IRS AND NONTAX RELATED CRIMINAL ENFORCEMENT INVESTIGATION

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT OF THE INTERNAL REVENUE SERVICE

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-SIXTH CONGRESS

SECOND SESSION

ON

S. 2402, S. 2403, S. 2404, S. 2405

JUNE 20, 1980

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IRS AND NONTAX RELATED CRIMINAL ENFORCEMENT INVESTIGATION

FRIDAY, JUNE 20, 1980

U.S. SENATE,
COMMITTEE ON FINANCE,
SUBCOMMITTEE ON OVERSIGHT OF THE
INTERNAL REVENUE SERVICE,
Washington, D.C.

The committee met, pursuant to notice, at 9:35 a.m., in room 2221, Dirksen Senate Office Building, the Honorable Max Baucus presiding.

Present: Senators Baucus and Byrd.

[The press release announcing this hearing and the bills S. 2402, S. 2403, S. 2404, S. 2405 follow:]

[Press Release]

FINANCE SUBCOMMITTEE ON OVERSIGHT OF THE INTERNAL REVENUE SERVICE SETS HEARING ON S. 2402, 2403, 2404, and 2405

Senator Max Baucus (D. Mont.), Chairman of the Subcommittee on Oversight of the Internal Revenue Service of the Senate Finance Committee, announced today that the Subcommittee will hold a hearing on Friday, June 20, 1980, on Senate bills 2402, 2403, 2404, and 2405 introduced by Senator Sam Nunn (D. Ga.). These bills would make amendments to the Internal Revenue Code relating to the use of Internal Revenue information and personnel in non-tax related criminal enforcement investigations. They also make changes relating to the duties of third parties who are asked to turn over tax information in their possession.

The hearing will be held in Room 2227, Dirksen Senate Office Building and will begin at 9:30 a.m.

In announcing the hearing, Senator Baucus stated, "We must strike a careful balance between individual privacy rights and the need for effective law enforcement. The Tax Reform Act of 1976 imposed stringent restrictions on disclosure of tax data and other information by the internal Revenue Service to curb flagrant abuses. The issue is whether such stringent restrictions are still appropriate."

The following witnesses and organizations have been scheduled to testify before the Subcommittee:

The Honorable Sam Numm, Senator from the State of Georgia.

The Honorable Lowell P. Weicker, Jr., Senator from the State of Connecticut.

The Honorable Jerome Kurtz, Commissioner of Internal Revenue.

the Honorable M. Carr Ferguson, Assistant Attorney General (Tax Division) U.S. Department of Justice.

Bill Anderson, Director, General Government Division, General Accounting Office.

The American Civil Liberties Union.

The American Bankers Association.

The American Bar Association.

Written testimony.—Senator Baucus stated that the Subcommittee would be pleased to receive written testimony from those persons or organizations who wish to submit statements for the record. Statements submitted for inclusion in the record should be typewritten, not more than 25 double-spaced pages in length and mailed with five (5) copies by July 11, 1980 to Michael Stern, Staff, Director, Committee on Finance, Room 2227 Dirksen Senate Office Building, Washington, D.C. 20510.

96TH CONGRESS
2D SESSION

S. 2402

To insure the confidentiality of information filed by individual taxpayers with the Internal Revenue Service pursuant to the Internal Revenue Code and, at the same time, to insure the effective enforcement of Federal and State criminal laws and the effective administration of justice.

IN THE SENATE OF THE UNITED STATES

MARCH 11 (legislative day, JANUARY 3), 1980

Mr. NUNN (for himself, Mr. PERCY, Mr. CHILES, Mr. COHEN, Mr. DECONCINI, Mr. LONG, Mr. TALMADGE, and Mr. RIBICOFF) introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To insure the confidentiality of information filed by individual taxpayers with the Internal Revenue Service pursuant to the Internal Revenue Code and, at the same time, to insure the effective enforcement of Federal and State criminal laws and the effective administration of justice.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That subsection (a) of section 6103 of title 26, United States
4 Code, is amended to read as follows:

1 "(a) GENERAL RULE.—Returns and nonreturn informa-
2 tion shall be confidential and disclosure of said returns or
3 nonreturn information shall be prohibited, except as author-
4 ized herein.".

5 SEC. 2. Paragraph (1) of subsection (b), section 6103 of
6 title 26, United States Code, is amended to read as follows:

7 "(1) RETURN.—The term 'return' means any doc-
8 ument the taxpayer is required by law to furnish to the
9 Secretary including any tax or information return, dec-
10 laration of estimated tax, or claim for refund required
11 by, or provided for or permitted under the provisions of
12 this title which is filed with the Secretary by, on behalf
13 of, or with respect to any person, and any amendment
14 or supplement thereto, including supporting schedules,
15 attachments, or lists which are supplemental to, or
16 part of, the returns so filed.".

17 SEC. 3. Paragraph (2) of subsection (b), section 6103 of
18 title 26, United States Code, is amended to read as follows:

19 "(2) NONRETURN INFORMATION.—The term
20 'nonreturn information' means—

21 "(A) Any information, other than a return,
22 which the Secretary collects, obtains, or receives
23 with respect to a taxpayer or return or with re-
24 spect to the determination of the existence, or
25 possible existence of liability (or the amount

1 thereof) of any person under this title for any tax
2 penalty, interest, fine, forfeiture, or other imposi-
3 tion or offense, and
4 "(B) Any part of any written determination
5 of any background file document relating to such
6 written determination (as such terms are defined
7 in section 6110(b)) which is not open to public in-
8 spection under section 6110.".
9 SEC. 4. Paragraph (3) of subsection (b), section 6103 of
10 title 26, United States Code, is amended to read as follows:
11 "(3) TAXPAYER IDENTITY.—The term 'taxpayer
12 identity' means any information in the possession of
13 the Internal Revenue Service which identifies the
14 name, address, or social security number of any tax-
15 payer or which reveals whether the taxpayer filed a
16 tax return for any given year.".
17 SEC. 5. Paragraph (6) of subsection (6), section 6103 of
18 title 26, United States Code, is hereby repealed, and para-
19 graphs (7), (8), and (9) are renumbered accordingly.
20 SEC. 6. Subsection (b) of section 6103 of title 26,
21 United States Code, is amended by adding thereto new para-
22 graphs numbered (9), (10), (11), and (12), as follows:
23 "(9) ATTORNEY FOR THE GOVERNMENT.—The
24 term 'Attorney for the Government' means the Attor-
25 ney General, any Deputy Attorney General, Assistant

1 Attorney General, Deputy Assistant Attorney General,
2 United States Attorney, Attorney in Charge of a
3 Criminal Division Organized Crime Strike Force, any
4 other head of a regional office of the Department of
5 Justice or a supervisory attorney specifically desig-
6 nated by the Attorney General.
7 "(10) SECRETARY OR HIS DESIGNEE.—The term
8 'Secretary or his designee' means the Secretary of the
9 Treasury or his designee and may include the Commis-
10 sioner of the Internal Revenue Service, any Regional
11 Commissioner or Assistant Regional Commissioner in
12 Charge of the Criminal Investigation Division of the
13 Internal Revenue Service, or any District Director or
14 Chief of the Criminal Investigation Division of any
15 local Internal Revenue Service office.
16 "(11) DISTRICT COURT.—The term 'district
17 court' means a United States district court judge or a
18 United States magistrate so designated by a United
19 States district court judge to perform his duties under
20 this section.
21 "(12) FEDERAL INVESTIGATIVE AGENCY.—The
22 term 'Federal investigative agency' means any Federal
23 department or agency which has the responsibility or
24 duty to investigate the violation of any Federal crimi-
25 nal statute.".

