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ADMINISTRATIVE MATTERS

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE

BY THE STAFF OF THE

JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

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INTRODUCTION

This pamphlet presents background information regarding a number of administrative matters relating to internal revenue taxes, substantially all of them focusing on income taxes. In addition, several items deal with withholding of State or local income taxes.

The matters discussed in this pamphlet include regulation of income tax return preparers, declaratory judgments as to status as charitable organizations, assessments in the case of mathematical or clerical errors on income tax returns, voluntary withholding of State (and county "piggyback") income taxes of certain Congressional personnel, withholding of State (and county "piggyback") income taxes of members of the Armed Forces, withholding of State and local income taxes of members of the National Guard and the Ready Reserve, withholding of Federal income taxes in the case of gambling winnings, treatment of State lotteries under the excise tax provisions, procedures to be followed in the case of jeopardy and termination assessments, minimum exemptions from levy, administrative summons, public inspection of private letter rulings, and regulation of disclosure of tax return information.

In each of these cases, the pamphlet will describe the present law and the issues that have been presented. Where these matters are dealt with to some extent in the House-passed bill (H.R. 10612), the House provisions are also briefly described. One or more subsequent pamphlets will discuss alternative proposals for dealing with these issues.

1. Income Tax Return Preparers

Present law

The Internal Revenue Code contains few provisions which affect the conduct of persons who prepare the tax returns of other persons for a fee. The tax return forms generally require that any person preparing a return for another person sign the return, but the law provides no penalty in cases of failure to sign. No other provisions in the Code require an income tax return preparer to disclose to the Internal Revenue Service that he is in the business of preparing returns or what returns he has prepared.

In addition, most sanctions prescribed by present law for improperly prepared returns relate to improper preparation by the taxpayer himself and not by a preparer. Taxpayers may be subject to criminal fraud penalties of up to $10,000 in fines and imprisonment for not more than five years for willful attempts to evade tax (sec. 7201). Taxpayers are also subject to civil fraud additions to tax of up to 50 percent of the amount of any underpayment of tax, or additions to tax for negligence or for intentional disregard of rules and regulations in an amount equal to 5 percent of any underpayment of tax (sec. 6653).

By contrast, persons who prepare returns of others for a fee are subject only to criminal fraud penalties for willfully aiding or assisting in the preparation of a fraudulent return, which crime can be punished by fines of up to $5,000 and imprisonment for not more than 3 years.[1]

Issue

The past few years has seen a substantial increase in the number of persons whose business is to prepare income tax returns for individuals and families of average income. The Service estimates that for the year 1972, 35 million taxpayers, or one-half of all those who filed income tax returns, sought some form of professional or commercial tax advice in preparing their returns. The Service also estimates that in 1972 approximately 250,000 persons were engaged in the business of preparing income tax returns.

The rapid growth of the business of professional and commercial preparation of tax returns has led to a number of problems for the Service. Some abuses have arisen in the preparation of returns for wage earners at the cost of a relatively small fee. In some of these cases, return preparers have made guarantees that individuals will obtain a refund because of the tax expertise of the preparer. In other cases, return preparers have suggested that a taxpayer sign a blank return (i.e., before it is prepared) in which case the taxpayer would not look at the return, let alone review it, before it is filed. In some of these cases, the preparer either claimed fictitious deductions or

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[1] Tax return preparers are, in addition, subject to criminal penalties for unlawfully disclosing or otherwise using information disclosed to them in connection with the preparation of a return (sec. 7216).

increased the number of exemptions claimed in order to achieve the desired refund or tax liability which was promised to the taxpayer.

In 1972 and again in 1973 the Service conducted surveys of preparers suspected to be engaging in these types of conduct. For 1972 the Service concluded that about 60 percent of the returns surveyed (or over 3,000 returns) showed significant fraud potential. In the 1973 survey, 22.3 percent of the returns prepared (or 1,112 returns) showed fraud potential. The sizable number of returns with fraud potential resulted in part because the Service focused on preparers suspected of improper conduct. Nonetheless, the surveys indicate that a significant number of preparers in those years had engaged in abusive practices.

Under present law, it is difficult for the Service to detect any individual case of improper preparation since the tax preparer might not sign the return. Thus, the Service has no way of knowing whether the return was prepared by the taxpayer or by a preparer who may be engaging in abusive practices involving a number of returns.

Furthermore, even if the Service can trace the improper preparation of tax returns to an individual tax return preparer, the only sanctions available against that preparer are the criminal penalties of the Code. Such criminal penalties are often inappropriate, cumbersome, and an ineffective deterrent given the costs and length of time involved in trying these cases in court. Because these criminal penalties are difficult to apply, the Service under present law generally proceeds against only the most flagrantly fraudulent cases involving income tax return preparers.

The abuses described above primarily involve "commercial" tax preparers (i.e., individuals often without formal training engaged in the seasonal business of preparing tax returns) rather than "professional" tax preparers, such as lawyers and certified public accountants. Yet it is difficult to single out any group alone for special regulation. At the request of the Joint Committee on Internal Revenue Taxation the General Accounting Office conducted a study of tax return preparation by all types of tax return preparers. The GAO report indicates that commercial preparers on the average have not had a significantly greater tendency to make mistakes in preparing returns than do other types of preparers. For example, the GAO studied the 22,000 tax returns which were audited in depth for the year 1971 under the IRS Taxpayer Compliance Measurement Project and discovered that for all returns (excluding 1040A short form returns) with adjusted gross incomes of $10.000 and under and for nonbusiness returns of adjusted gross income between $10,000 and $50,000, the percentage of tax adjustment determined from the Service's audits averaged 10.9 percent for returns prepared by commercial preparers and 10.2 percent for returns prepared by professional preparers. Other parts of the study also indicate that commercial preparers are not more likely to make more or larger mistakes on the returns they prepare than are professional preparers. This result occurs probably because most commercial preparers are generally involved only with those returns which are relatively simple to prepare, while professional preparers are generally involved in more complex returns. It should be noted that the errors made by professional return preparers do not necessarily result from the types of abuses referred to above but may result from differences of interpretation. Nonetheless, the fact that all types of preparers are about equally likely to make errors in preparing tax returns

led the GAO to recommend that any regulation of tax return preparers apply equally to all preparers.

House bill

Under the House bill (sec. 1201), a series of provisions dealing with income tax return preparers would apply in general to returns and documents prepared after December 31, 1975. These provisions include the following:

1. Each prepared return, statement, or other document must contain the identification number of the return preparer and other data sufficient to identify the preparer. A $25 penalty is provided for each failure to comply, if without reasonable cause.

2. Each preparer must furnish to the taxpayer a copy of the taxpayer's return or claim for refund prepared by the tax return preparer at the time the return or claim is given to the taxpayer for his signature. A $25 penalty is provided for failure to comply, if without reasonable cause.

3. Each person employing a tax return preparer to prepare the returns of others must file an annual report with the Service listing the name, identification number, and place of work of each such employed preparer. Self-employed preparers also have to file such returns. Failure to comply without reasonable cause would result in a $100 penalty for each failure to file an annual return and a $5 penalty for each failure to include a name, identification number, or place of work in the annual report. These penalties are not to exceed $20,000 for a 12-month period.

4. Each return preparer or employer of return preparers must retain for three years either a list of taxpayers for whom returns were prepared or copies of their returns and claims for refunds. A $50 penalty is provided for each failure to retain a copy of a return or to list a taxpayer for whom a return was prepared, up to a maximum of $25,000 for all returns in a year.

5. A $100 penalty is provided for negligent or intentional disregard of Internal Revenue Service rules or regulations by a tax return preparer. A $500 penalty is provided for a willful attempt to evade, defeat or understate any tax by a tax return preparer. A separate penalty may be imposed for each return or claim for refund.

6. A $500 civil penalty is provided for any endorsement or other negotiation by a person who is an income tax return preparer of any check received by a taxpayer from the Service.

7. The Service would be given the authority to seek a court injunction against income tax return preparers (1) engaging in conduct subject to penalties, (2) misrepresenting their qualifications (including eligibility to practice before the Internal Revenue Service), (3) guaranteeing the payment of a tax refund, or (4) engaging in other conduct similar in nature to the above types of conduct which substantially interferes with the proper administration of internal revenue laws. A tax return preparer who files a bond of $50,000 to guarantee payment of further penalties would not be subject to an injunctive proceeding for penalty-type conduct.

8. The Internal Revenue Service would be authorized to provide the names, addresses, and taxpayer identifying numbers of preparers to State authorities charged with enforcing State provisions regulating tax return preparers.

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2. Declaratory Judgments—Charitable, Etc., Organizations

Present law

An organization that meets the requirements of section 501(c)(3) of the Internal Revenue Code [1] is exempt from tax on its income.[2]

* * * * * * *

"(c) List of Exempt Organizations.—The following organizations are referred to in subsection (a):

* * * * * * *

"(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office."

In general, a domestic organization which is exempt under section 501(c)(3) is also eligible to receive deductible charitable contributions (sec. 170(c)(2)).

If such an organization is a private foundation (defined in sec. 509), then it is subject to a series of restrictions on its activities (sec. 4941 *et seq.*), as well as a tax on its investment income (see footnote 2 above). Also, if it is classified as a private foundation (other than an operating foundation (sec. 4942(j)(3)), its status as a charitable contribution donee is in some respects significantly less favorable than if it is not so classified (compare sec. 509(a) with sec. 170(b)(1)).

Although the tax status of an organization generally does not depend on the Internal Revenue Service's position as to the organization, as a practical matter, most organizations hoping to qualify for exempt status find it imperative to obtain a favorable ruling letter from the Service and to be listed in the Service's "blue book" (Cumulative List of Organizations Described in Section 170(c) of the Internal Revenue Code of 1954, Publication 78). An exemption letter and listing in the blue book assure potential donors in advance that contributions to the organization will qualify as charitable deductions under

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[1] "SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.

"(a) Exemption From Taxation.—An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503.

[2] Such an organization is, nevertheless, subject to tax on its "unrelated business taxable income" (sec. 511 *et seq.*) and, if it is a private foundation, is also subject to tax on its "net investment income" (sec. 4940); however, it is not subject to Federal income tax on its related business income. The tax on private foundations' investment income is at the rate of 4 percent; by comparison, the rates applicable to taxable corporations are up to 48 percent, and to taxable trusts are up to 70 percent.

section 170(c)(2). In general, potential donors may rely upon these indicia even though the organization may not in fact be qualified under the statute for this treatment at the time of the gift.[3]

In two cases decided in 1974 (*Bob Jones University* v. *Simon*, 416 U.S. 725, and *Alexander* v. "*Americans United*" *Inc.*, 416 U.S. 752), the Supreme Court held that an organization could not obtain the assistance of the courts to restrain the Internal Revenue Service from withdrawing a favorable ruling letter or withdrawing its listing in the blue book. In effect, this means that a judicial determination as to the organization's status cannot be had by the organization or its contributors, except in the context of a suit to redetermine a tax deficiency or to determine eligibility for a refund of taxes.

By the time the Supreme Court issued its opinions in *Bob Jones* and *Americans United*, both Houses of Congress had already passed versions of what became the Employee Retirement Income Security Act of 1974 (Public Law 93–406). Each House's version of the bill included provisions for declaratory judgments as to the tax-qualified status of employee retirement plans. This added section 7476 to the Internal Revenue Code.

Under that provision, the Tax Court has been given jurisdiction to hear declaratory judgment suits as to the tax qualification of an employee retirement plan (pension, profit sharing, stock bonus, etc.), so that the plan's status can be tested without the necessity of the Service issuing a notice of deficiency or a taxpayer suing for a refund of taxes.

Issue

In *Bob Jones University* v. *Simon*, the Supreme Court summarized the problems faced by an organization seeking to establish its charitable tax-exempt status. The Court noted that, as it interpreted present law,

> "Congress has imposed an especially harsh regime on § 501(c)(3) organizations threatened with loss of tax-exempt status and with withdrawal of advance assurance of deductibility of contributions. * * * The degree of bureaucratic control that, practically speaking, has been placed in the Service over those in petitioner's position [i.e., the position of Bob Jones University] is susceptible to abuse, regardless of how conscientiously the Service may attempt to carry out its responsibilities. Specific treatment of not-for-profit organizations to allow them to seek preenforcement review may well merit consideration." [4]

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[3] See Rev. Proc. 72–39, 1972–2 C.B. 818, for the Service's position on the extent to which contributors may rely on the listing of an organization in the blue book,

[4] The Court's opinion noted that former Internal Revenue Commissioner Thrower had criticized the present system for resolving such disputes between the Service and the organization.

