtless also in the Conference's adoption of its first recommendation, it cannot be said that they are clearly inferable from, much less clearly expressed in, the recommendation as formulated by the Committee and adopted by the Conference. These three objectives can be stated as follows:

> (1) that all tax returns pertaining to the liability of individuals and decedents should be held and treated as confidential by the Internal Revenue Service, that is, that such returns should not be subject to disclosure to the public in general, nor to any individual member of the public, as for example, in response to a request made to the Internal Revenue Service under the Freedom of Information Act;
> (2) that any tax return pertaining to the tax liability of an individual or decedent should be discloseable by the Internal Revenue Service pursuant to a request made respectively by such individual or by the authorized representative of such decedent;
> (3) that the Internal Revenue Service should, in making any particular authorized tax return disclosure, limit the amount of information that it discloses to that which is necessary to accomplish the purpose for which such disclosure is authorized.

Perhaps the reason that the recommendation quoted above is silent, or at least not at all explicit, about these objectives is that they were taken for granted as obviously desirable and perhaps thought of as implicit in the general policy reflected by the Steering Committee's approach to the topic of tax return confidentiality. However, because the Conference's Tax Return Confidentiality recommendations are intended to serve as guides for the enactment of legislation that will anchor its policy objectives relative to tax return confidentiality in statutory law, the statement of these recommendations should leave no room for doubt or ignorance as to what the Conference's agreed upon policy objectives are.

New Provision

For this reason, it is recommended that the Conference amend paragraph (b) of its Tax Return Confidentiality Recommendation, No. 75–8, to read as follows:

> *Para. (b) of Rec. No. 75–8 as adopted*
> (b) *General*
> (1) Legislation should be enacted which would permit the disclosure of tax returns by the Internal Revenue Service only as authorized by express statute designating the persons to whom and the purposes for which disclosure may be made, the procedures governing such disclosure, and limitations on use or redisclosure that shall govern such disclosure.
> (2) Legislation should be enacted which would provide that tax returns of individuals and decedents are confidential and, except as specifically authorized by statute, shall not be disclosed by the Internal Revenue Service to the general public, or any individual member thereof, either at the initiative of the Internal Revenue Service or in response to a request for disclosure made to the Service by any member of the general public, provided that such prohibition shall not prevent disclosure by the Service of any tax return of an individual or a decedent upon a request duly made by such individual or his authorized representative or by the authorized representative of such decedent.

(3) Legislation should be enacted providing, as a general limitation on all tax return disclosure authority conferred on the Internal Revenue Service, that in making any authorized disclosure of a tax return to any person other than the taxpayer to whom the return pertains, the Service shall disclose no more information than is necessary to effectuate the purpose for which such disclosure is authorized and providing further that the Service shall establish administrative procedures designed to assure that every particular disclosure is made in strict accordance with the authority therefor and with such general limitation.

Paragraph (b)(1) is unchanged from its adoption as paragraph (b). Paragraph (b)(2) is designed to make explicit the first two of the additional objectives expressed above and would appear to require no further explanation. Paragraph (b)(3) is designed to make explicit the third of the additional, heretofore implicit, objectives. A few words are in order to explain why the Steering Committee deems it important to incorporate paragraph (b)(3) in the Conference's general recommendation on tax return confidentiality.

The Steering Committee and the Conference subscribe to the objective that information in the files and records of the Internal Revenue Service pertaining to individuals and decedents should be treated as confidential; that is, no such information should be disclosed to the general public by the Internal Revenue Service. For the purpose of applying this general principle of confidentiality, the Conference's recommendation borrowed from existing Treasury Regulations the definition of the term "tax return" embracing all information obtained by the Internal Revenue Service — from whatever source and by whatever means — pertaining to the tax liability of an individual (or decedent). We may regard this as an omnibus definition of tax return which serves well to assure the breadth of application desired for the principle of confidentiality, i.e., non-disclosure by the Service to the general public. The omnibus definition also serves well to provide a blanket prohibition on disclosure by the Service to all governmental agencies.

The omnibus definition of "tax return," however, produces an unintended undermining of another objective to which the Steering Committee (and, we believe, the Conference also) subscribes. This objective is that each disclosure of tax returns made by the IRS (as authorized by the Congress) should be no greater in scope of information disclosed than is necessary to achieve fairly, effectively, and efficiently the purpose for which the disclosure is authorized. This objective might usefully be called the principle of limited disclosure. To adhere strictly to the principle of limited disclosure, each particular statutory authorization for tax return disclosure should specify exactly what information may be disclosed (i.e., only what is necessary for the particular purpose) rather than to speak generally of disclosure of "tax returns." Or if the term "tax return" is to be used, no single definition of the term "tax return" should be used for every disclosure authorization, because not all purposes for disclosure require the same information to be disclosed. And most assuredly, the term "tax return" should not be given the same, *omnibus* definition for all disclosure purposes as it has been given for the purpose of applying the principle of confidentiality. An omnibus definition of "tax return" is necessary to give the confidentiality principle the broad scope intended; whereas the limited disclosure principle will usually be violated by using an omnibus definition of tax return in disclosure authorizations.