1 SEC. 7. Paragraphs (1), (2), (3), and (4) of subsection (i),
2 section 6103 of title 26, United States Code, are amended to
3 read as follows:

4 "(1) DISCLOSURE TO FEDERAL OFFICERS OR EM-
5 PLOYEES FOR THE ADMINISTRATION OF FEDERAL LAWS
6 NOT RELATING TO TAX ADMINISTRATION.—

7 "(1) TAX RETURNS.—Disclosure of tax returns
8 for purposes not related to tax administration shall be
9 permitted only as follows:

10 "(A) EX PARTE ORDER.—Upon application
11 by an attorney for the Government, a United
12 States district court may, by ex parte order,
13 direct that a tax return be disclosed to the attor-
14 ney for the Government for use during or in prep-
15 aration for any administrative, or judicial, or
16 grand jury proceeding, or in a criminal investiga-
17 tion which may result in such a proceeding. Such
18 ex parte order shall be issued only upon a deter-
19 mination that—

20 "(i) the application is made in connec-
21 tion with a lawful administrative, judicial, or
22 grand jury proceeding, or an investigation
23 which may result in such a proceeding, per-
24 taining to the enforcement of a specifically
25 designated Federal criminal statute (not in-

1 volving tax administration) to which the
2 United States or any Federal investigative
3 agency thereof is or may be a party; and
4 "(ii) there is reasonable cause to believe
5 that the information contained in the return
6 is material and relevant to such proceeding
7 or investigation.
8 "(B) APPLICATION FOR ORDER.—The appli-
9 cation for an ex parte court order shall set forth
10 the name of the taxpayer whose return is being
11 requested; the time period to which the request
12 relates; the statutory authority under which the
13 investigation is being conducted; the nature and
14 purpose of the proceeding or investigation; and
15 the reasons why, in the opinion of the attorney for
16 the Government, the disclosure of the information
17 on the return is material and relevant to the pro-
18 ceeding or investigation.
19 "(C) PROCEDURES.—A United States dis-
20 trict court shall act upon any application for an ex
21 parte order within 5 days of the receipt thereof.
22 In the event that the United States district court
23 denies the application—

1 "(i) a motion for reconsideration shall
2 be acted upon not later than 5 days after the
3 receipt of such motion; and
4 "(ii) an appeal shall be disposed of as
5 soon as practicable but not later than 30
6 days after receipt of appeal.
7 "(D) DUTY OF THE SECRETARY.—The Sec-
8 retary or his designee shall disclose to the attor-
9 ney for the Government such tax returns ordered
10 disclosed pursuant to paragraph (i)(1)(A) of this
11 subsection within 10 days of receipt of an ex
12 parte court order issued pursuant thereto.
13 "(E) FURTHER DISCLOSURE.—The attorney
14 for the Government may further disclose any
15 return, which has been disclosed to him pursuant
16 to an ex parte order, to such other Government
17 personnel as he deems necessary to assist him
18 during or in preparation for any administrative,
19 judicial, or grand jury proceeding, or in a criminal
20 investigation which may result in such a
21 proceeding.
22 "(2) DISCLOURE OF NONRETURN INFORMA-
23 TION.—Information in the possession of the Secretary
24 or his designee, other than tax returns, shall be dis-
25 closed as follows:

1 "(A) Within 10 days of the receipt of a writ-
2 ten request by an attorney for the Government,
3 the Secretary or his designee shall disclose any
4 nonreturn information in the possession of the
5 Secretary. Such written request shall set forth the
6 name and address of the taxpayer; the taxable pe-
7 riods to which the information relates; that the re-
8 quest is being made in connection with an admin-
9 istrative, judicial, or grand jury proceeding, or an
10 investigation which may result in such a proceed-
11 ing, pertaining to the enforcement of a specifically
12 designated Federal criminal statute (not involving
13 tax administration) which the United States or
14 any Federal investigative agency thereof is au-
15 thorized to pursue; and the reasons why, in the
16 opinion of the attorney for the Government, the
17 disclosure is or may be material to such proceed-
18 ing or investigation.
19 "(B) The attorney for the Government may
20 further disclose such nonreturn information to
21 such Government personnel as he deems neces-
22 sary to assist him during or in preparation for any
23 administrative, judicial, or grand jury proceeding,
24 or in a criminal investigation which may result in
25 such a proceeding.

"(3) TAXPAYER IDENTITY.—The Secretary or his designee shall make taxpayer identity information available to the attorney for the Government upon written request for such information.

"(4) SECRETARY'S DUTY TO DISCLOSE NONTAX CRIMINAL INFORMATION.—

"(A) The Secretary shall disclose, as soon as practicable, to an attorney for the Government any information, except returns, which may constitute evidence of a violation of any Federal criminal law or which may be pertinent to any investigation of a violation of Federal statutes, to the degree necessary to permit an attorney for the Government to request nonreturn information as provided in paragraph (i)(2)(A) of this subsection. In carrying out this duty, the Secretary or his designee shall provide, as soon as practicable, to the attorney for the Government the name and address of the taxpayer; the taxable period to which the information relates; the Federal criminal statute to which the Secretary or his designee has reason to believe the information may be relevant; and such information as deemed necessary by the attorney for the Government to fully comply with the written request requirement with

1 respect to nonreturn information as provided in
2 paragraph (i)(2)(A) of this section.
3 "(B) EXIGENT CIRCUMSTANCES.—Under
4 exigent circumstances, including a possible threat
5 to persons, property, or national security, the
6 Secretary or his designee shall disclose such infor-
7 mation, including returns, to the extent necessary
8 to apprise the appropriate Federal investigative
9 agency charged with the responsibility for enforc-
10 ing such laws. As soon as practicable thereafter,
11 the Secretary shall notify the attorney for the
12 Government of his actions with respect to this
13 paragraph, and the attorney shall thereupon notify
14 an appropriate United States district court of such
15 disclosure pursuant to exigent circumstances.
16 "(5) ASSISTANCE OF IRS IN JOINT TAX AND
17 NONTAX INVESTIGATIONS.—No portion of this section
18 shall be interpreted to preclude or prevent the Internal
19 Revenue Service from assisting the Department of
20 Justice or any other Federal investigative agency in
21 joint tax and nontax investigations or criminal matters
22 which may lead to income tax violations, nor shall any
23 portion of this section be interpreted to preclude or
24 prevent the Internal Revenue Service from investigat-
25 ing or gathering relevant information concerning per-