> "This is an extremely unfortunate situation for several reasons. First, it offends my sense of justice for undue delay to be imposed on one who needs a prompt decision. Second, in practical effect it gives a greater finality to IRS decisions than we would want or Congress intended. Third, it inhibits the growth of a body of case law interpretative of the exempt organization provisions that could guide the IRS in its further deliberations." (Thrower, IRS Is Considering Far Reaching Changes in Ruling on Exempt Organizations, 34 Journal of Taxation 168 (1971).)

The opinion then suggested that this is an appropriate matter for the Congress to consider.[5]

In order to provide an effective appeal from an Internal Revenue Service determination that an organization is not exempt from tax, or is not an eligible donee for charitable contributions, or is a private foundation (an operating foundation or a nonoperating foundation), it has been urged that there be access to the courts through some declaratory judgment procedure.

The questions that have been raised include (1) which courts should be given jurisdiction to hear such cases; (2) whether declaratory judgment suits should be available to test other exempt organization questions, such as whether an organization is a social welfare organization under sec. 501(c)(4), a fraternal organization under sec. 50(c)(8), a cemetery company under sec. 501(c)(13), etc.; (3) whether such a proceeding should be available to test revocations of prior favorable Service determinations, as well as initial unfavorable determinations (or refusals to rule); (4) what should be the tax treatment of persons who make contributions to the organization during the pendency of the suit, if it is ultimately determined that the organization was not exempt (i.e., if the court agrees with the Internal Revenue Service); and (5) whether contributors or third parties should be permitted to seek a declaratory judgment that the organization is exempt (despite a Service decision that it is not exempt) or that the organization is not exempt (despite a Service determination that it is exempt).

House bill

Under the House bill (see 1202), a declaratory judgment procedure would be provided if the IRS revokes an organization's prior ruling or fails to issue a favorable ruling. In this case the organization may petition the United States Tax Court or the Federal district court for a declaratory judgment as to its exempt status as a religious, educational, charitable, etc., organization under section 501(c)(3), its classification as a private foundation or a private operating foundation, or its classification as an organization eligible to receive deductible charitable contributions.

The declaratory judgment procedure would be available only to the organization seeking to establish its own status and then only when the organization has exhausted the administrative remedies reasonably available to it within the Internal Revenue Service.

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[5] In a dissenting opinion to *Alexander* v. *"Americans United" Inc.*, the companion case to *Bob Jones University* v. *Simon*, Mr. Justice Blackmun stated that "where the philanthropic organization is concerned, there appears to be little to circumscribe the almost unfettered power of the Commissioner.[11] This may be very well so long as one subscribes to the particular brand of social policy the Commissioner haappens to be advocating at the time (a social policy the merits of which I make no attempt to evaluate), but applicaations of our tax laws should not operate in so fickle a fashion. Surely, social policy in the first instance is a matter for legislative concern. To the extent these determinations are reposed in the authority of the Internal Revenue Service, they should have the system of checks and balances provided by judicial review *before* an organization that for years has been favored with an exemption ruling is imperiled by an allegedly unconstitutional change of direction on the part of the Service." (Footnote omitted.)

If the declaratory judgment involves a revocation of a prior favorable charitable donee status decision, then deductions for contributions made to the organization (1) after the IRS's announcement that contributions to the organizations are no longer deductible and (2) before the court's decision in the suit, would not generally be disallowed merely because the court determined in that suit that the organization was not tax exempt. Contributions of less than $1,000 made during the period between the IRS announcement and the court decision could be deductible. Also, the organization would be treated as a charitable donee with regard to other charitable donees for this period. However, no contribution deductions would be available during this period to any person who was responsible for the organization's actions or inactions that caused it to lose its charitable donee status.

This provision would apply to pleadings or petitions filed with the Tax Court or Federal district court more than 1 year after the date of enactment of this legislation.

3. Assessments in Cases of Mathematical or Clerical Errors

Present law

Under present law (sec. 6213(a)), in general, the Internal Revenue Service must send the taxpayer a notice of deficiency and provide the taxpayer an opportunity to petition the Tax Court before the Service can assess a deficiency of income, estate, or gift tax, or of a tax imposed under the private foundations provisions (chapter 42) or under the provisions relating to qualified pension, etc., plans (chapter 43). An exception under present law permits the Service to summarily assess any additional tax resulting from correction of "a mathematical error appearing on the return" (sec. 6213(b)(1)). In such a case, the Service is not required to send a notice of deficiency to the taxpayer, nor does the taxpayer have a right to judicial review (through a Tax Court petition) before being required to pay the tax.

Where the Internal Revenue Service determines that a mathematical error has been made and that, as a result, the taxpayer owes additional tax, an assessment is summarily made, and a notice of mathematical error which describes the error is sent to the taxpayer. Under the Service's policy, before it begins to collect the amount of tax due on account of the apparent error, the Service permits the taxpayer to explain why he or she believes there is no error. If the taxpayer substantiates the claim, the Service's policy is to abate any assessment which it may have made or refund any additional tax which the taxpayer may have paid. Under present law, however, a taxpayer has no right to claim abatement of any income, estate, or gift tax (sec. 6404(b)).

Issue

The term, mathematical error, has been interpreted by the Service to include several types of error which are broader in nature than literal errors of arithmetic. The Service's position is that mathematical error includes the following: errors in arithmetic (such as 2+2=5); errors in transferring amounts correctly calculated on a schedule, form, or another page of Form 1040 to either page 1 or page 2 of Form 1040; missing schedules, forms, or other substantiating information required for inclusion with Form 1040; inconsistent entries and computations (such as cases where total exemptions claimed do not agree with the total used in computing the tax); and errors where the entry exceeds a statutory numerical or percentage limitation (such as a standard deduction claimed in excess of the maximum allowed by the Code).

Court opinions, however, generally have limited the scope of the term, mathematical error, to arithmetic errors involving numbers which are themselves correct.

Questions have been raised as to whether the Service has used its mathematical errors summary assessment powers in cases where their use is not authorized by the statute. The Service maintains that it properly uses this procedure in categories of cases where most taxpayers do not dispute the Service's conclusions, thereby substantially reducing administrative and other costs.

On the other hand, concerns have been expressed where the Service proceeded summarily where the Service may have erred in its determination.

House bill

Under the House bill (sec. 1203), summary assessments would be allowed in the following five categories:

(1) errors in addition, subtraction, etc., shown on the return;

(2) incorrect use of a Service table if the error is apparent from the return;

(3) inconsistent entries on a return;

(4) omission of information required to be supplied on the return in order to substantiate an item on that return; and

(5) an entry of a deduction or credit in excess of the statutory limit (e.g., taking a standard deduction greater than the permitted maximum standard deduction).

If the Service determines that there has been such an error, it would notify the taxpayer, who would have 90 days to respond to the Service determination. If the taxpayer requests an abatement of the assessment, the Service would have 60 days to decide whether its original determination was correct. If the Service notifies the taxpayer within the 60 days that it intends to pursue the matter, the taxpayer would have 30 days to confirm the request for abatement which then must be granted. In the absence of confirmation, the Service may then use the regular notice of deficiency procedure.

The Service would be required by statute to explain to the taxpayer just what adjustments it is making to the taxpayer's return when the Service determines that the taxpayer has an additional tax liability.

These provisions would apply with respect to returns filed after December 31, 1975.

4. Withholding—State Tax—Legislative Personnel

Subsequent to the inclusion of this material in the House bill (sec. 1204), the House of Representatives passed House Resolution 732 which provides for the voluntary withholding of State income taxes in the case of those legislative officers and employees covered under this section of the bill. Senate Members and employees are already covered under a similar withholding system. (Public Law 93–371, August 13, 1974).

The Finance Office of the House of Representatives has begun to implement this withholding procedure effective for April. Consequently, this provision can be deleted from the House bill.

5. Withholding—State Tax—Armed Forces

Present law

Under present law, the Secretary of the Treasury is required to enter into agreements with States which request it to withhold State income tax from Federal employees. These agreements may not apply to members of the Armed Forces.

Previously, the military provided States with information concerning the earnings of military personnel. This practice was eliminated as of September 25, 1975, when the Office of Management and Budget (OMB) cancelled Circular No. A38 which was the basis for providing States with payroll information concerning military personnel on the grounds that provision of such information conflicted with the authorization of the Privacy Act of 1974 (P.L. 93–579).

Issue

It has been claimed that the absence of withholding has created difficulties for some servicemen who may not know that they are subject to State income tax and may be assessed with a large deficiency when they return from active duty. In addition, it is stated that in the absence of withholding, many members of the Armed Service have difficulty making the lump sum payments required when complying with the State tax on an annual basis.

The General Accounting Office, in its report on this question; Report to the Congress, By the Comptroller General of the United States, "A Case for Providing Pay-As-You-Go Privileges to Military Personnel for State Income Taxes", states in part:

"The Congress should enact legislation to provide military personnel with pay-as-you-go privileges for State income taxes. Laws which permit these taxes to be withheld from Federal civilian pay prohibit such withholding on military pay * * *."

House bill

The House bill (sec. 1205) would amend present law to eliminate the prohibition against the Secretary of the Treasury entering into agreements with States and the District of Columbia to withhold State (and county "piggyback") income taxes from members of the Armed Services and would provide for such withholding in cases where the members request it.

This provision requires the Secretary to enter into a withholding agreement 120 days after the request from the proper State official and such a request cannot be made until after the date of enactment of this provision.

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6. Withholding—State and City Taxes—National Guard and Ready Reserve

Present law

Under present law, the Secretary of the Treasury is required to enter into agreements with States and cities to withhold State and city income taxes from the compensation of Federal employees. The agreement, however, may not apply to pay for service as a member of the Armed Forces.

Issue

In the case of members of the National Guard or Ready Reserve who are serving in this status within the State of which they are a resident, the inability of the Federal Government to withhold State income tax from their compensation often means they are faced either with large lump-sum payments at the time of filing or they must make a declaration of estimated tax and pay the tax quarterly. This is the same concern which led to the adoption of the Federal withholding of State income tax provision in the first instance.

House bill

The House bill (sec. 1206) would extend the provision under present law requiring the Secretary of the Treasury to enter into agreements with States, the District of Columbia, and cities to withhold income taxes from Federal employees to members of the National Guard and Ready Reserve when they are paid for performing regular training.

The bill requires the Secretary to enter into a withholding agreement 120 days after the request from the proper State official and such a request cannot be made until after the date of enactment of this provision.

7. Withholding—U.S. Tax—Gambling Winnings

Present law

Under present law, withholding of United States income tax on racetrack winnings is not required although payouts to winners of the daily double, Exacta, Perfecta, and similar type pools are reportable on Form 1099 information returns if the payout is based on betting odds of 300 to one or higher. In addition, Nevada gambling casinos are required to report certain large winnings from Keno and bingo games on Forms 1099 to the Internal Revenue Service depending on the price of the ticket purchased, as well as on the amount won.

Issue

It has been suggested that although most wagering transactions have no tax significance, since the majority of bettors end up the year with no net wagering gains, the special types of wagers mentioned above represent occasional windfalls that generally produce a signfi-cant tax liability. The view has been expressed that even with the existing information reporting requirements, many taxpayers have not reported these winnings on their income tax returns. One source of this nonreporting of income is, for example, the use of the so-called "10-percenters" at the racetrack. A 10-percenter is a person hired by the winner to cash the winner's ticket for 10 percent of the winnings and provides fictitious identification so that the reporting on Form 1099 is provided in a name other than that of the actual winner. These 10-percenters themselves seldom pay any income tax either by filing no tax return or claiming sufficient offsetting losses.

One type of gambling that is sometimes regarded as different from others because of its automated nature is slot machines. However, in the windfall situations referred to above, the large payoff from a slot machine is in the form of a check or cash being paid to the winner by an employee of the gambling establishment, rather than thousands of quarters pouring out of the machine. Consequently, in the case of large winnings, even slot machine payoffs appear to be amenable to whatever system of record-keeping or withholding is chosen for other forms of gambling.