There may be a number of disclosure purposes that would require disclosure of only one (or a very few) specifiable item of data, e.g., IRS disclosure of wages and tips subject to social security tax withholding, to the Social Security Administration, for the purpose of maintaining employee earnings records for social security benefit determinations. In this instance, disclosure authorization could be framed to cover only the particular information that needs to be disclosed. In contrast, any and all information obtained by the IRS pertaining to an individual's tax liability might need to be available to the Department of Justice in order for it to carry out effectively the purpose of enforcing the tax laws through court litigations. In the latter instance, it would be easier, more direct, and avoid any risk of inadvertent omission of some necessary items of information from the disclosure authorization, to make the authorization applicable to "tax returns" — relying on an omnibus definition of the term — rather than to try to specify the information in full factual detail.

Other disclosures that might be authorized will lie between the two extreme examples just discussed — one requiring the disclosure of a single item of information and the other requiring, potentially at least, the disclosure of any or all information encompassed by an omnibus definition of tax return. These in-between cases will involve disclosure purposes that require more than a single (or very few) specifiable item of information and *less than* omnibus information availability. For example, there might be a need for IRS disclosure to a National Health Insurance Agency of certain information about health and medical services claimed as itemized deductions by individual taxpayers. For such in-between cases, it may not be possible to specify precisely what information is to be discloseable and yet disclosure authorization framed in terms of the omnibus meaning of tax return would clearly offend the limited disclosure principle.

From the foregoing analysis, it appears that some statutory disclosure authorizations may of necessity or for convenience be drafted to apply to "tax returns" as defined in the same omnibus sense used to establish the principle of confidentiality. Thus the clear risk of violation of the principle of limited disclosure will be inevitable unless a general statement of this principle is embodied as a statutory limitation on all IRS disclosure authority. Hence our proposed amendment of adding new paragraph (b)(3) to the Conference's Recommendation No. 75–8.

Our reasoning and proposed amendment of paragraph (b) may be recapitulated as follows. First, the basic principles of confidentiality and limited disclosure should be established.

1. *Confidentiality* — All information obtained by the Internal Revenue Service (by whatever methods and from whatever sources) which may be pertinent to the tax liability of an individual shall be confidential and shall therefore not be disclosed by the Internal Revenue Service to any person except pursuant to the written request or consent of such individual, or except as specifically authorized by an act of the Congress.

2. *Limited disclosure* — Any act of the Congress which authorizes disclosure by the Internal Revenue Service of any confidential information shall provide for disclosure of no more of such information than is necessary to be disclosed to accomplish fairly, effectively, and efficiently the purpose for which such disclosure is authorized.

Next, we must consider how to provide guidance for the legislative task of framing disclosure authority that will adhere to the principle of limited disclosure. An approach to standards for doing this follows.

For some purposes, it may be necessary that only a very few, precisely specifiable, items of information be available; for these types of purposes, authorized disclosure can and should be limited to those particular items.

For some other purposes, it may be necessary that any or all information be available; for these types of purposes, authorized disclosure should be extended to all information. However, it should also be provided that the items of information actually disclosed in any particular instance of accomplishment of such a purpose must be limited to no more than is necessary for the particular instance.

For all other purposes, it should be recognized that all information will not need to be available, that certain types of information will never be needed, but that what information is needed will be more than a few precisely specifiable items of information, and may vary, depending upon particular circumstances, within a specifiable range or type of information. For these types of purposes, the disclosure authority should (i) specify the statement of the purpose for disclosure in substantial detail; (ii) describe the information authorized to be disclosed as clearly as feasible, perhaps in part by range or type, and perhaps with specified exclusions from the disclosure authority of any information that will clearly not be needed; and (iii) be subject to a proviso that no more information should ever be disclosed in any particular instance than is necessary to accomplish the specified purpose.

Examples can be found in the Internal Revenue Code, in Treasury Department regulations, and in recommendations by the Conference of disclosure authority provisions that display some features of the strategy outlined above. The one feature that is novel, and that should be included as a provision of overriding general applicability to all tax return disclosure authority, is the proviso that in any particular instance of authorized disclosure, no more information should be disclosed than is needed to accomplish fairly, effectively, and efficiently the purpose for which disclosure is to be made. The policy objective of this proviso is the same as that reflected by the provision of the Privacy Act of 1974 which seeks to limit Federal agencies to having only such information about an individual as is "relevant and necessary to accomplish a purpose of the agency. . . ."

Application of the proviso can effectively be achieved by requiring the establishment of administrative procedures designed to assure that a sufficient showing will be available to the Internal Revenue Service whereby it can be held accountable for determining that whatever information it discloses, pursuant to authority that is subject to the proviso, is limited to that which is genuinely necessary to accomplish the purpose for which disclosure is being made.