1 sons involved in criminal activities which may lead to
2 income tax violations.
3 "(6) REASON FOR NONDISCLOSURE BY THE SEC-
4 RETARY OR HIS DESIGNEE.—
5 "(A) If the Secretary or his designee deter-
6 mines and certifies that the disclosure of tax re-
7 turns or nonreturn information would identify a
8 confidential informant or seriously impair a civil
9 or criminal tax investigation, the Secretary or his
10 designee may make application to a Federal dis-
11 trict court to prevent disclosure. Such applications
12 shall contain the name and address of the tax-
13 payer whose information is being requested; the
14 taxable period or periods to which the request re-
15 lates; the details of the request for disclosure; the
16 reason or reasons the Secretary or his designee
17 determines and certifies that such disclosure
18 would identify a confidential informant or seri-
19 ously impair a civil or criminal tax investigation;
20 and a certification that the Secretary or his desig-
21 nee has provided a copy of such application to the
22 attorney for the Government.
23 "(B) Upon receipt of such application, the at-
24 torney for the Government shall have 5 days to
25 reply to said application for nondisclosure stating

1 his reasons why said disclosure would not identify
2 an informant, including sufficient information to
3 assure the district court that the identity of said
4 informant will not be disclosed; and why said dis-
5 closure would not seriously impair a civil or crimi-
6 nal tax investigation, including sufficient informa-
7 tion to assure the district court that the disclosure
8 of said information is of such substantial impor-
9 tance to a Federal criminal investigation that said
10 disclosure should take precedence over the consid-
11 erations for any civil or criminal tax investigation.
12 "(C) The district court shall enter an order
13 with respect to such application for nondisclosure
14 not less than 5 nor more than 15 days from the
15 receipt thereof.
16 "(D) In the event that the district court
17 denies the Secretary's application, any motion for
18 reconsideration shall be acted upon within 5 days
19 after the receipt of such motion to reconsider.
20 "(E) The order entered by the court shall be
21 appealable, and any appeal from such order shall
22 be disposed of as soon as practicable, by not later
23 than 30 days from the filing thereof.

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1 "(7) DISCLOSURE TO STATE AUTHORITY UPON
2 CERTIFICATION OF EVIDENCE OF A STATE FELONY
3 VIOLATION.—
4 "(A) The attorney for the Government to
5 whom disclosure is made pursuant to this section
6 may make application to a district court for an ex
7 parte order to disclose to an appropriate State of-
8 ficial, whose duty it is to investigate or prosecute
9 the crime involved, such information in his posses-
10 sion constituting evidence of or material to the
11 violation of a State felony statute.
12 "(B) Said application shall set forth the name
13 and address of the taxpayer; the taxable period or
14 periods to which the information is relevant; the
15 exact information sought to be disclosed; the
16 State felony violation to which said information is
17 evidence of or is material to, including the State
18 statute involved; a certification by the attorney for
19 the Government that said disclosure is necessary
20 to enable the State authority to investigate or to
21 prosecute a State felony violation; and the name
22 and official position of the appropriate State offi-
23 cial whose duty it is to investigate or prosecute
24 the violation and to whom said disclosure will be
25 made.

1 "(C) Upon receipt of such application, the
2 district court within 10 days shall issue an order
3 concerning such disclosure of information relating
4 to a State felony investigation or prosecution,
5 upon a finding that the application is made in con-
6 nection with an investigation or proceeding con-
7 cerning the enforcement of a specifically desig-
8 nated State felony statute; that such disclosure is
9 necessary to enable the State authority to investi-
10 gate or prosecute a State felony violation; and
11 that the State official named in the application is
12 an appropriate State official to whom disclosure
13 may be made.

14 "(D) Any motion to reconsider, supplemental
15 application, or appeal under this section shall be
16 made pursuant to the procedures set forth in
17 paragraph (i)(1) of this subsection.

18 "(8) DISCLOSURE BY THE ATTORNEY FOR THE
19 GOVERNMENT CONCERNING FEDERAL CIVIL LITIGA-
20 TION.—

21 "(A) The attorney for the Government to
22 whom information has been disclosed pursuant to
23 this section may make application to a district
24 court for an ex parte order to further disclose
25 such information if, in his opinion, the information

1 is evidence of or material to any Federal civil liti-
2 gation involving a Federal civil claim.
3 "(B) Said application shall contain the name
4 and address of the taxpayer; the years to which
5 the information is relevant; the nature of the in-
6 formation sought to be disclosed; the Federal stat-
7 utory authority under which such civil litigation is
8 authorized; a certification by the attorney for the
9 Government that said disclosure is necessary to
10 enable Federal authorities to initiate, investigate,
11 or litigate any Federal civil claim; and the name
12 and position of the appropriate Federal official
13 whose duty it is to initiate, investigate, and liti-
14 gate such Federal civil claim and to whom said
15 disclosure will be made.
16 "(C) Upon receipt of such application, the
17 district court shall within 10 days issue an order
18 concerning such disclosure of material relating to
19 Federal civil litigation upon a finding that the ap-
20 plication is made in connection with an investiga-
21 tion or proceeding concerning the litigation or po-
22 tential litigation of a specifically designated Fed-
23 eral statute; that the disclosure is necessary to
24 enable Federal authorities to initiate, investigate
25 or litigate any Federal civil claim; and that the of-

1 ficial named in the application is the appropriate
2 Federal official to whom disclosure may be made.
3 "(D) Any motion to reconsider supplemental
4 application, or appeal under this section shall be
5 made pursuant to the procedures set forth in
6 paragraph (i)(1) of this subsection.
7 "(9) DISCLOSURE FOR USE IN MUTUAL ASSIST-
8 ANCE TREATIES.—The Secretary shall disclose tax re-
9 turns and nonreturn information consistent with the
10 procedures outlined in this section to the attorney for
11 the Government for his use in the performance of his
12 duties pursuant to any mutual assistance treaty be-
13 tween the United States and a foreign country which
14 provides for an exchange of criminal evidence or
15 information.".
16 SEC. 8. Paragraph (5) of subsection (i), section 6103 of
17 title 26, United States Code, is renumbered as paragraph
18 (10) and is amended to delete the term "return information"
19 wherever it appears in that paragraph and insert in lieu
20 thereof the term "nonreturn information.".
21 SEC. 9. Paragraph (6) of subsection (i), section 6103 of
22 title 26, United States Code, is renumbered as paragraph
23 (11) and is amended to delete the term "return information"
24 wherever it appears in that paragraph and insert in lieu
25 thereof the term "nonreturn information.".

96TH CONGRESS
2D SESSION

S. 2403

To protect taxpayers' privacy regarding third-party recordkeepers summoned to produce records of taxpayers and at the same time to insure effective, efficient enforcement of Internal Revenue Service third-party summons.