House bill

Under the House bill (Sec. 1207), the present information report-ing requirement on certain gambling winnings would be replaced with a 20-percent withholding requirement on such winnings. The persons making the payment of winnings subject to withholding would be required to deduct and withhold from the payment 20 percent of the payment. The withholding would be based on the entire payment rather than the amount of the winnings. The winnings subject to withholding would be proceeds of more than $1,000 from wagers in

sweepstakes, wagering pools, or lotteries (whether or not conducted by a State or agency or instrumentality of a State). In the case of winnings other than those mentioned above, withholding would be required on payments of more than $1,000 from the wagering transaction if the amount of the proceeds was at least 300 times as large as the amount wagered. The receiver of the winnings subject to withholding would be required to furnish the payor with the name, address and taxpayer identification number of the person receiving the payment and of each person entitled to any portion of such payment, under penalty of perjury.

These provisions would apply to wagering transactions occurring after December 31, 1975.

8. State Lotteries

Present law

Under present law, each person engaged in the business of accepting wagers is subject to an excise tax of 2 percent on the amount of wagers placed with that person (sec. 4401). The excise tax on wagers generally applies to any person who is conducting a lottery. In addition, a related occupational tax of $500 per year is imposed on each person who is liable for the tax on wagers (or who is engaged in the business of receiving wagers for or on behalf of a person who is in turn, liable to pay the excise tax on wagers) (sec. 4411). Also, a special occupational tax of $250 per year is imposed on the operation of coin-operated gaming devices, including a vending machine which dispenses tickets on lotteries (sec. 4461). An exemption from the wagering tax is provided for sweepstakes or lotteries conducted by an agency of a State if the ultimate winners of the sweepstakes or lotteries are determined by the results of a horse race (sec. 4402).

Issue

In 1963, New Hampshire became the first State in recent history to establish a State lottery. The lottery was similar in operation to the Irish Sweepstakes, so that the lottery's ultimate winners were determined by the results of a designated horse race, which was run following a preliminary selection of the prospective winners by lot. The lottery, when established, was subject to the Federal taxes on wagering. In 1965, however, Congress provided an exemption for State-conducted sweepstakes, wagering pools, or lotteries from the excise tax on wagers. The exemption was specifically based upon the New Hampshire-type of lottery and has two basic requirements: (1) the sweepstakes, wagering pool, or lottery must be conducted by an agency of a State acting under authority of State law; and (2) the ultimate winners must be determined by the results of a horse race (sec. 4402(3)). The provision was added to the Excise Tax Reduction Act of 1965 by a Senate floor amendment. In the course of the brief debate on this amendment, it was stressed that the provision is similar to a parimutuel system in horse racing and that parimutuel wagering licensed under State law was already exempt from the wagering tax.

Since the appearance of the New Hampshire lottery, several other States have established and are operating lotteries. Several more States haves either authorized, or are investigating the feasibility of lottery operations. The lotteries which have been established since 1965, including a revised version of the New Hampshire lottery, differ substantially in the manner in which they operate from the form of lottery which was made exempt by Congress in 1965. Although most States use a format which gives the appearance that the ultimate

winners are determined on the basis of a horse race, as a matter of fact, ultimate winners are determined by lot. Consequently, the lotteries, as now conducted, do not satisfy the second requirement for exemption from the tax on wagers, that is, the use of a horse race to determine the winners.

House bill

Under the House bill (sec. 1208), State-conducted lotteries would be exempt from the 2-percent wagering tax. Vending machines which dispense tickets on a sweepstakes or lottery conducted and maintained by State lottery agencies would be exempted from the occupational tax on wagering.

These provisions would apply with respect to wagers placed after March 10, 1964.

9. Jeopardy and Termination Assessments

Present law

Under normal assessment procedure, there is generally a considerable lapse of time between a taxpayer's first notice that the Internal Revenue Service is seeking to collect taxes from him and the actual enforced collection of those taxes. For example, a taxpayer who does not agree with a proposed assessment of income taxes, may pursue administrative appeals within the Service and, if no agreement is reached, the taxpayer may petition the Tax Court after the Service has issued a notice of deficiency, all without paying the tax allegedly due. On the other hand, when the Service determines that the collection of a tax may be in jeopardy, it may forgo the normal time-consuming assessment and collection procedures and immediately assess and collect the tax. For this purpose, there are two basic types of special assessments—jeopardy assessments and termination assessments.[1] Jeopardy assessments are of two different types depending on whether the taxes involved are (1) income, estate, gift, or certain excise taxes (those taxes that are normally dealt with under the notice of deficiency procedures) or (2) other taxes (such as employment taxes and wagering taxes).

Use of jeopardy assessments relating to income, etc., taxes.—If the Service determines that the collection of income estate, gift, or certain excise taxes is in jeopardy, a jeopardy assessment may be made under section 6861 of the Code. Under such an assessment, the Service determines that a deficiency exists and that its assessment or collection would be jeopardized by the delay. The Service is then authorized immediately to (1) assess the tax, (2) send a notice and demand for payment, and (3) levy upon the taxpayer's property for its collection. The 10-day waiting period normally required between demand for payment and seizure of the taxpayer's property does not apply in this case. However, if the jeopardy assessment is made before the statutory notice of deficiency is sent to the taxpayer, the Service is required to send the notice within 60 days after the jeopardy assessment is made.

The judicial remedies available to a taxpayer who has been subject to a section 6861 jeopardy assessment are identical to the remedies available for a normal assessment. Upon receiving a notice of deficiency, the taxpayer may file a petition for redetermination in the Tax Court.[2] Alternatively, the taxpayer may pay the full amount of the

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[1] The Internal Revenue Manual states that a jeopardy or termination assessment should not be made unless at least one of the following three conditions is met:

(1) The taxpayer is or appears to be designing quickly to depart from the United States or to conceal himself;

(2) The taxpayer is or appears to be designing quickly to place his property beyond the reach of the Government either by removing it from the United States, or by concealing it, or by transferring it to other persons, or by dissipating it; or

(3) The taxpayer's financial solvency appears to be imperiled.

[2] The notice is a jurisdictional prerequisite to litigation in the Tax Court.

deficiency, file a claim for refund with the Service, wait 6 months (unless the claim is denied by the Service sooner), and then file a refund action in a Federal district court or the Court of Claims.

The taxpayer who has been subjected to a jeopardy assessment, however, does not have all the protection afforded the ordinary taxpayer during the judicial review. In the normal deficiency case, the Service is prohibited from making an assessment and taking collection action against a taxpayer's property or assets prior to the time allowed for filing a petition for redetermination and during the time litigation is pending in the Tax Court. Although the Service is generally precluded from selling any property seized prior to or during Tax Court litigation, the jeopardy taxpayer—unlike the ordinary taxpayer—loses the use of whatever property and assets are seized by the Service while relief is sought in the Tax Court.

Use of jeopardy assessments relating to other taxes.—If the Service determines that collection of any tax liability relating to a tax other than an income, estate, gift, or certain excise tax is in jeopardy, the Service may make a jeopardy assessment under section 6862. This type of jeopardy assessment differs from that jeopardy assessment under section 6861 in that the taxpayer does not have the right to appeal the Service's determination to the Tax Court because the Tax Court has no jurisdiction in cases involving the type of taxes covered by section 6862.

As in the case of a section 6861 jeopardy assessment, if the Service determines that a tax is due and that the assessment or collection of the tax would be jeopardized by delay, the Service is authorized to immediately assess and levy upon the taxpayer's property. However, unlike the prohibition that prevents the Service from selling any property seized under a section 6861 jeopardy assessment before Tax Court appeal rights have been exhausted, property seized as a result of a section 6862 jeopardy assessment (since the case cannot be taken to the Tax Court) can be sold before the taxpayer has a right to contest the tax liability.

The appeal rights for a taxpayer who has been subject to a section 6862 jeopardy assessment begin after payment of the tax and filing of a claim for refund with the Service. The taxpayer must wait 6 months—unless the Service denies the claim sooner—and then either the Federal district court or Court of Claims will consider a refund suit by the taxpayer.

Use of termination assessments.—The two types of jeopardy assessment discussed up to this point are used only where the deficiency is determined after the end of the year to which it relates. A termination assessment (sec. 6851 of the Code) may be made when the collection of an income tax is in jeopardy before the end of a taxpayer's normal tax year or before the statutory date the taxpayer is required to file a return and pay the tax. Under a termination assessment, which may be made only to collect income taxes, if the Service finds that the collection of a tax is in jeopardy, it is authorized to:

(1) serve notice on the taxpayer of the termination of his taxable period;

(2) demand immediate payment of any tax determined to be due for the terminated period; and

(3) if payment is not received, immediately levy upon of the taxpayer's property.

Any amount collected as a result of the termination assessment is credited against the tax finally determined to be due for the taxpayer's full year liability. The 10-day waiting period normally required between demand for payment and seizure of the taxpayer's property does not apply when a termination assessment is made.

In recent years there has been considerable litigation and confusion concerning the judicial remedies of taxpayers who have been subject to termination assessments. It has been the Service's position in the case of termination assessments, that its authority to assess is *not* limited by requirements (such as found in section 6861) that the Service must send to the taxpayer a deficiency notice within 60 days after assessment. Thus, under the Service's position, a taxpayer who has been subject to a termination assessment may contest the assessment only by (1) paying the assessed tax, (2) filing a claim for refund with the Service, and (3) after 6 months, unless the refund claim is denied sooner, filing a refund action with the Federal district court or Court of Claims. Since it also has been the Service's practice not to consider a refund claim until after the end of the taxpayer's normal tax year, there could be a considerable delay until the taxpayer can obtain judicial review of his case, and during this delay the taxpayer is deprived of the use of any refund to which he or she would be entitled. Before the *Laing* decision (see footnote 3, below), some courts had sustained the Service's position, and other courts had rejected it.

On January 13, 1976 (after H.R. 10612 was passed by the House), the Supreme Court held [3] that when a taxpayer has been subjected to a termination assessment, the Service is required to send the taxpayer a notice of deficiency within 60 days after assessment (see footnote 2, above). In addition, the Court held that the Service has no authority to sell property seized pursuant to a termination assessment before the taxpayer has had any opportunity for judicial review of the tax liability in the Tax Court.

In recent years, most taxpayers who have been subject to termination assessments have been suspected of dealing in narcotics. Particularly during 1972 and 1973, a concerted effort was made to utilize termination assessments to "reduce the profitability" of dealing in illegal drugs. In 1974, however, the Service revised its guidelines to emphasize that termination assessments (and jeopardy assessments) were to be utilized to achieve maximum compliance with the internal revenue laws rather than to attempt to disrupt the distribution of narcotics.

Issue

As a result of concern in this area, the Joint Committee on Internal Revenue Taxation, on December 27, 1974, requested the General Accounting Office to act as its agent in reviewing the procedures followed by the Internal Revenue Service in making jeopardy assessments. The review was to include how the Service uses these enforcement tools, how often they are used, and whether their use varies significantly from district to district. Because of developing Congressional tax reform schedules, the GAO expedited its review and therefore limited its work to two IRS districts. The GAO has submitted its draft report to the Joint Committee.

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[3] *Laing* v. *United States*, ——— U.S. ———, 76–1, USTC par. 9164, 37 AFTR 2d 76–530, 96 S. Ct. 473.

The GAO draft report indicated that most jeopardy assessments and termination assessments were utilized against taxpayers allegedly engaged in illegal activities, although some of the jeopardy assessments under section 6862 were utilized to collect penalty taxes from persons who had failed to collect, or pay over, employment taxes. Although the GAO generally concluded that these types of assessments had not been misused, it did note that the termination assessments were generally unproductive from a tax collection viewpoint, since in 25 cases which had been completed at the time of review, $742,294 was assessed but the total tax deficiency after audit was only $36,665 (4.9 percent of the assessments). The GAO also noted that, in at least one case where a section 6862 jeopardy assessment was used to collect penalty taxes resulting from a corporation's failure to pay employment taxes, it was at least possible that the taxpayer was not liable for payment of the penalty tax.

The jeopardy and termination assessment powers granted to the Internal Revenue Service are generally considered valuable weapons which the Service can effectively utilize in unusual circumstances to prevent taxpayers from avoiding the payment of taxes. However, a taxpayer who has been subjected to such an assessment may suffer considerable hardship. This may result from the suddenness with which action may be taken.

