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

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

Dear Ms Paul:  

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

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

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

Sincerely,  

Paul J. Sax  
Chair, Section of Taxation  

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

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**Taxpayer Confidentiality and Tax Return Information Confidentiality in General**  

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

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

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

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

B. **Recommendations.**  

   1. Because section 6103 prohibits taxpayer A from examining taxpayer B’s return information, the likelihood of abuse of such information could be high. There is no regulatory framework to guarantee that taxpayer B’s return information will not be used unfairly against taxpayer A. The Service should be prohibited from using such information in the litigation of taxpayer A.
2. The use of third party return information in an audit or litigation with another taxpayer substantially increases the likelihood that such information will be intentionally or inadvertently disclosed. Section 6103 is designed to prevent just such an eventuality. The use of third party taxpayer information should be prohibited.

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

A. Regulatory Inefficiency.

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

1. those who have never filed.
2. those who have filed in the past but no longer do so.

B. Implications.

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

C. Recommendations.

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

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

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

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

A. Regulatory Complexity.

Regulatory complexity with respect to sections 6103 and 6110 have decreased the amount and quality of guidance from the Service. In particular, efforts at categorizing disclosable guidance has created confusion among tax practitioners, legal publishers, and taxpayers. This confusion has spurred multiple lawsuits designed to force the disclosure of agency documents, while at the same time providing the Service a propensity to develop otherwise disclosable internal guidance under a different name–thereby avoiding disclosure. As a result, disclosable guidance has dropped while new secret guidance has flourished.

1. A decrease in public guidance. Recent FOIA litigation for the release of IRS internal guidance has had the effect of significantly decreasing the amount of guidance the Service issues each year. With the holding in *TWRF v. IRS*, releasing General Counsel Memoranda (GCM), Technical Memoranda (TM)s and Actions on Decision (AOD), the number of
guidance issues have dropped significantly. In 1980 (the year of TWRF), the Service issued 372 GCMs; in 1983 and 1984, the number dropped to one. The year 1995 saw three GCMs, and 172 AODs were issued in 1980. However, that number dropped to five in 1983 and 1984. There were 16 AODs in 1995. In 1976 section 6110 made technical advice memoranda and letters rulings public, but both of these forms of guidance have dropped as well. In 1980, the Service issued 1127 TAMs but only 182 in 1995. Letter rulings were in the 5000s in the late 1980s and dropped into the 2000s in the 1990s.

B. The Proliferation of Secret Guidance.

As older forms of guidance have declined in recent years, newer, secret forms of guidance have increased. The Service has not commented on the shift of public to internal guidance, but one such factor might be that internal guidance is quicker, thus allowing field personnel to expedite the disposition of a matter. The Service has filled the gap left by section 6110 and FOIA with Field Service Advice (FSAs), Tax Litigation Bulletins (TLBs), Legal Memoranda (LMs), and Advance Pricing Agreements (APAs). Although The Service has started to release some of these forms of guidance as a result of Tax Analysts’ FOIA litigation, much of these guidance documents are redacted to the point that their usefulness is called into question.

C. Recommendations

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

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

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

Taxpayer Confidentiality in Transfer Pricing

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

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

In recent litigation to force disclosure of APAs, the IRS eventually took the position that APAs were written determinations under section 6110 of the Code, and as such the IRS would release the APAs, after
The possible disclosure of APAs as written determinations under section 6110 of the Code raises serious questions. As written determinations, the background files for an APA would also be subject to disclosure.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(1) Closing Agreements.

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

(2) Lobbying Activities.

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

(3) Political Action Committee.

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

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

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

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

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

b. Present Disclosure Requirements.

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

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