IN THE SENATE OF THE UNITED STATES

MARCH 11 (legislative day, JANUARY 3), 1980

Mr. NUNN (for himself, Mr. PERCY, Mr. CHILES, Mr. COHEN, Mr. DECONCINI, Mr. LONG, Mr. TALMADGE, and Mr. RIBICOFF) introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To protect taxpayers' privacy regarding third-party recordkeepers summoned to produce records of taxpayers and at the same time to insure effective, efficient enforcement of Internal Revenue Service third-party summons.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That the last sentence of subsection (a)(1) of section 7609 of
4 title 26, United States Code, is amended to read as follows:
5 "Such notice shall be accompanied by a copy of the summons
6 which has been served and shall contain directions for filing a
7 motion to quash the summons under subsection (b)(2).".

1 SEC. 2. Subsection (a)(3) of section 7609 of title 26,
2 United States Code, is amended to read as follows:
3 "(3) DEFINITIONS.—
4 "(A) 'Third-party recordkeeper' means—
5 "(i) any mutual savings bank, coopera-
6 tive bank, domestic building and loan associ-
7 ation, or other savings institution chartered
8 and supervised as a savings and loan or simi-
9 lar association under Federal or State law,
10 any bank (as defined in section 581), or any
11 credit union (within the meaning of section
12 501(c)(14)(A));
13 "(ii) any consumer reporting agency (as
14 defined under section 603(d) of the Fair
15 Credit Reporting Act (15 U.S.C. 1681a(f));
16 "(iii) any person extending credit
17 through the use of credit cards or similar
18 devices;
19 "(iv) any broker (as defined in section
20 3(a)(4) of the Securities Exchange Act of
21 1934 (15 U.S.C. 78c(a)(4)));
22 "(v) any attorney; and
23 "(vi) any accountant.

1 "(B) 'Persons entitled to notice' means any
2 individual or partnership of not more than five in-
3 dividuals.".
4 SEC. 3. The subtitle of subsection (b) of section 7609 of
5 title 26, United States Code, is amended to read as follows:
6 "(b) RIGHT TO INTERVENE; CHALLENGE TO SUM-
7 MONS.—".
8 SEC. 4. Subsection (b)(2) of section 7609 of title 26,
9 United States Code, is amended to read as follows:
10 "(2) CHALLENGE TO SUMMONS.—Within 14 days
11 after the day notice is given in the manner provided in
12 subsection (a)(2), a person entitled to notice of a sum-
13 mons under subsection (a) may file a motion to quash
14 the summons with copies served upon the person sum-
15 moned and upon such person and to such office as the
16 Secretary may direct in the notice referred to in sub-
17 section (a)(1). Service shall be made under this subsec-
18 tion by delivering or mailing by registered or certified
19 mail. A motion to quash a summons shall be filed in
20 the United States district court in which the person en-
21 titled to notice resides. Such motion shall contain an
22 affidavit or sworn statement stating—
23 "(A) that the movant is the person to whom
24 the records sought by the summons relate; and

1 "(B) the reasons that the records sought are
2 not relevant to a legitimate tax inquiry or any
3 other legal basis for quashing the summons.
4 The United States shall file its response within 10
5 days from receipt of the motion to quash. A district
6 court judge or United States magistrate shall enter an
7 order on the motion within 10 days of the filing of the
8 response of the United States.
9 "A court ruling denying a motion to quash under
10 this section shall not be deemed a final order and no
11 interlocutory appeal may be taken therefrom by the
12 person to whom the records pertain. An appeal of a
13 ruling denying a motion under this section may be
14 taken by said person within such period of time as pro-
15 vided by law as part of any appeal from a final order
16 in any legal proceeding initiated against him arising
17 out of or based upon the records summoned.
18 "The Challenge procedures of this section consti-
19 tute the sole judicial remedy available to a person en-
20 titled to notice under subsection (a) to oppose disclo-
21 sure of records summoned pursuant to this section.
22 "Nothing in this section shall enlarge or restrict
23 any rights of a third-party recordkeeper to challenge a
24 summons for records. Nothing in this title shall entitle

1 a person entitled to notice under subsection (a) to
2 assert the rights of a third party.".
3 SEC. 5. Subsection (d) of section 7609 of title 26,
4 United States Code, is amended to read as follows:
5 "(d) RESTRICTION ON EXAMINATION OF RECORDS.—
6 No examination of any records required to be produced under
7 a summons as to which notice is required under subsection (a)
8 may be made—
9 "(1) before the expiration of the 14-day period al-
10 lowed for the motion to quash under subsection (b)(2),
11 or
12 "(2) upon the filing of a motion to quash pursuant
13 to subsection (b)(2) except in accordance with an order
14 of the court.".
15 SEC. 6. Subsection (e) of section 7609 of title 26,
16 United States Code, is amended to read as follows:
17 "(e) SUSPENSION OF STATUTE OF LIMITATIONS.—If
18 any person takes any action as provided in subsection (b) and
19 such person is the person with respect to whose liability the
20 summons is issued (or is the agent, nominee, or other person
21 acting under the direction or control of such person), then the
22 running of any period of limitations under section 6501 (re-
23 lating to the assessment and collection of tax) or under sec-
24 tion 6531 (relating to criminal prosecutions) with respect to
25 such person shall be suspended for the period during which a

1 proceeding, and appeals therein, with respect to any litiga-
2 tion relating to such summons is pending.".
3 SEC. 7. Subsection (h)(2) of section 7609 of title 26,
4 United States Code, is hereby repealed and subsection (h)(1)
5 of said section is renumbered accordingly.
6 SEC. 8. Section 7609 of title 26, United States Code,
7 shall be amended by adding thereto a new subsection as
8 follows:
9 "(i) DUTY OF THIRD PARTY.—Upon receipt of a sum-
10 mons for records under this section, the third party shall,
11 unless otherwise provided by law, proceed to assemble the
12 records requested and must be prepared to deliver the rec-
13 ords pursuant to the summons on the day upon which the
14 records are to be examined or, in the event a motion to quash
15 has been filed, within 10 days of the entry of the court's
16 order.".

II

96TH CONGRESS
2D SESSION

S. 2404

To provide penalties for unauthorized disclosure of tax information.

IN THE SENATE OF THE UNITED STATES

MARCH 11 (legislative day, JANUARY 3), 1980

Mr. NUNN (for himself, Mr. PERCY, Mr. CHILES, Mr. COHEN, Mr. DECONCINI, Mr. LONG, Mr. TALMADGE, and Mr. RIBICOFF) introduced the following bill; which was read twice and referred to the Committee on Finance

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A BILL

To provide penalties for unauthorized disclosure of tax information.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That section 7213 of title 26, United States Code, is
4 amended to strike the term "return information" wherever it
5 appears and insert in lieu thereof the term "nonreturn infor-
6 mation".
7 SEC. 2. Section 7213 of title 26, United States Code, is
8 amended by adding at the end thereof a new subsection, as
9 follows:

1 "(e) It shall be an affirmative defense to a prosecution
2 under this section that such disclosure of return or nonreturn
3 information resulted from a good faith, but erroneous, inter-
4 pretation of section 6103 while a Federal employee was
5 acting within the scope of his employment or duties.".

96TH CONGRESS
2D SESSION

S. 2405

To provide for civil damages for unauthorized disclosures of tax information.