Hardship may also result because of the requirement that, if the assessment is made under section 6862 (jeopardy assessment for other than income, estate, or gift tax, or certain excise taxes), the taxpayer must pay the tax, file a claim for refund, and then wait six months before filing a suit for refund. In addition, property seized following a jeopardy assessment under section 6862 can be sold before the taxpayer can contest the tax liability.

Since a taxpayer subjected to a section 6851 termination assessment or a section 6861 jeopardy assessment must be mailed a deficiency notice within 60 days after the assessment, the problem is less acute in his case than in the case of a taxpayer subjected to a section 6862 assessment. However, since, even in the case of a termination assessment or a section 6861 jeopardy assessment, a taxpayer may have to wait at least 60 days to petition the Tax Court and then his case will be placed on the regular docket of the Tax Court, his judicial remedy (considered in the light of the fact that substantially all of his assets may have been seized) is not sufficiently speedy to avoid undue hardship in cases where the assessment may have been inappropriate. In addition, although a taxpaper subjected to an assessment under section 6851 or 6861 has statutory protection against his assets (seized pursuant to the assessment) being sold prior to or during judicial proceedings, no such protection exists with respect to assets seized pursuant to assessments made under section 6862.

Furthermore, some may argue that a taxpayer's rights for review of the Commissioner's action are constitutionally inadequate. That argument would be based on the premise that, in view of the hardship that may be suffered by a taxpayer who has been the subject of a jeopardy or termination assessment, it is not sufficient to provide that within 60 days a taxpayer could file a petition with the Tax Court which

generally could be expected to render an opinion within 12 to 30 months after the petition is filed.

On March 8, 1976, the Supreme Court decided the case of *Commissioner* v. *Shapiro*, _____ U.S. _____, 76–1 USTC par. 9266, 37 AFTR 2d 76–959 (1976), involving an interpretation of the Anti-Injunction Act (section 7421 of the Code) with respect to a taxpayer against whom a jeopardy assessment had been made. In this case, the Supreme Court rejected the Commissioner's position that he "has no obligation to prove that the seizure has any basis in fact no matter how severe or irreparable the injury to the taxpayer and no matter how inadequate his eventual remedy in the Tax Court." (Slip opinion, p. 15) The Supreme Court also indicated that, at least in certain circumstances, a taxpayer may be constitutionally entitled to a more rapid judicial or administrative review of the Service's basis for a seizure of assets pursuant to a jeopardy assessment than is provided by his right to petition the Tax Court under the normal Tax Court procedures. In its opinion (at footnote 12), the Supreme Court also stated:

> Nothing we hold today, of course, would prevent the Government from providing an administrative or other forum outside the Art. III judicial system for whatever preliminary inquiry is to be made as the basis for a jeopardy assessment and levy.

House bill

Under the House bill (sec. 1209), Tax Court review of jeopardy and termination assessments would be provided on an expedited basis.

If a jeopardy or termination assessment is made, the taxpayer would be able to promptly petition the Tax Court for judicial review. Within 20 days after the filing of a petition, the Tax Court would determine whether the Service had reasonable cause for making the assessment and whether the amount of the assessment made was appropriate in view of all of the circumstances. In addition, until completion of judicial review, the Internal Revenue Service would not be permitted to sell property (other than perishables) seized pursuant to jeopardy or termination assessment procedures.

These rules would apply to jeopardy assessments, termination assessments, and levies made after December 31, 1975.

10. Exemption from Levy

Present law

Present law (sec. 6334 of the Code) enumerates a list of items of a taxpayer which are exempt from levy for taxes. The items so exempt are generally as follows: (1) wearing apparel and school books necessary for the taxpayer or members of his family; (2) if the taxpayer is the head of a family, up to $500 worth of the following: the fuel, provisions, furniture, and personal effects in his household, arms for personal use, livestock, and poultry; (3) up to $250 worth of books and tools necessary for the taxpayer's trade, business, or profession; (4) unemployment benefits (including any portion payable with respect to dependents); (5) undelivered mail; (6) annuity or pension payments under the Railroad Retirement Act, benefits under the Railroad Unemployment Insurance Act, special pension payments received by a person whose name has been entered on the Army, Navy, Air Force, and Coast Guard Medal of Honor roll, and annuities based upon retired or retainer pay under the Retired Servicemen's Family Protection Plan; (7) workmen's compensation payments (including any portion payable with respect to dependents); and (8) so much of the taxpayer's salary, wages, or other income as is necessary to comply with a pre-levy court-ordered judgment for support of the taxpayer's minor children.

Under present law, a levy extends only to obligations which exist at the time of levy (sec. 6331(b)). Consequently, the Internal Revenue Service can levy on salaries and wages only to the extent they have been earned as of the date of the levy. If the amount of such wages or salary levied upon is inadequate to satisfy the taxpayer's obligations, the Internal Revenue Service may utilize successive levies against additional salaries or wages until those obligations have been satisfied.

Issue

It has been pointed out that, since no portion of a taxpayer's salary or wages is exempt from levy (except for court-ordered child support payments), but unemployment compensation is exempt, an employed taxpayer who is subject to a levy is substantially worse off than an unemployed taxpayer would be under similar circumstances. Concern has been expressed that this rule may serve to induce taxpayers to go on unemployment compensation rather than to continue to receive a salary which is entirely subject to levy.

Also, it has been suggested that the requirement of successive levies in the case of salary and wages results in substantial administrative problems for the Internal Revenue Service and does not afford individual taxpayers any significant benefit.

House bill

Under the House bill (sec. 1210), a limited amount of a taxpayer's wages, salary, and other income would be exempt from levy under jeopardy and termination assessment procedures and otherwise. The amount that would be exempt for a taxpayer who receives all of his wages, salary, or other income on a weekly basis would be $50 plus $15 for each individual who is specified as a dependent of the taxpayer in a verified written statement submitted to the person on whom notice of levy is served. The bill also provides that a levy on a taxpayer's salary or wages shall be continuous until the tax liability with respect to which it is made is satisfied or becomes unenforceable because of the lapse of time.

These provisions would apply only with respect to levies made after December 31, 1975.

11. Administrative Summons

Present law

Under present law, the Internal Revenue Service is given authority, during the course of an investigation to determine the tax liability of a person, "to examine any books, papers, records, or other data which may be relevant or material" to the investigation. This includes not only the right to examine records in the possession of the taxpayer but also the authority to issue a summons to "any person" having possession or custody of records "relating to the business of the person liable for tax" as well as the authority to take the testimony of any such person under oath. In certain cases, where the Service has reason to believe that certain transactions have occurred which may affect the tax liability of some taxpayer, but is unable for some reason to determine the specific taxpayer who may be involved, the Service may serve a so-called "John Doe" summons, which means that books and records relating to certain transactions are requested, although the name of the taxpayer involved is not specified (*United States* v. *Bisceglia*, 420 U.S. 141 (1975)). The summonses served by the Internal Revenue Service, which may be referred to as administrative summonses, may be enforced where necessary by court procedure.

Where the summons is served on a person who is not the taxpayer (i.e., a third-party summons), the party summoned may challenge the summons for procedural defects (i.e., on grounds that the summons is not validly served or is ambiguous, vague, or otherwise deficient in describing the material requested), on grounds of the attorney-client privilege (where applicable), and on other grounds, such as an assertion that the material subject to summons is not relevant to a lawful investigation, or that it is not possible for the witness to comply (as where the records are not in his possession).

The person to whom the records pertain may also have some protectible interest which could be asserted to bar enforcement of the summons. However, there is no legal requirement that the taxpayer (or other party) to whose business or transactions the summoned records relate be informed that a third-party summons has been served.

Issue

The Service maintains that the use of the administrative summons, including the third-party summons, is a necessary tool in conducting many legitimate investigations concerning the proper determination of tax. The Service argues that the administration of the tax laws requires that it be entitled to obtain records, etc., without an advance showing of probable cause or other standards which usually are involved in the issuance of a search warrant. On the other hand it is contended by others that the use of this important investigative tool should not be allowed to infringe on the civil rights of taxpayers, including the right to privacy.

The Service has instituted an administrative policy designed to establish certain safeguards in this area. Under this policy, Service representatives are instructed to obtain information from taxpayers and third parties on a voluntary basis where possible. Where a third party summons is served, advance supervisory approval is required. In the case of a John Doe summons, the advance supervisory approval must be obtained on a high level basis. Many believe, however, that these administrative changes, while commendable, do not provide all of the safeguards which might be desirable in terms of protecting the right of privacy.

It has been suggested that many of the problems in this area would be cured if the parties to whom the records pertain were advised of the service of a third-party summons, and were afforded a reasonable and speedy means to challenge the summons where appropriate. (While the third-party witness also has this right of challenge, even under present law, the interest of the third-party witness in protecting the privacy of the records in question is frequently far less intense than that of the person to whom the records pertain.)

In the case of a John Doe summons, advance notice to the taxpayer is obviously not possible. Here some have suggested that the IRS agent should be required to show adequate grounds for serving the summons in an independent review process before a court before any such summons can be served.

House bill

Under the House bill (sec. 1211), in the case of a third-party summons (when the identity of the taxpayer is known), the Service would be required to include sufficient information to enable the third-party recordholder to locate the records. The taxpayer (or other person to whom the summoned records pertain) would receive notice of the summons from the Service at the time of its issuance and would have the right to stay compliance by notifying the person summoned (within 14 days after the date on which the summons is served), not to comply with the summons. The Service would then be required to seek enforcement of the summons in a Federal court and the taxpayer would have standing to challenge such enforcement. However, notice to the taxpayer would not be required in the case of an administrative summons to a bank, issued in connection with the collection activities of the Service where the purpose of the summons was solely to ascertain whether or not the taxpayer has assets in that bank. In the case of a "John Doe" summons (where the identity of the taxpayer is not known), the Service would have to go into court, establish reasonable cause for requesting the summons, and receive court approval before issuing the summons. In the case of a canvas of districts, pursuant to section 7601, a John Doe summons would not be issued, except in accordance with this court procedure.

These provisions would apply to summons issued after December 31, 1975.

12. Public Inspection of Private Letter Rulings

Present law

As a part of the tax system the Internal Revenue Service provides written advice to taxpayers on the tax treatment of their specific transactions.[1]

Advice may be issued upon a written request from the taxpayer, giving factual details about the transaction and after the taxpayer answers questions the Service may have about the transaction. (Information provided by the taxpayer to the Service often contains confidential financial (or personal) information about the taxpayer. Some of this information is repeated in the letter of advice that is issued by the Service.) The letter of advice generally is called a "ruling" and is in the form of a letter to the taxpayer.[2]

The letter ruling to the taxpayer has been treated as "private" in the sense that it is issued in response to the request of the taxpayer and is officially kept confidential. Even if another taxpayer obtains a copy of a private ruling, he cannot use it as a precedent in his own case. A private ruling applies only to the taxpayer who is the subject of the ruling, and only to the particular factual situation described in the ruling.

In addition, the Service publishes revenue rulings in its official bulletins. Taxpayers and Service employees may rely on these published rulings as precedent. However, before publication, all identifying information is deleted from the proposed revenue ruling, facts may be altered to conceal identity, the position of the Service may be changed, and this "sanitized" version is subject to extensive administrative review.

In 1975, the Technical Office of the National Office handled 29,620 ruling requests. Approximately one-half of these (14,867) dealt with requests for changes in accounting periods and methods; these requests are handled rapidly and normally do not involve any substantive issue.

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[1] Statement of Procedural Rules § 601.201: Rev. Proc. 72–3, 1972–1 CB 698, modified by Rev. Proc. 73–7. 1973–1 CB 776. However, the IRS will not rule on all transactions. For example, the IRS will not rule on whether compensation is reasonable in amount or on whether a taxpayer who advances funds to a charitable organization and receives a promissory note therefore may deduct as contributions amounts of the note forgiven by the taxpayer in later years. Rev. Proc. 72–9. 1972–1 CB 718. In addition, in some cases, the IRS has established guidelines describing the form a transaction must take before a favorable ruling will be issued. See, e.g., Rev. Proc. 75–21. 1975–1 CB 715, which sets out conditions which a transaction must meet before a favorable ruling will be granted that a transaction is a leveraged lease and not a conditional sale.

[2] While an erroneous ruling issued to a taxpayer may be modified or revoked, generally (in the absence of an omission or misstatement of material facts or change in law) an advance letter ruling which is relied upon by the taxpayer in good faith will not be modified or revoked retroactively if the facts which subsequently develop are not materially different from the facts on which the ruling was based. Statement of Procedural Rules § 601.201(1)(5).

Of the remaining rulings in 1975, the Technical Office responded to 14,753 taxpayer ruling requests. These requests dealt with exempt organizations (3,386), pension trusts (1,358), actuarial matters (1,280), other income tax matters (7,388), and miscellaneous matters (1,341).

The National Office of the Service also will answer requests for advice from the district offices on issues that arise in the course of an audit of a taxpayer's return. This advice is in the form of a technical advice memorandum. A technical advice memorandum is addressed to a field office of the Service but has an effect similar to that of a private letter ruling in that the technical advice involves a determination of tax questions concerning a particular taxpayer who generally has a right to, and usually does, participate in the technical advice proceeding. In 1975, the Service handled 1,551 requests for technical advice.

In 1975, the Service published 576 revenue rulings in its official bulletin. The source of these revenue rulings was both private rulings and technical advice memoranda. In one of the areas of tax law generally considered to be very complex—that of corporate reorganizations—the Service published 35 rulings in 1975. In that same year, there were approximately 2,600 private rulings issued in the corporate reorganization area.

Freedom of Information Act.—The Freedom of Information Act (FOIA) became effective on July 4, 1967. The FOIA requires each agency to make available for public inspection and copying "interpretations which have been adopted by the agency * * *." (5 U.S.C. § 552(a)(2)(B).) However, there are a number of exceptions from the requirement of disclosure under the FOIA, including matters that are specifically exempted from disclosure by statute.

Recently, the courts have considered the issue of whether private rulings are exempt from disclosure under the FOIA because they constitute tax returns (or return information) which are exempt from disclosure under the Internal Revenue Code (secs. 6103 and 7213). In these cases, both the U.S. Court of Appeals for the District of Columbia and the U.S. Court Appeals for the Sixth Circuit held that private letter rulings were not covered under sec. 6103 and 7213 of the Code and were subject to disclosure under the FOIA. *Tax Analysts & Advocates v. Internal Revenue Service;*[3] *Fruehauf Corp. v. Internal Revenue Service.*[4]

In addition, in *Fruehauf*, the court held that technical advice memoranda were to be open to inspection to the extent intended for issuance to a taxpayer. However, in *Tax Analysts* the court held that a technical advice memorandum was not open to inspection, being a part of a tax return and therefore exempt from disclosure under the FOIA (by reason of secs. 6103 and 7213 of the code).

In 1975, a suit was brought under the FOIA to compel release of all private letter rulings issued by the IRS since July 4, 1967, the effective date of the FOIA. *Tax Analysts & Advocates v. Internal Revenue Service.* —— F. Supp. ——, 37 AFTR 2d 76–352, 75–2 USTC par. 9869 (DC, DC). After considering the plaintiff's motion for summary judgment, the court ruled that the FOIA applies to unpublished

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[3] 505 F. 2d 350 (D.C. Cir. 1974).

[4] 75–2 USTC ¶ 16.189 (6th Cir. 1975) (petition for cert. granted Jan. 12, 1976).

private letter rulings issued since July 4, 1967, but stayed further proceedings in the case pending Supreme Court action in *Fruehauf*.

Proposed IRS Rules.—On December 10, 1974, the IRS issued proposed procedural rules dealing with the publication of private rulings. In general, these proposed rules provide for public inspection beginning approximately 30 days after the issuance of the ruling. (Furthermore, in certain cases, a delay in public inspection could be granted for an additional period not to exceed 13 weeks.) Under these proposed rules, the Internal Revenue Service would make available for public inspection the full text of private rulings, including identifying information. However, these proposed rules provide procedures for protecting trade secrets and national defense or foreign policy secrets.

On March 25, 1975, the IRS held public hearings on these proposed rules, at which time there was substantial public comment. In addition, the IRS was informed by the Justice Department that at least one part of the proposed rules (dealing with "required rulings") might be contrary to other principles of law.

Issue

It has been argued that the private ruling system has developed into a body of secret law known only to a few members of the tax profession. Additionally, it is contended that the secrecy surrounding letter rulings has generated suspicion that the tax laws may be used by the "influential" to their advantage, and that the tax laws are not being applied on an evenhanded basis.

These types of concerns led to the lawsuits described above to open private rulings to public inspection. While two courts have held private rulings to be open, significant additional questions have been raised since these court decisions. These questions concern the parts of a ruling file that should be published, whether private rulings should be available as "precedent" for other taxpayers, what procedures should be established to allow taxpayers to claim that protected material should not be disclosed, etc.

The questions generally apply to future as well as to past rulings. There are additional questions concerning past rulings, however, because taxpayers who previously obtained rulings applied for them in reliance on the service's position that the information submitted to the service would be treated as confidential tax information. (See Statement of Procedural Rules § 601.601(d)(2)(iv)(*h*), (v)(*b*).)

House bill

Under the House bill (sec. 1212), private "letter rulings" issued by the Internal Revenue Service pursuant to a request filed on or after September 25, 1975, would be made available to the public in public reading rooms and the material released would generally include the names of taxpayers who receive these rulings. However, because letter rulings deal with transactions by specific taxpayers, the same type of material presently protected from disclosure under the Freedom of Information Act would generally be deleted from letter rulings before they are made public. Only the letter ruling itself would be in the reading rooms, and not the underlying file.

To protect taxpayers' privacy, there would be a 30-day delay in the disclosure of letter rulings. The taxpayer would then be allowed a further delay in disclosure until the transaction is completed (or up to 6 months, whichever is shorter). An additional delay in publication of up to 6 months could be allowed by the IRS on application by the taxpayer.

Additional protection of privacy for "required rulings" would be provided. In general, identifying details in required rulings would not be disclosed. In the case of rulings dealing with changes in accounting periods and methods, a short synopsis of the ruling would be disclosed.

Technical advice memoranda would also be made public. However, because these memoranda arise out of audits or similar activities, disclosure of the taxpayer's identity would be deleted from technical advice memoranda before they are made public.

A letter ruling (or technical advice memorandum) could not be used as precedent by any taxpayer or by the Service.

These rules would apply to letter rulings and technical advice memoranda requested on or after September 25, 1975.

In the case of rulings and technical advice memoranda requested before September 25, 1975, and issued after July 4, 1967 (the effective date of the Freedom of Information Act, the identity of the taxpayer involved would not be disclosed. These prior rulings would be disclosed in the order of the date they were issued. However, disclosure of these prior rulings would be contingent upon the availability of appropriated funds for purposes of processing these rulings. Rulings and technical advice memoranda issued before July 4, 1967, would not be made public under these rules.

13. Disclosure of Tax Return Information

In General

The general statutory rules governing disclosure apply to tax "returns." (Sec. 6103 of the Code.)

The regulations under sec. 6103(a) have defined tax "return" to include information returns, schedules, lists, and other written statements filed with Internal Revenue Service which are supplemental to or become a part of the return. Tax "return" also includes other records, reports, information received orally or in writing, factual data, documents, papers, abstracts, memoranda, or evidence taken, or any portion thereof relating to returns and schedules, etc. The definition also includes reproductions or recordings of all or part of any such documents.

The regulations under sec. 6103(b) and 6103(c) provide a different definition of tax return. Under these regulations, a "return" includes information returns, schedules, lists and other written statements filed with the Internal Revenue Service which are supplemental to or become a part of the return, and also includes, in the discretion of the Commissioner of Internal Revenue, other records or reports containing information included or required by statute to be included in the return.

Under present law, all income tax returns are described as "public records." However, tax returns are generally open to inspection only under regulations approved by the President, or under Presidential order.[1]

This applies to returns concerning income tax, estate tax, gift tax, manufacturers excise taxes, communications tax, and transportation tax. The statute does not cover returns concerning a number of other types of taxes. These returns may be open to inspection at the discretion of the Commissioner, and include returns with respect to excise taxes on private foundations, and Federal Insurance Contribution Act (FICA) taxes. A more complete list is set out in the margin.[2] Addi-

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[1] Under the statute, income tax returns are open to inspection upon order of the President and under Treasury rules and regulations approved by the President (sec. 6103(a)(1). Income tax returns also are "open to public examination and inspection" to the extent authorized in rules and regulations established by the President. (Sec. 6103(a)(2).)

Estate and gift tax returns and miscellaneous excise tax returns also are open to inspection under rules and regulations established by the President.

[2] Classes of returns which may be open to inspection at the Commissioner's discretion include: (a) Rules Applicable to Recovery of Excessive Profits on Government Contracts. (Chapter 4); (b) Federal Insurance Contributions Act (Chapter 21); (c) Railroad Retirement (Chapter 22); (d) Collection of Income Tax at Source on Wages (Chapter 24); (e) Special Fuels (Subchapter E of Chapter 31); (f) Taxes on Wagering (Chapter 35); (g) Certain Other Excise Taxes (Chapter 36)—(1) Occupational Tax on Coin-Operated Devices (Subchapter B), (2) Tax on Use of Certain Vehicles (Subchapter D), (3) Tax on

tionally, the statute provides a number of specific situations in which tax returns can be disclosed.

In addition to the provisions of the Internal Revenue Code and the Treasury regulations, the Privacy Act of 1974 (Public Law 93–579) and the Freedom of Information Act (5 U.S.C. 552) affect the disclosure of tax information. The Privacy Act generally prohibits an agency from disclosing any of its records concerning an individual to another agency, without that individual's consent. However, under this Act, records may be disclosed to other agencies without such prior consent for a "routine use," for civil and criminal law enforcement activities, to the Bureau of the Census for census purposes, and in certain other cases.[3]

Under the Freedom of Information Act, the courts have held that private rulings must be made public; the courts have also required the disclosure of the names of the individuals to whom the letter rulings were issued. (The issue of private rulings is discussed in part 12 of this pamphlet.)

Disclosure to Congress

Present law

Congressional committees are classified in three categories for disclosure purposes. The tax committees may inspect tax information in executive session. (Sec. 6103(d).) Select committees of the House and Senate may inspect tax information, in executive session, if specifically authorized to do so by a resolution of the appropriate body. (Sec. 6103(d).) Standing and select committees may inspect tax information under an executive order issued by the President for the committee in question,[4] and on the adoption of a resolution (by the full committee) authorizing inspection. (Reg. § 301.6103(a)–101.) The resolution must set out the names and addresses of the taxpayers in question and the periods covered by the returns to be inspected. Subcommittees may inspect tax information under an executive order and resolution of the full committee. The designated agents of any authorized committee also may inspect tax information. (See 6103(d), Reg. § 301.6103 (a)–101.)

The tax committees and select committees authorized to inspect tax information may submit "any relevant or useful" information obtained to the House or Senate. (Sec. 6103(d)(1)(C).)

Use of Civil Aircraft (Subchapter E); (h) Sugar (Subchapter A of Chapter 37); (i) Regulatory Taxes (Chapter 39); (j) Private Foundations (Chapter 42); (k) Taxes on Distilled Spirits, Wines, and Beer (Chapter 51); (l) Taxes on Tobacco, Cigars, Cigarettes and Cigarette Papers and Tubes (Chapter 52); (m) Taxes on Machine Guns and Certain Other Firearms (Chapter 53). IRM 1272, Disclosure of Official Information Handbook 320.

[3] It is not yet clear what constitutes a routine use of tax information. However, from the legislative history of the Privacy Act it seems that routine use would include disclosure to the Department of Justice in tax cases, disclosure to State and local tax agencies to administer their tax laws, and disclosure to tax committees of the Congress and to their staffs. It also appears that the IRS may, under the Privacy Act guidelines prepared by the Office of Management and Budget, treat as a routine use, disclosure of tax information currently allowed pursuant to statute and regulations. See IRS Notice 403 (8–75) and 40 Fed. Reg. 38024 (Aug. 26, 1975).

[4] A new executive order must be issued every two years for a committee which wants to continue to obtain tax information, because an executive order is good only for the Congress in which it is issued.