IN THE SENATE OF THE UNITED STATES

MARCH 11 (legislative day, JANUARY 3), 1980

Mr. NUNN (for himself, Mr. PERCY, Mr. CHILES, Mr. COHEN, Mr. DECONCINI, Mr. LONG, Mr. TALMADGE, and Mr. RIBICOFF) introduced the following bill; which was read twice and referred to the Committee on Finance

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A BILL

To provide for civil damages for unauthorized disclosures of tax information.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That section 7217 of title 26, United States Code, is
4 amended to strike the term "return information" wherever it
5 appears, to insert in lieu thereof the term "nonreturn infor-
6 mation," and to add a new section thereto, as follows:
7 "(e) The United States shall be liable for damages
8 awarded to the plaintiff in any cause of action, authorized by
9 this section, if the disclosure was made within the scope of

1 office or employment of a Federal official or employee against
2 whom damages are awarded: *Provided,* That any disclosure
3 made corruptly, maliciously, in return for anything of value,
4 or willfully in violation of section 6103 of this title shall
5 not be considered within the scope of such office or
6 employment.".

Senator BAUCUS. The Subcommittee on Oversight of the Internal Revenue Service will come to order.

This morning, we begin hearings on several bills, S. 2402, S. 2403, S. 2404, and S. 2405, introduced by Senator Nunn and other Members of the Senate.

S. 2402 amends disclosure provisions of the Internal Revenue Code. In general, this bill would expedite the flow of information between the Internal Revenue Service and the Department of Justice.

S. 2403 amends the summons provisions of the Internal Revenue Code. These provisions require the Internal Revenue Service to notify the taxpayer whenever it issues a summons for the taxpayer's records to a third party. The proposal would eliminate the automatic stay which is granted now if a taxpayer does not want information disclosed.

S. 2404 and S. 2405 relax the criminal and civil penalties for unauthorized disclosure of tax information.

Senator Nunn and his colleagues have drafted these bills to help strengthen the Federal fight against narcotics trafficking and organized crime.

I commend Senators Nunn, Chiles, and Percy for the work they have done in this area, both in developing a comprehensive hearing record and in drafting legislation.

The Tax Reform Act of 1976 placed stringent restrictions on the disclosure of tax data and other information by the Internal Revenue Code. The 1976 reforms were in response to serious abuses which had occurred previous to that time. Those of us who participated in the development of the 1976 act felt that the information and individual files of the Internal Revenue Service should have the same confidentiality as his private books and records..

The Service has very broad powers to compel the production of information. In some areas, these powers go far beyond the authority which Congress has seen fit to grant to law enforcement agencies, such as the Department of Justice, the FBI, and the Drug Enforcement Administration.

Recognizing that the IRS has broad authority to gather information, Congress has made it difficult for this information to be disseminated. As we examine possible amendments to the disclosure provisions of the Internal Revenue Code, we will want to emphasize the privacy rights of Americans.

At the same time, the Senate should give high priority to strengthening and streamlining law enforcement efforts. There are cases where the privacy provisions of the Internal Revenue Code have impeded such efforts. There are suggestions that the strict disclosure provisions have discouraged cooperation between the Service and other law enforcement agencies.

One of the key issues that this hearing will address is the proper role of the Service in law enforcement activities. The Service could again be an effective law enforcement agency. It has great expertise in financial matters and broad authority to gather information.

On the other hand, other agencies have the primary responsibility for law enforcement. It can be argued that the Service should

concentrate its limited resources only on the questions of tax administration.

The record developed today will be very important, as the committee considers whether modifications to the privacy provisions of the Code are necessary to provide more effective law enforcement. We look forward to the testimony of today's witnesses.

Our first witness is the Senator from Georgia, Senator Nunn, who has been very active in this area, particularly his work on the Government Affairs Committee.

Senator, we very much look forward to your testimony this morning.

STATEMENT OF HON. SAM NUNN, A U.S. SENATOR FROM THE STATE OF GEORGIA

Senator NUNN. Thank you very much, Chairman Baucus.

I want to first thank you for scheduling these hearings in such a timely fashion and for giving me an opportunity to testify along with Senator Percy. I believe Senator Percy will be here in a few minutes, and I hope Senator Chiles will be able to come, too. He had a conflict. But in the meantime, I am pleased to have an opportunity to testify on behalf of the four bills that I introduced along with Senators Percy, Chiles, Cohen, DeConcini, Long, Talmadge, Ribicoff, Jackson, Boren, and Schmitt.

This legislative package is the result of extensive hearings held by the Permanent Subcommittee on Investigations last December on illegal narcotic profits and the impediments faced by law enforcement authorities in eliminating those profits.

Mr. Chairman, in the interest of time—I know you have a long schedule of witnesses—I am summarizing, to the extent possible, from my statement, and I would like for the full statement to be put in the record.

Senator BAUCUS. Without objection.

Senator NUNN. A report on our investigation has been circulating for several, I guess, months now. It is a very long and complex report, and it has been approved by a majority of our subcommittee. There was an article in the New York Times this morning that described the report. I regret that the report has found its way into the public domain before it has been either agreed to or dissented from by all the members. That is not in any way sanctioned or condoned by me as chairman, but when you have this many reports circulating for this many months, I suppose there is some degree of inevitability to its getting out.

Nevertheless, at some point it will be made public, without any doubt, and hopefully in the near future. Since there has already been a reference to it in the newspaper, we would certainly make available to your staff a draft of that report, with the understanding it is in draft form. Although it has been approved by a majority, all the members have not completed their comments, and we would hope you would treat it in that respect, because there may be some other changes made based on positive suggestions from other members.

Mr. Chairman, it has long been recognized that financial investigations relying on financial and tax records are one of the most effective tools in piercing the veil of secrecy that protects those at

the top of any organized crime ring, be it a drug smuggling operation or traditional organized crime family.

Today, when organized crime and narcotics trafficking are becoming bigger and more sophisticated than ever before, the one law enforcement agency that the kingpin criminals fear most, the Internal Revenue Service, has withdrawn from the battle.

The FBI testified at our December hearings that its cooperative effort with the Internal Revenue Service was down over 95 percent since 1976. The IRS intitiated cases against organized criminals are down more than 50 percent during that same time period. During all of 1979, the IRS made just 10 or 12 cases against high level narcotics traffickers.

In 1974, IRS had 927 employees working on narcotics cases. In 1979, that number had dropped to 163. The untaxed profits from narcotics and organized crime run into the billions of dollars each year, and are growing all the time, yet since 1976, the IRS had made only a minimum effort to tax these profits or helped convict those who make them.

Mr. Chairman, these are some of the findings which are contained in our subcommittee's draft report. I point them out today to illustrate that the IRS has withdrawn as an effective weapon against organized crime and narcotics dealers. I also point them out in order to emphasize that the beginning of this decline coincided with the enactment of the disclosure provisions of the Tax Reform Act of 1976.

Now, I do not in any way attribute all the problems to those reforms, and I will get into that in later testimony. These disclosure provisons, however, which are found in 26 U.S.C. 6103, were passed in the wake of certain abuses that came to light during the various Watergate and intelligence gathering investigations.

For the most part, these abuses involve the loose dissemination outside IRS of individual tax returns for various purposes, such as coercing campaign contributions, or checking on groups which some agencies consider to be subversive, and I don't want any of my remarks today to in any way insinuate that I condone or approve of those practices. I deplore those practices, and I understand the motives behind the Tax Reform Act, although I do not believe that those who authored the act anticipated the results that have flowed from it.

To cure these abuses, Congress enacted section 6103, which makes tax returns confidential and subject to disclosure by IRS only in accordance with very strict procedures, but the section goes much further and covers more than just tax returns. Also included in its prescription is most other information that IRS gathers in connection with tax investigations.

Under section 6103, IRS agents are forbidden to disclose on their own initiative not only tax returns but tax return information, which is any information they gather in connection with a tax return or taxpayer return information, which is any information they obtain from a taxpayer or his representative, such as his attorney or accountant.

In other words, the prohibition now applies to information gathered from such items as books and records, bank accounts, taxpayer interviews, and so forth.

The other law enforcement agencies once relied on IRS to disclose to them evidence gained from these sources, but this is no longer true. As a result, there is very little criminal information exchanged today between IRS and the other Federal law enforcement agencies.

IRS has turned over an average of just 32 pieces of criminal evidence per year over the past 3 years. DEA officials testified at our hearings that they had received no nontax criminal evidence over the same period. DEA, of course, is the agency responsible for one of our most serious crimes in this country today, and that is the overall problem of drugs.

What happens to the nontax criminal evidence that IRS agents come across during the course of their tax investigations? Apparently, it is buried somewhere in the IRS files. For example, IRS agents told our subcommittee that they found evidence of massive embezzlements when they audited a labor union's records, but they could not report this information to the Justice Department. Thus, Justice had no information upon which to begin a nontax prosecution.

In another example, IRS agents found evidence in a taxpayer's business records that he had bribed a policeman. That evidence was never disclosed, and the policeman is still on the job.

These examples pale in comparison to an incident known as the case of the Trashcan, in which DEA was investigating a chemist suspected of concocting illegal drugs. DEA learned that an IRS agent had searched the chemist's trashcan and had discovered evidence that the chemist indeed was making illegal drugs.

However, IRS would not volunteer this evidence. The prosecutor subpenaed the IRS agent and the trashcan documents, but IRS cited the Tax Reform Act and refused to let the agent answer the subpena. IRS said the trash was gathered in connection with the chemist's tax return, therefore the prosecutor needed a court order under section 6103 to see the documents.

In my mind, by keeping secret this evidence of a criminal activity found in a taxpayer's books and records, bank accounts, statements, and check stubs, we have legislated an exemption for criminals.

Our investigation has convinced me that the disclosure provisions of section 6103, coupled with the way they have been interpreted and enforced by the Internal Revenue Service—and I emphasize interpretation and enforcement by IRS—together, these have had a highly detrimental effect on our Federal law enforcement system.

I want to discuss just for a moment, Mr. Chairman, the catch 22 aspects of the law as it now is interpreted. It is possible, of course, for other agencies to obtain tax returns and other IRS-gathered information under section 6103. However, they must apply for a court order in order to get the tax returns, and they must make written request to obtain other IRS information about nontax crimes such as forgery, bribery, or narcotics violations that come from sources other than tax returns.

In either situation, the requesting agency must describe the information it seeks to obtain. The court order and written request requirements have created a catch 22 situation. Since Internal

Revenue Service agents are forbidden to tell the other agencies of the criminal evidence they gather, it is virtually impossible for these other agencies even to know that such information exists, much less to describe that information with such particularity that they can satisfy the requirement for a court order or written request.

In other words, Mr. Chairman, section 6103 requires Federal investigative agencies to go through elaborate request procedures to obtain information that they may not even know that IRS has. This catch 22 situation has made it all but impossible for the FBI, DEA, and other agencies to receive the necessary information and cooperation from IRS.

Section 6103 is only part of the problem. The bulk of the problem lies with the attitude of the top officials of the Internal Revenue Service and the policies and procedures they have adopted in interpreting and applying section 6103. I must say, Mr. Chairman, that this is an attitude that is bipartisan. It crosses more than one administration and both parties. It is not in any sense a partisan kind of attitude. It has developed as an institutional attitude at the top.

For the past 6 years, a series of IRS Commissioners and their top aides have taken the view that IRS should stick to tax administration, by which they mean tax collection and only tax collection, and out of the general law enforcement arena. They say that paying attention to ordinary taxpayers is a better way of keeping the voluntary tax collection system working than is cracking down on organized criminals who pay no taxes on their tremendous ill-gotten gains.

I beg to differ with that view of tax administration. Obviously, IRS must be aggressive in collecting the Nation's taxes, but I can understand the skepticism of a small-town waitress who is caught for underreporting her tips when organized crime millionaires escape without reporting a cent of their illegal income.

I believe that if the average taxpayer knows that IRS can successfully collect taxes from the mob, he or she is a lot more likely to ante up their fair share, if for no other reason than the fear of being caught. I do not mean to imply that IRS is totally unaware of the effect of the Tax Reform Act. Just last December, for example, the Deputy Commissioner of IRS appointed a special study group to assess the impact of the disclosure provisions. That group made a number of recommendations for administrative action. A copy of the group's report has been provided to our subcommittee, and I submit that for your consideration.

[The report referred to follows:]

REPORT OF DISCLOSURE STUDY GROUP

IMPACT OF IRC 6103 ON SERVICE ACTIVITIES

Introduction

On December 20, 1979, the Deputy Commissioner appointed a group of Service representatives to study the impact of IRC 6103 on Service activities. Composition of the group was as follows:

Howard T. Martin, Director,
Appeals Division, Chairman

Merle Heye, Assistant Director,
Examination Division

Robert Potter, Assistant Director,
Criminal Investigation Division

Michael J. Quinn, Assistant Director,
Collection Division

Lem A. Roberson, Assistant District
Director, Cleveland

Richard Wassenaar, Assistant Regional
Commissioner (Criminal Investigation),
Western Region

Background

At various times over the past three years the Service has attempted to analyze the impact of the disclosure provisions (IRC 6103) on our ability to effectively administer the tax laws. GAO has also attempted to measure the impact of the statute several times. Their conclusion, as well as ours, was that the disclosure provisions have afforded taxpayers increased privacy over information they provide IRS, but it was too early to determine whether Service implementation of the law was adversely affecting IRS' ability to cooperate with other Federal law enforcement agencies.

In recent testimony before the Senate Permanent Subcommittee on Investigations, DEA, Justice and GAO identified problems concerning the disclosure provisions and IRS' implementation of these provisions. These problems, as viewed by those agencies, were created by

the new tax disclosure law (IRC 6103). In his testimony, Commissioner Kurtz stated that, while imperfections do exist in the disclosure provisions, more could be done within the existing statute to exchange information with other law enforcement agencies. The disclosure statute has now been in effect more than three years. In his December 20, 1979, memorandum establishing the study group (Attachment 1), the Deputy Commissioner stated it is an appropriate time for the Service to again assess the impact of the statute on Service operations.