Facts

The Joint Committee on Internal Revenue Taxation has used tax information most recently in its investigation of the use of the IRS for political purposes (both in the investigation concerning the "friends" and "enemies" lists and the investigation concerning the former Special Service Staff). It has also made use of tax return information in examining (as requested) the tax returns of former President Nixon, President Ford and Vice President Rockefeller. In addition it has examined returns in connection with its statutory duty to review certain refunds. Although the Senate Finance Committee and the House Ways and Means Committee have access to tax information, traditionally these two committees, to the maximum extent possible, consistent with their responsibilities, have used tax data that is not associated with individual taxpayers. Instead the Joint Committee staff has compiled data from individual tax returns and the data has been used by the Finance and Ways and Means Committees.

In 1972, the Joint Committee staff made a survey of the other committees that had requested tax data in recent years. Generally, the survey showed that these other committees used tax information sparingly. For the most part, tax information was used in investigations of alleged misconduct with respect to government operations, in corroborating financial records otherwise obtained, and in developing investigative leads.

Disclosure to the White House

Present law

For a number of years, it has been the position of legal advisers to the Commissioner of Internal Revenue that the President (and the White House) has unrestricted access to tax returns and tax information.

The Internal Revenue Code does not provide specifically for disclosure to the President. However, the Code generally provides that disclosure can be made as authorized in rules and regulations established by the President. (Sec. 6103(a).) Under this provision, the President could issue a "rule or regulation" providing for his access, and that of White House employees, to tax information. Additionally, in a previous administration, the then-Chief Counsel for the IRS informed the Commissioner in a legal opinion that, as a constitutional matter, there are no restrictions on the Commissioner disclosing tax information to the President. This interpretation was based on the part of the Constitution which vests executive power in the President and, on this basis, it was contended that he was entitled to all information relative to his control of the Executive Branch.

President Ford, by executive order, has established rules that govern the disclosure of tax information to the White House. (Executive Order 11805, September 20, 1974.) Under this order, tax returns are available for inspection by the President. Requests for inspection are to be in writing and signed by the President personally. Requests are to state the name and address of the taxpayer in question, the kind of returns which are to be inspected, and the taxable periods covered by the returns.

Under this executive order, other White House employees also may obtain tax information. The order provides that the President may designate, by name, employees of the White House who may receive tax information. This is limited to employees with an annual rate of basic pay not less than that prescribed by 5 U.S.C. § 5316 (at present, $37,800 per year). No further disclosure (except to the President) may be made by such employees without the written direction of the President.

Commissioner Alexander also has instructed the employees of the Internal Revenue Service with respect to procedures that are to be followed concerning requests for tax information from the White House. Any IRS employee who receives a request for tax information from the White House is to promptly communicate that fact to the Commissioner, through channels. The Commissioner will evaluate the request, and only the Commissioner (or, in his absence, his deputy) is to make the tax information available to the White House. This procedure also applies to "tax checks" on potential Presidential appointees. (IRS Information Notice 74–23, August 9, 1974.)

Facts

Disclosure of tax returns.—Generally, there have been three types of tax information provided to the White House. In some cases, tax returns, parts of tax returns, or analyses of tax information with respect to specific individuals have been provided the White House.[5]

"Tax checks" on potential Government appointees.—The White House also receives information on "tax checks" of Presidential appointees. The staff understands that, under the current procedure, a tax check on a potential Presidential appointee is initiated by the White House Counsel's Office as part of a "security and conflicts review" to which the potential appointee consents. As part of this review, the FBI conducts a "full field investigation" which includes checks with various governmental agencies, including the Internal Revenue Service. Therefore, the inquiry to the IRS with respect to a potential Presidential appointee comes directly from the FBI rather than from the White House.

Under the procedure established by Commissioner Alexander, only the Commissioner (or, in his absence, the Deputy Commissioner) may authorize disclosure of information under a tax check made for the White House. Additionally, under the Commissioner's procedures, the information provided is limited to whether an individual has filed

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[5] For example, John J. Caulfield testified that, while employed at the White House, he received tax information concerning Billy Graham, John Wayne, a number of individuals in the entertainment industry who were "politically active," and an individual working in the re-election campaign of former President Nixon. (Testimony of John J. Caulfield before the Senate Select Committee on Presidential Campaign Activities, March 23, 1974.)

Additionally, Clark Mollenhoff, while a White House employee, received tax information relating to the 1968 Presidential campaign of Governor George Wallace and to income received by his brother, Gerald Wallace. (Affidavit of Clark R. Mollenhoff before the House Committee on the Judiciary, dated June 4, 1974.) Also, Carmine Bellino, formerly special consultant to President Kennedy, received tax returns in 1961 while conducting investigations for the White House (and simultaneously the Justice Department and the Senate Permanent Subcommittee on Investigations of the Government Operations Committee). (*Congressional Record*, April 16, 1970.)

income tax returns for the immediately preceding three years; owes any unpaid taxes and, if so, for what years; has been under any criminal tax investigation and the result of such investigation; or has been assessed a penalty for fraud or negligence. (IR Manual, MT 1272–6 (8–22–74).)

This information is reported to the FBI which in turn reports it to the White House Counsel's Office. The staff is informed that the White House Counsel's Office transmits a report to the President that the security and conflicts review of the potential appointee has either been approved or disapproved. The tax information received by the White House Counsel's Office is, under present practice, not transmitted to any other office in the White House.

The staff also is informed that the White House security and conflicts review is used for Presidential appointees, White House staff, some of the Executive Office staff and others who receive a "White House pass" giving them access to the White House and to the President. Tax checks are also made on persons nominated for Department of Commerce "E" Awards (established by Executive Order 10978).[6]

The reports of the IRS to the Joint Committee for calendar year 1975 show the following tax checks requested by Federal agencies:

Agency:	*Number*
White House	1,139
Department of Justice	706
Department of Treasury	1,499
Department of State	165
Department of Commerce	96
Export-Import Bank	9
United States Information Agency	30
District of Columbia Judicial Commission	6
Congressional Committee	1
Total	3,651

Disclosure to Justice Department—Tax Cases

Present law

Tax returns and other tax information may be furnished without written application to U.S. Attorneys and Justice Department attorneys in civil or criminal tax cases referred by the IRS to the Justice Department for prosecution or defense. (Reg. § 301.6103(a)–1(h).) Where the Justice Department is investigating a possible violation of the civil or criminal tax laws and the matter has not been referred by the IRS, a Justice Department attorney or U.S. Attorney may obtain tax information upon written application where it is "necessary in the performance of his official duties." (Reg. § 301.6103(a)–1(g).) The written application must state the name and address of the taxpayer, the kind of tax, the tax period, and the reason inspection is desired. It must be signed by the Attorney General, Deputy Attorney General, an Assistant Attorney General or by a U.S. Attorney.

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[6] In addition to tax checks at the request of the White House, some tax checks are made at the request of other Federal agencies. These checks may be made at the request of the head of the other agency, and apparently also may be made at the request of other agency officers or employees. Also, it appears that occasionally tax checks are made on potential employees of congressional staffs, at the request of the Members of Congress concerned.

The Justice Department can obtain the returns of potential witnesses and third parties. Also, in a tax case (or any other case), the IRS will answer an inquiry from the Justice Department as to whether a prospective juror has been investigated by the IRS. (Reg. § 301.6103(a)–1(h).) However, other tax information is not available for examining prospective jurors.

Tax information obtained by the Justice Department may be used in proceedings conducted by or before any department or establishment of the Federal Government or in which the United States is a party. (Reg. § 301.6103(a)–1(f).)

Facts

The Justice Department is responsible for almost all civil and criminal tax matters litigated before the Federal courts (except for the Tax Court).[7] Most civil tax cases handled by the Justice Department are tried by attorneys of the Tax Division of the Justice Department. The Tax Division is routinely furnished the entire IRS file on a particular taxpayer with respect to any matter in controversy in a tax case concerning that taxpayer. Additionally, most civil tax litigation involves refund suits by taxpayers where the taxpayer's liability is directly in issue; in refund cases, it is common for the taxpayer to place his tax return in evidence.

Most criminal tax cases are conducted by U.S. attorneys (subject to the Tax Division's supervision). These cases generally are based on referrals from the IRS recommending prosecution. In these cases, also, the Justice Department is routinely furnished the entire IRS file on the taxpayer.

Tax returns obtained by the Justice Department generally pertain to the taxpayer whose civil or criminal tax liability is directly involved in the case. However, the Justice Department also may obtain directly from the IRS district offices tax returns of potential witnesses for the taxpayer or Government, and third parties with whom the taxpayer has had some transactional or other relationship.[8]

The returns of witnesses generally are obtained for purposes of cross examination and impeachment. In many cases, the information obtained from the witness' tax return is used to cast doubt upon his credibility as a witness, as opposed to establishing the tax liability in issue.

Additionally, in the course of a tax case, the Justice Department may obtain the return of a third party who will not be a witness in the case but who has had a transactional relationship with the taxpayer involved in the case.[9] In a criminal tax case, third-party returns may be used to develop leads to evidence establishing the guilt of a defendant. In civil tax cases, third-party returns may be used to develop

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[7] In the U.S. Tax Court, the Commissioner is represented by the Chief Counsel for the IRS.

[8] A request to the IRS National Office for tax information need only be made in the event the IRS district office rejects the Justice Department request. Rejection is to occur in those instances where the district office finds that the party for whom the tax information is requested is neither a potential witness nor has had any transactional relationship with the taxpayer.

[9] Also, the staff has been informed that third-party returns sometimes are obtained where the third party has a transactional relationship with a witness in a forthcoming trial and not with the taxpayer in the trial.

evidence pertaining either directly to the tax liability of a taxpayer, or to impeach the testimony of the party whose tax liability is at issue (or to impeach the testimony of witnesses testifying on his behalf).

The Government also obtains the tax returns of its own witnesses to determine the veracity of their proposed testimony and their credibility in general.

Disclosure to Justice Department—Nontax Criminal Cases

Present law

Under Treasury regulations, a U.S. Attorney or an attorney of the Department of Justice may obtain tax information in any case "where necessary in the performance of his official duties." This may be obtained on written application, giving the name of the taxpayer, the kind of tax involved, the taxable period involved, and the reason inspection is desired. The application is to be signed by the U.S. Attorney involved or by the Attorney General, Deputy Attorney General, or an Assistant Attorney General. (Reg. § 301.6103(a)–1(g).)

Tax information obtained by the Justice Department may be used in proceedings conducted by or before any department or establishment of the Federal Government or in which the United States is a party. (Reg. § 301.6103(a)–1(f).)

The service also will answer an inquiry from the Justice Department as to whether a prospective juror has been investigated by the IRS. (Reg. § 301.6103(a)–1(h).) However, other tax information is not available for examining prospective jurors.

Last month, the U.S. Supreme Court (in *Garner* v. *U.S.*, slip opinion, March 23, 1976) held that a taxpayer's Fifth Amendment privilege against compulsory self-incrimination was not violated when his income tax returns (which showed his occupation to be "gambler") were not introduced in a criminal gambling conspiracy trial. The Court held that he had waived his rights by making these disclosures on his income tax returns. The Court indicated that, in order to preserve his rights, he would have to claim the privilege against self-incrimination on his return, even though this meant that he would not have filed a complete income tax return. The opinion has been read as suggesting that a failure to file a tax return, because of a decision of a taxpayer to claim rights under the Fifth Amendment, would not constitute a violation of the Internal Revenue Code provision (sec. 7203) which makes it a crime to willfully fail to file a tax return. Presumably, this doctrine would not be limited to the particular factual situation in *Garner* (i.e., it would not be limited to gambling cases).

Facts

Strike Force.—The Organized Crime and Racketeering Section of the Department of Justice coordinates, through Federal Strike Forces, an integrated investigation and prosecution program against organized crime and racketeering activities. These investigations involve the participation of various Federal agencies, including the IRS.

In investigating organized crime, a strike force may focus on a single person, identified by various intelligence agency sources as a leader, member, or associate of a criminal organization, and investigate the transactions in which he is involved. Also, a strike force may

focus on a racketeering situation, and from there determine the persons who should be investigated in connection with that situation.

A strike force generally "targets" a suspect and investigates all his activities to determine what criminal laws he may have violated. In this process, it often may obtain tax information from the IRS to determine whether there has been a violation of the criminal statutes, both nontax and tax. Examples of nontax crimes which a strike force may investigate are counterfeiting and forgery, loan sharking, mail fraud, interstate transportation of stolen property, and illegal payments and loans to labor unions and employees.