Study Group Objectives

The objectives of this study were as follows:

1. Assess the impact of the disclosure statute on Service dealings with other law enforcement agencies;

2. Identify significant administrative problems relative to the implementation of the statute by the Service; and

3. Develop recommendations to improve administration of the disclosure provisions.

Study Group Methodology

Before commencing the review, the study group assembled copies of existing law, regulations, available testimony before the Senate Permanent Subcommittee on Investigations, policies, procedures and guidelines currently in effect pertaining to the disclosure of tax information. To facilitate the review process, the study group developed two questionnaires (Attachment 2) and requested that each district director complete and return them to the study group. The questionnaires were utilized to gather data on a uniform basis. Also, during its fact-finding stage, the study group was briefed by various National Office officials and a representative from the Department of Treasury regarding Title 31.

The study group did not have available the results of a Department of Justice survey of United States Attorneys' experiences with IRC 6103(i)(1) and (i)(2)

requests. This information should be analyzed by the Disclosure Operations Division when received and appropriate administrative steps implemented to address any additional problems identified by the Department of Justice.

Study Group Terminology

The terms "return," "return information," and "taxpayer return information" used throughout this report are defined in IRC 6103(b). The reader should be aware that the term "return information" includes within its definition the subcategories of return information referred to as "taxpayer return information" and "nontaxpayer return information." "Nontaxpayer return information" is a term developed by the study group for use in place of the statutory phrase "return information other than taxpayer return information." The term "tax information" is used to describe returns and all subcategories of return information.

Significant Findings of the Study Group

1. National Office centralization of IRC 6103(i)(1) and (i)(2) procedures by IRS and the Department of Justice inhibits the exchange of tax information for nontax criminal purposes.

2. IRC 6103(i)(3) procedures are not being utilized to the greatest extent possible to apprise appropriate Federal law enforcement authorities of information indicating possible nontax criminal violations.

3. The Service cannot disclose returns and return information indicating serious threats to life or personal safety except to the limited extent provided for in IRC 6103(i)(3).

4. Generally, IRC 6103 lessens IRS' participation in the Government's Strike Force Program and in other programs where the taxpayer has income from illegal sources or corrupt practices.

5. The disclosure restrictions of IRC 6103 inhibit the effective participation of the IRS in the enforcement of the recordkeeping and reporting requirements of the Bank Secrecy Act.

6. There is no procedure in IRC 6103(i) for disclosing wagering tax information to other Federal agencies for the enforcement of nontax Federal criminal laws.

7. Generally, disclosure training has been adequate; however, training in specialized areas may be necessary.

Findings, Analyses and Recommendations

Finding One - National Office centralization of IRC 6103(i)(1) and (i)(2) procedures by IRS and the Department of Justice inhibits the exchange of tax information for nontax criminal purposes.

The current law governing the disclosure of returns and return information became effective January 1, 1977, following extensive Congressional hearings and debate. During the course of these deliberations, Congress gave particular attention to the former policy of granting relatively free access to tax information to other Federal agencies, including the Department of Justice, for use in nontax related criminal investigations. Under prior law, information currently categorized as returns and return information, including taxpayer return information, was available upon written request by a United States Attorney or, in the case of the Department of Justice, the Attorney General, Deputy Attorney General, or an Assistant Attorney General, pursuant to Treasury Regulations approved by the President. Disclosures in response to such requests were permissible in any case in which the United States Attorney specified that the requested information was necessary in the performance of official duties or for use in any litigation in which the United States was an interested party.

Until 1973, the authority to process such requests was vested in district directors who could provide returns or return information directly to the requesting United States Attorneys. In 1973, as a result of growing

concern regarding possible misuse of the requested records, the regulations were changed to require United States Attorneys to submit their requests to the Commissioner in Washington.

Under current law, IRC 6103(i)(1) provides that the Department of Justice or another Federal agency may have access to tax returns or tax information provided by or on behalf of the taxpayer (returns and taxpayer return information) solely for use in connection with enforcement of nontax Federal criminal laws upon the grant of an ex parte court order approving inspection. The head of a Federal agency, or in the case of the Department of Justice, the Attorney General, Deputy Attorney General, or an Assistant Attorney General, must approve any application for such a court order. Under IRC 6103(i)(2), the head of a Federal agency or, in the case of the Department of Justice, the same officials required to approve an application for a court order, must make a written request for tax information which is obtained from sources other than the taxpayer (nontaxpayer return information) solely for use in connection with enforcement of nontax Federal criminal laws. In either case, the IRS may withhold the requested information if disclosure would reveal the identity of a confidential informant or seriously impair a civil or criminal tax investigation.

Prior to enactment of the disclosure provisions of the Tax Reform Act of 1976, no distinction was made between information provided to the Service by a taxpayer and information obtained from other sources. The distinction between taxpayer return information and nontaxpayer return information made by the Tax Reform Act of 1976, necessitates that the Service segregate and categorize information before a disclosure can be made. In addition, the Examination, Collection, and Criminal Investigation functions in the district must be querried to ensure the requested disclosure would not identify a confidential informant or seriously impair a civil or criminal tax investigation.

The administrative procedures adopted to implement the requirements of the new law remain centralized in the National Office much as they were under prior law. These procedures provide that districts may be authorized to disclose the requested returns or return information only after review of an IRC (i)(1) order or an (i)(2) request and approval by the National Office. IRC 6103(i)(1) procedures are illustrated in the flow chart shown on page 6. IRC 6103(i)(2) procedures are much the same.

IRC 6103(i)(1)

	FIELD		NATIONAL OFFICE
Step 1 DOJ centralized authorization process	U.S. Attorney submits application for (i)(1) order to DOJ National Office for approval	→	DOJ approves application and responds in writing. Information copy sent to IRS National Office
	Upon receipt of National Office approval, U.S. Attorney makes application for court order	←	↓
Step 2 IRS field clearance process			IRS National Office receives a copy of DOJ approval letter *
	Upon receipt of clearance request, District canvasses CID, Exam. and Collection to determine if disclosure would identify an informant or seriously impair a civil or criminal tax investigation	←	↓ Clearance letter sent to District
	↓ Records are secured from the Service Center or Federal Records Center if not available in the District and the screening process begins		
	↓ District responds to clearance request	→	IRS National Office holds District clearance pending receipt of (i)(1) order
Step 3 IRS centralized authorization process	Federal judge reviews and issues (i)(1) order		↓
	↓ U.S. Attorney sends copy to IRS National Office	→	
	District receives authorization and discloses as records are received and segregated into returns and taxpayer return information	←	IRS National Office reviews (i)(1) order and authorization is sent to the District
	↓ U.S. Attorney receives requested records		

* If the IRS is not advised that the United States Attorney has sought approval to apply for an (i)(1) order, as is often the case, the clearance and assembly process does not begin until receipt of the (i)(1) order by the IRS.

The study group considered whether IRC 6103(i)(1) and (i)(2) authority should remain centralized in the National Office or decentralized to district directors.