Tax information may be used to provide strike force investigators leads relating to such criminal activity. Moreover, tax information is used to gather leads or make connections between various individuals and entities. The staff has been informed that the tax information considered most useful by strike force personnel in its nontax criminal investigation work is that which IRS investigators acquire from parties other than the taxpayer.

Tax information obtained in strike force investigations is used in prosecuting criminal offenses. Thus, requests are made for tax information pertaining to the defendant, and to defense witnesses in the course of the investigation, at the pretrial level, and sometimes during the trial. The returns of defense witnesses in nontax criminal trials are often requested to obtain information for cross-examination and impeachment of witnesses.

The tax returns of Government witnesses are also obtained in order to evaluate the veracity of their proposed testimony, as well as to evaluate their credibility in general.

Tax information also is obtained with respect to third parties who have had some transactional or other relationship with the defendant in order to seek investigative leads.

The staff has been informed that during the calendar year 1975 there were 166 requests for tax information by strike forces (and an additional 62 by the Criminal Division) of the Justice Department. The strike force requests concerned 8,103 tax returns of 1,711 taxpayers.

U.S. Attorneys.—As the chief law enforcement representatives of the Attorney General within their respective judicial districts, U.S. Attorneys are responsible for investigating and prosecuting persons who violate the Federal criminal laws.

U.S. Attorneys use tax information in investigating and prosecuting criminal activities. In calendar year 1975, U.S. Attorneys made 1,350 disclosure requests for tax information. These requests pertained to 17,678 tax returns of 4,330 taxpayers. It appears that a significant proportion of the requests made by U.S. Attorneys are for criminal investigative purposes, and this may be due to the increased investigative activity of U.S. Attorneys. For example, in some localities, special team investigations, sometimes referred to as "task forces", (which are analogous to the national level strike forces) have been conducted under the leadership of a U.S. Attorney.

According to the Justice Department, most U.S. Attorney tax data requests for investigative purposes pertain to potential "white collar" crimes involving some form of corruption (e.g., bribery, illegal kick-

backs) or "major fraud" (e.g., bank, investment, and mail frauds). Ordinarily, requests for tax returns are not made with respect to crimes of violence or for routine misdemeanor cases.

Disclosure to Justice Department—Nontax Civil Cases

Present law

Under Treasury regulations, a U.S. Atorney or an attorney of the Justice Department may obtain tax information in nontax civil cases in the same manner and to the same extent as in nontax criminal cases.

Facts

During 1975 there were 77 requests for tax information by divisions of the Justice Department involved with civil-nontax matters. These requests pertained to 515 returns of 119 taxpayers.

The Justice Department has used tax returns in suits brought against the Government seeking money damages for injury or wrongful death. The Justice Department has informed the staff that tax information is used in these cases to verify the claims of loss of income, and also to determine, through claimed medical expenses deductions. whether the plaintiff had suffered other injuries before or after the accident in question.

Tax information is also used in suits concerning the renegotiation of Government contracts, where the Renegotiation Board has determined that excess profits were earned on a Government contract. Here, tax information is used to verify the income earned on the contracts in question.

Nontax civil cases also involve affirmative money claims, including civil fraud claims, by the Government against various private parties. In these cases, tax information may be used to determine whether the defendant is financially able to pay the demand contemplated by the Government.

Tax returns are also requested after the Government has obtained a judgment against a party in order to verify statements made by the judgment debtor as to his financial ability to make payment of his debt.[10]

Much of the nontax civil litigation falling under the responsibility of the Civil Division of the Justice Department is handled by U.S. Attorneys, who request tax returns for the purposes described above.

As noted above in connection with tax and nontax criminal cases, disclosure requests also are made with respect to the tax returns of defense witnesses, Government witnesses, and third parties having a transactional relationship with the defendant or a defense witness.

Statistical Use

Present law

Several agencies obtain information from tax returns for statistical purposes. Under regulations allowing general inspection of tax information; the Department of Commerce (Census Bureau and Bureau

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[10] The Civil Division is the chief Justice Division using tax information for nontax civil purposes. Other divisions involved with nontax civil matters request and use tax returns on a minimal level. These include the Anti-Trust Division, the Land and Natural Resources Division, and the Civil Rights Division.

of Economic Analysis) is authorized to use information from tax returns for statistical purposes, (Reg. § 301.6103(a)–104). The Federal Trade Commission (Reg. § 301.6103(a)–106) and the Securities and Exchange Commission (Reg. § 301.6103(a)–102) also are authorized to use information for statistical purposes.

Other agencies which do not have Executive Orders allowing general inspection of returns probably could obtain tax returns for statistical purposes under the regulations allowing disclosure on a case-by-case basis. (Regs. § 301.6103(a)–1(f).)

For a short period, the Agriculture Department was authorized to obtain tax information on a general inspection basis for statistical purposes. This authority was established in 1973 and revoked in 1974.

Facts

Census Bureau.—The most extensive user of tax information for statistical purposes is the Census Bureau, within the Department of Commerce.[11]

In most cases the Census Bureau does not obtain the full tax returns. Instead, the information consists of name, address, industrial activity, and some coded financial information (i.e., whether the taxpayer has gross receipts within a given range, on a scale of 10 ranges). In the case of the Economic Census, information is provided concerning wages paid.

In general, information from tax returns is used by the Census Bureau to prepare lists of persons to be surveyed by the Bureau. The Bureau uses information from tax returns to assist in preparing the Economic Indicators, the Survey of Minority-owned Business Enterprises, and the Survey of County Business Patterns.

The Economic Census (conducted every five years) is used for the Index of Industrial Production (of the Federal Reserve Board), the Index of Wholesale Prices (of the Bureau of Labor Statistics), and the Gross National Product accounts. The Current Economic Indicators include information on retail sales, manufacturers' shipments, orders and inventories, investment, and are used for the Index of Industrial Production (Federal Reserve Board).

These statistics are used as a basis for national economic policy, for distributing funds by agencies, by State and local governments in determining their programs, and by private business in forecasting, marketing, investment, etc.

Generally, these statistics are not based on data from tax returns. The Census Bureau has stated that information from tax returns is largely used to prepare lists for census and survey, to tabulate statistical links between data reported by the Service and the Census Bureau, to excuse smaller firms from filing reports (by using data from tax returns instead), and to weed out firms that do not need to report.

The Census Bureau has made an analysis of the effect of not allowing it to use tax data. Generally, the Bureau has stated that the effect

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[11] For example, in 1975, he following income tax return records were transferred to the Census Bureau:

1. 8,400,000 Business Master File Entity Change Records showing employer identification number (EIN), name, address, and zip code.

2. 21,200,000 Forms 941 showing EIN, total compensation, FICA wages, taxable tips, master file account, tax period, and address change.

of entirely prohibiting it from having access to information from tax returns would be to significantly increase the costs of collecting data and to significantly decrease the quality of the statistics developed.

In the alternative, the Census Bureau has evaluated the impact of having limited data from tax returns, such as name, address, size, and kind of business. With regard to the Economic Census (next scheduled for 1977), the Bureau states that, with access to such limited data, it could "assemble a satisfactory mailing list with a cost, time, and workload frame similar to the 1972 Economic Census." However, if actual tax record values for annual sales and annual payroll were not available, the Bureau states that "it would be necessary" to collect this information from small as well as large businesse (apparently affecting about 3 million small firms).

The 1974 Agricultural Census used the limited tax identification information of name, address, identification number, and size class. Additionally, this type of information is essentially what the Bureau now obtains for the Economic Indicators program.

The Census Bureau also currently uses "relatively small samples of individual tax records," on a case-by-case basis, to compare income reported in tax returns with income reported in the census. Similar evaluation studies are used by the Bureau in connection with surveys such as the Current Population Survey.

Information from tax returns is also used by the Bureau in determining amounts to be allocated under revenue sharing; this use was specifically contemplated by the Congress in establishing the revenue sharing program (see General Explanation of the State and Local Fiscal Assistance Act, H.R. 14370, 92nd Congress, Public Law 92–512, page 39 (Feb. 12, 1973).)

Bureau of Economic Analysis.—The Bureau of Economic Analysis (BEA) prepares the National Income Accounts, including the National Income and Product Accounts focusing on GNP, and the Balance of Payments Accounts.

BEA has stated that a major input into GNP is the IRS published Statistics of Income series. However, BEA has also stated that it needs access to a sample of individual large corporation's tax returns to prepare "industry extrapolators," and to be able to distinguish changes in the IRS Statistics of Income series that occur on account of shifts in economic development from changes that occur on account of shifts in tax reporting.

The staff is informed that BEA does not obtain tax information. from individuals' returns, but only from returns of large corporations. Generally, BEA employees examine IRS transcript cards that summarize information from 500 to 1,000 returns of the largest corporations. (In calendar year 1974, BEA obtained 300 "transcript-edit sheets" of corporate returns.) BEA employees copy data from these cards and also inspect 20 to 100 tax returns over the course of a year.

Federal Trade Commission.—In 1974,[12] the Federal Trade Commission obtained the following information for use in the Industrial and Financial Reports Program and the Quarterly Financial Report series:

1. 58,729 specially prepared abstract sheets for corporation returns.

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[12] 1975 data are not yet available.

2. 43,000 Forms 1120, etc., including name, address, EIN, date incorporated, gross receipts, taxable income, total assets, industry code, accounting period, and name, address and EIN of consolidated subsidiaries.

3. 31,000 abstracts of corporate tax returns showing name, address, zip code, EIN, date incorporated, gross receipts, taxable income, total assets, industry code, accounting period, and name, address and EIN of consolidated subsidiaries.

The staff has been informed by the FTC that, for the most part, it does not need detailed financial information from the IRS, and in any case does not use information about individuals. The FTC has stated that it uses the information it receives to develop a sample of corporations which the FTC then surveys. To develop this sample, the FTC needs the following information: name, address, EIN, industry code, sample code, and gross assets indicator. (The "industry code" tells what the principal industrial activity of the corporation is, the "sample code" tells the sampling process used by the IRS with respect to its Statistics of Income (not with respect to audit, etc.), and does not appear to be tax information. A gross assets indicator would tell, e.g., whether the corporation had gross assets of over $10 million, $5–$10 million, $3–$5 million, $1–$3 million, or less than $1 million.)

The FTC has also stated that other information as the accounting period and consolidated return indicator are helpful in developing more accurate statistics, but are not basic to its statistical process. The same is true with respect to net receipts and net income.

Agriculture Department.—On January 17, 1973, Executive Order 11697 was issued allowing the Agriculture Department general inspection of tax returns to obtain data about farming operations to be used "for statistical purposes only." The regulations issued under this Executive Order allowed the Agriculture Department to obtain the name, address, and EIN of taxpayers and "any other data" on the tax returns.

On March 27, 1973, a second Executive Order (E.O. 11709) was issued, along with regulations. These regulations limited the information which could be obtained by the Agriculture Department to name, address, EIN, type of farm activity, and one or more measures of size of farm operations, as gross income from farming or gross sales of farm products.

On March 21, 1974, these two Executive Orders were revoked by E.O. 11773. Revocation occurred after significant criticism was directed at inspection of tax returns by the Agriculture Department. (See "Executive Order 11697 and 11709", Hearings before a subcommittee of the House Committee on Government Operations, 93rd Congress, 1st Sess., May 9 and August 3, 1973.)

The data to be obtained by the Department of Agriculture was similar to that obtained by Census for its agricultural census. However, Congressional testimony has suggested that the two cases are different because the Census Bureau is "the statistical handmaiden of the entire Federal Government," but the Agriculture Department statistical division "has a responsibility to gather statistical data for the policy-making of the Department of which it is a part." Consequently, "the fear existed that the material obtained by the Agriculture Depart-

ment would, or at least could, be used by Agriculture in making decisions with respect to the programs which it directs."

Securities and Exchange Commission.—The staff is informed that the SEC has not obtained tax information for statistical purposes for several years, since the functions for which the SEC required this information were moved to the Federal Trade Commission.

Other Federal Agency Uses

Present law

Tax information is available to each executive department and other establishments of the Federal Government in connection with matters officially before them on the written request of the head of the agency.

Tax information can be inspected for nontax administration purposes by Treasury employees (who are not in the IRS) on the written request of the head of the appropriate bureau or office. The request is to state the name and address of the taxpayer, the kind of tax and the taxable period involved, the reason why inspection is desired, and the name and position of the employee who will inspect the return (this last item is not required for non-IRS Treasury Department inspections). Tax information obtained in this manner may be used as evidence in any proceedings before any "department or establishment" of the United States or any proceedings in which the United States is a party.

Under the regulations, several agencies may generally inspect tax information for qualified purposes, without the head of the agency having to write a specific request to the IRS identifying the taxpayer and the reason for the desired inspection. For example, the Department of Health, Education, and Welfare may inspect individual tax returns as required to administer Title II of the Social Security Act (old-age, survivor, etc., benefits). Inspection is authorized on the written application of any authorized officer or employee of the department.

Also, Customs, Secret Service, and other Treasury enforcement agents may obtain limited tax information on their own request, without the request of the head of their office. This includes information on whether a delinquent account has been issued, whether an audit was made, whether an Intelligence investigation was conducted, and the taxpayer's address.

Facts

During calendar year 1975, the following agencies obtained tax information under this provision:

Federal agency	Number of requests	Number of taxpayers
Department of Agriculture	2	7
Bureau of Alcohol, Tobacco, and Firearms	1	1
General Accounting Office	1	234
Renegotiation Board	3	5
Department of Justice	51	84
U.S. Attorneys	29	62
Small Business Administration	3	65
Total	90	458

In 1972, the Joint Committee staff conducted a survey of the variout Federal agencies which had previously requested tax data from the Internal Revenue Service. The agencies were asked the uses to which the information was put. For the most part, information obtained by the agencies on a case-by-case basis (under Regs. § 301.6103 (a)–1(f)) was used in investigations of suspected violations of laws under the jurisdiction of the agency. These investigations concerned kickbacks, failure to file reports or verification of information and reports, concealment of assets and other undisclosed interests, unlawful control of assets, "financial fitness", etc. The Renegotiation Board has used tax information in conjunction with its responsibility under the Renegotiation Act to eliminate excessive profits from contracts with the Federal Government. Tax data is requested by the Social Security Administration to obtain evidence of earnings so that an individual's entitlement to monthly benefits may be properly determined. This information can be used to the benefit of the individual or to the benefit of the government with respect to determining Social Security benefits.

State and Local Governments

Present law

On the written request of the State governor, individuals' and organizations' tax returns may be inspected by State tax officials for purposes of administering the State's tax laws. At the governor's written request, tax information also may be obtained for local governments to be used in administering their tax laws. (Sec. 6103(b).) Income tax information is not furnished directly by the IRS to local governments. Instead, State tax officials furnish such information to local governments where the IRS has approved such action at the request of the Governor.

Under the regulations, with the permission of the Commissioner and for purposes of State tax administration, a State may be allowed to inspect on a general basis all income, estate, and gift tax returns filed in the district in which the State is located. The same is true for other types of returns such as estate tax and gift tax returns. Additionally, the specifically identified returns of taxpayers who filed within the relevant district, and of taxpayers who filed in districts which do not include the State in question, may be inspected on a case-by-case basis on the written request of the State Governor.

Facts

On request, the Commissioner may allow each State to inspect on a general basis all tax returns filed by residents of the State. The staff understands that all States except Nevada have made such requests and may make a general inspection of returns. The ability to inspect returns under this procedure applies to the physical inspection of the documents in question.

The States may also enter into tax coordination agreements with the IRS with respect to inspection of tax information. (All States except Nevada and Texas have entered into these agreements, and the staff is informed that Texas is now negotiating with the IRS regard-

ing an agreement.[13] These agreements generally provide for cooperation between the IRS and the States in tax administration, for an exchange of tax information, for assistance in locating delinquent taxpayers (and their property), and for cooperative audits, and also provide for preserving the confidentiality of tax information.

By far the largest IRS/State information exchange program, in terms of amounts of information transferred, is the furnishing of Federal tax information on magnetic tape. In 1975, 41 States (plus the District of Columbia and Puerto Rico) participated in this program. Under the 1975 Individual Master File (IMF) program, information on nearly 66 million taxpayers was provided to the States. (This covers approximately 80 percent of individual taxpayer records.) IMF tax data available to the States include: name, address, social security number, filing status, tax period, exemptions claimed, wages and salaries, adjusted gross income, interest income, taxable dividends, total tax, and audit adjustment amount.

Under the tape exchange programs, the States agree to conduct a joint review with the IRS of safeguards of tax information.

A Business Master File (BMF) program is also available to the States to aid them in establishing their own business master files. Information from the Exempt Organization Master File is also available to the States, as is gift tax data.

Under the cooperative audit program, copies of examination reports are furnished the States. In 1974, nearly 700,000 abstracts of these reports were furnished the States. (The 1975 figures are not available.) Also, the IRS furnishes the States information on returns that appear to have good audit potential but will not be audited by IRS because of manpower restrictions. In 1974, information was furnished on more than 70,000 returns under this program. (The 1975 figures are not available.)

It has been suggested that tax information that is supplied to tax officials at the State and local levels may not be invariably subject to appropriate safeguards on confidentiality. Also, it has been suggested that political considerations may produce unwarranted interest by State and local governments in tax information, even at higher levels, for nontax purposes.

IRS studies have indicated that in several situations, State authorities have allowed other States (or local governments) to inspect Federal tax information, have not maintained adequate records of inspection of Federal tax information, and have inadequate procedures to instruct employees with respect to Federal tax return confidentiality. However, it is the staff's understanding that when these problems have been brought to the attention of the State authorities involved, remedial action has been taken.

On the other hand, it appears that it is important to the States that they have access to Federal tax information. With Federal tax information, the States are able to determine if there are discrepancies be-

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[13] A State is not precluded from inspecting tax information if it has not entered into an agreement. Therefore, Texas may inspect returns of its residents on a general and case-by-case basis, and Nevada may inspect returns of its residents on a general and case-by-case basis.

tween the State and Federal returns in, *e.g.*, reported income. Also, many States have only a few, if any, of their own tax auditors and rely largely (or entirely) on information concerning Federal enforcement in enforcing their own tax laws.

Taxpayers With a Material Interest

Present law

Under the regulations, income tax returns presently are open to the filing taxpayer, trust beneficiaries, partners, heirs of the decedent, etc. "Return information", as opposed to the tax returns themselves, is only available to the taxpayer, etc., at the discretion of the IRS.

Also, the statute specifically authorizes the inspection of a corporation's income tax returns by a holder of 1 percent or more of the corporation's stock. (Sec. 6103(c).)

Miscellaneous Disclosures

Present law

Under present law, several provisions of the regulations allow disclosure of tax information for miscellaneous administrative and other purposes. For example, accepted offers in compromise (under sec. 7122) are open to inspection. Internal Revenue officers may disclose limited information to verify a deduction, etc. Additionally, in a number of cases, tax information may be disclosed at the discretion of the Commissioner, as the statute is wholly silent with respect to certain types of returns. For example, FICA tax returns and private foundation excise tax returns are within this category.

In other cases, the statute specifically requires public disclosure of certain types of returns. Under the Code, applications for exempt status by organizations and applications for qualification of pension, etc., plans are generally open to public inspection. (Sec. 6104(a).) Also, the annual reports of private foundations are open to public inspection. (Sec. 6104(d).) Returns with respect to the taxes on gasoline and lubricating oils are open to inspection by State officials (Sec. 4102.) Under certain circumstances, the amount of an outstanding tax lien may be disclosed. (Sec. 6323(f).)

Upon inquiry, the IRS is to disclose whether any person has filed an income tax return for the year in question (Sec. 6103(f).)

Facts

Inquiries under section 6103(f) are made by, among others, news media and commercial concerns.

Additionally, the IRS sometimes is asked to provide information concerning a taxpayer's address. Address information will be provided to State or local officials for tax administration purposes, to State or local enforcement officials if furnishing the information will aid in Federal special enforcement programs (*e.g.*, narcotics programs), to Federal agencies in general to assist in administering their responsibilities and to "educational lending institutions" to locate delinquent borrowers under Federal loan guarantees. Address information will not, however, be provided to commercial concerns. Also, address in-

formation is provided to local welfare agencies regarding "runaway parents" under Public Law 90–248 (section 410 of the Social Security Act). Address information also may be provided individuals in emergency situations.

Procedures and Records Concerning Disclosure

Present law

Several different offices of the IRS have responsibility for approving disclosure of tax information to particular agencies. For example, the Disclosure Staff (National Office) deals with case-by-case requests for tax returns by other Federal agencies while the Statistics Division deals with the disclosure of information to Federal agencies (largely on magnetic tape) to be used for statistical purposes. Additionally, the Planning and Research Division deals with disclosure of information on magnetic tape to the States while the Disclosure Staff deals with case-by-case disclosure to the States.

While these offices negotiate and approve disclosures of tax information, the actual transfer of the information generally takes place in other offices, such as the Service Centers, District Office, Computer Center, etc. In addition, District Directors and Service Center Directors are authorized to approve applications for certain types of disclosure, such as disclosure to persons with a material interest in the returns, and returns of the taxpayer (in tax cases) to U.S. attorneys.

The IRS presently maintains records concerning disclosure. However, the staff understands that the type of records maintained are not standardized as between, e.g., Service Centers, and that the IRS does not maintain a complete inventory of records so, for example, it cannot determine what has been disclosed and what has been returned or destroyed.

Under the Privacy Act of 1974 (P.L. 93–579), each Federal agency is to account for disclosures to other agencies, noting the date, nature, and purpose of each disclosure and the name and address of the agency to which disclosure is made. This rule does not apply to disclosures by State agencies. The accounting is designed to enable the agency to inform the individual concerned of disclosures made with respect to him.

Facts

Recently, there have been cases reported where tax information was transferred outside the IRS, without following what might be considered proper procedures. For example, John J. Caulfield testified before the Senate Select Committee on Presidential Campaign Activities that he received a "back door copy" of tax information on Billy Graham. Mr. Caulfield testified that he received this information from Vernon Acree who was Assistant Commissioner (Inspection) at that time.

There does not presently appear to be a standardized system of accounting for disclosure, so that the IRS can determine what information has been transferred, for what purposes, what use has been made

of it, and whether it has been destroyed, returned, etc., after it has been used. Also, studies indicate that in several situations, inadequate records have been maintained of transfer of tax information to the various Federal agencies and to State authorities, and that, in certain instances, IRS procedures have not been properly followed.

Safeguards

Present law

Except for the general criminal penalty for unauthorized disclosure, the tax law does not provide rules for safeguarding tax information disclosed by the IRS to other agencies. However, some of the existing Agreements on Coordination of Tax Administration entered into between the Federal Government and the States' include provisions for safeguarding tax information.

The Privacy Act requires that each agency establish appropriate administrative, technical, and physical safeguards to secure records on individuals. This requirement applies to each Federal agency that maintains a "system of records". This provision does not apply to State or local government agences that receive Federal tax records.

The IRS has no authority under the Privacy Act to audit the safeguards established by other agencies, or to stop disclosure to other agencies that did not properly maintain safeguards.

Enforcement

Present law

Unauthorized disclosure of Federal tax information by a Federal or State employee is a misdemeanor punishable by a fine of up to $1,000, or imprisonment of up to one year, or both (together with the costs of prosecution). Federal officers or employees also are to be dismissed from office or discharged from employment. It also is a misdemeanor (punishable in the same manner) for any person to print or publish in any manner not provided by law any income return or financial information appearing therein. (Sec. 7213(a) (1), (2), see also 18 U.S.C. § 1905.)

One-percent shareholders who examine a corporate return are guilty of a misdemeanor (punishable as above) if they disclose in any manner "not provided by law" the amount of any income, etc., shown on the return.

Issue

The IRS has conducted investigations concerning the possible improper disclosure of confidential information as follows:

	Fiscal year—		
	1973	1974	1975
Investigations conducted	58	103	179
Disciplinary actions	9	23	23
Separations from employment	4	2	5

There have also been criminal prosecutions for illegal disclosure of confidential tax information, as follows:

	Fiscal year—		
	1973	1974	1975
Prosecution referrals	8	8	4
Prosecutions declined	7	5	4
Convictions	1	3	0

Two of the four people convicted were IRS employees and two were private detectives. The two IRS employees were given probation (and one was fined $350). The two private detectives were each fined $250, placed on two-year probation, and jailed for short periods of time (i.e., 24 hours for two Tuesdays).

House Action

The House Ways and Means Committee held extensive hearings on this subject, but did not deal with it in H.R. 10612.

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