First, the study group examined the level of field expertise. Under current procedures, considerable reliance is already placed upon districts in IRC 6103(i)(1) and (i)(2) cases. For example, districts provide feedback to the National Office relative to any objections to proposed disclosures. Districts are responsible for the actual screening and categorization of returns, taxpayer return information, and nontaxpayer return information prior to disclosure. Also, the Disclosure Operations Division analyzed responses to a study group survey of the districts' experiences in processing 788 IRC 6103(i)(1) and (i)(2) authorizations for disclosure to the Department of Justice for 1977 through 1979. These responses indicate that the percentage of authorizations completed in less than thirty days from receipt by the district increased from sixty percent in 1977, to seventy-one percent in 1979. A conclusion which can reasonably be drawn from these figures is that as district personnel processed more IRC 6103(i)(1) and (i)(2) cases, the level of expertise in obtaining and reviewing the requested information has increased. A review of each district response to the study group survey reveals that the average district processing time for IRC 6103(i)(1) and (i)(2) authorizations in 1979 was 35 calendar days.* As a result of these factors, the study group concludes that sufficient expertise exists in the districts to make independent determinations necessary to authorize disclosures under IRC 6103(i)(1) and (i)(2).

Second, field offices were asked to respond to the question of whether IRC 6103(i)(1) and (i)(2) authority should be decentralized. Sixty-nine percent of the district directors indicated that they were in favor of decentralization. Typical comments were:

1. The personal contact would provide for more cohesive relationships between our agencies.

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* This average includes those cases involving ongoing disclosures and mutually agreed upon delays.

2. In light of the clearance process, crucial decisions are made in the districts anyway.

3. Current delays and procedures cause some agencies to lose interest.

Third, the study group considered the time savings which would be realized through decentralization. An independent analysis by the Disclosure Operations Division of all its IRC 6103(i)(1) and (i)(2) cases for 1979 reveals that the National Office processing time for IRC 6103(i)(1) cases averages 14 days. National Office processing time for IRC 6103(i)(2) cases averages 26 days. This National Office processing time would be saved in any decentralization plan, in addition to unquantified administrative time consumed in the mail and during the routing and preparation of correspondence.

The Department of Justice's procedures for initiating IRC 6103(i)(1) orders and (i)(2) requests remain, at present, centralized in its National Office. The study group is aware that the Department of Justice is currently considering decentralization of its procedures. Decentralization by IRS and the Department of Justice to district directors and United States Attorneys, respectively, would simplify and expedite the exchange of information and promote greater utilization of the statute. For example, the Disclosure Operations Division analyzed its case files for 1977 through 1979 and found that of the 94 United States Attorneys, only 64 made requests under IRC 6103(i)(1) or (i)(2). Disclosure Operations Division records also reveal that in 1977, there were 173 IRC 6103(i)(1) and (i)(2) requests nationwide, of which 56* were identified as strike force cases. In 1978, there were 254 requests, of which 45* were strike force cases. In 1979, nationwide requests totaled 321, including only 40 strike force cases.

Chief Counsel advises that decentralization by the Department of Justice is not permissible under the

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* This number represents those IRC (i)(1) and (i)(2) requests identified as strike force cases. It is possible that other strike force requests were made without having been so identified.

existing statute. Nevertheless, the study group believes that time saving and increased utilization benefits will accrue from IRS decentralization, notwithstanding the inability of the Department of Justice to decentralize under current law.

The study group also finds that the appropriate placement of disclosure authority in any decentralization plan would be with district directors and United States Attorneys. Placement of disclosure authority at this level would impose the mature judgement of senior officials on the disclosure process. Such decentralization would establish responsibility, and would serve to ensure compliance with statutory safeguards and recordkeeping requirements.

Recommendations to Finding One

1. Disclosure authority under IRC 6103(i)(1) and (i)(2) should be administratively decentralized to district directors.

2. The IRS should encourage and support the Attorney General in seeking a legislative change to permit decentralization to United States Attorneys of authority to seek IRC 6103(i)(1) orders and to make IRC 6103(i)(2) requests.

Finding Two - IRC 6103(i)(3) procedures are not being utilized to the greatest extent possible to apprise appropriate Federal law enforcement authorities of information indicating possible nontax criminal violations.

The Service's ability to disclose nontaxpayer return information which may constitute evidence of a nontax criminal violation of Federal law is governed by the provisions of IRC 6103(i)(3). This provision of the Code is distinguishable from IRC 6103(i)(1) and (i)(2) in that there is no formal access procedure to the tax information in the possession of the Service. As a result, disclosure under this provision may be initiated only by IRS.

Since IRC 6103(i)(3) limits disclosure to nontaxpayer return information, the Service cannot disclose returns or taxpayer return information even if the information

constitutes irrefutable evidence of a nontax Federal criminal violation.* Federal prosecutors may obtain access to returns and taxpayer return information only when they possess independent knowledge of the crime to enable them to seek disclosure under IRC 6103(i)(1) and (i)(2).

The study group examined the administrative procedures utilized by IRS to implement this Code section to determine their impact upon IRS' disclosure of information which may constitute evidence of nontax Federal criminal violations.

IRM 1272 (28)70(2) instructs Service personnel discovering evidence of a violation of a Federal criminal statute not administered by the Service, regardless of the source of the information, to report the information by memorandum to the disclosure officer. The memorandum is to contain a summary of the facts and circumstances surrounding the nontax violation, the sections of the United States Code believed to be violated and, the specific source of the information. The disclosure officer reviews the information and prepares a memorandum to the Director, Disclosure Operations Division indicating whether the information may be disclosed under IRC 6103(i)(3). If the statutory requirements are met, the Director will apprise the head of the appropriate Federal agency in writing as required by the statute. In most instances, disclosure will be made to the Attorney General for violations outside the jurisdiction of the Department of Treasury, since the Department of Justice represents the various Federal agencies in the prosecution of the violations. Information falling within the jurisdiction of a Treasury agency is disclosed in writing directly to that agency. A case file is maintained in the Disclosure Operations Division of those instances in which disclosure could not be initiated by the Service because the information constituted taxpayer return information.

An analysis of the responses to the study group's questionnaires reveals there is a widespread belief that IRC 6103(i)(3) is being underutilized. At the request of the study group, the Disclosure Operations Division

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* While IRM 1272(35)00 provides instructions for disclosure in connection with nontax crimes, it is limited to <u>nontax</u> <u>information</u>.

compiled statistics on the extent to which Service personnel are reporting information indicating nontax Federal criminal violations and the number of referrals made by the Service to Federal agencies pursuant to IRC 6103(i)(3). This information is displayed in Table A below.

TABLE A

Year	Reports of return information by Service personnel indicating potential nontax Federal criminal violations	Referrals by IRS to Federal agencies	Percentage of reports referred
1977	61	34	56%
1978	63	34	54%
1979	43	28	65%
Totals	167	96	57%

During the three year period IRC 6103(i)(3) has been in effect, Service personnel have reported return information indicating potential violations of nontax Federal criminal laws at a rate of approximately 56 per year. This figure yields an average of only 8 reported violations per region per year.

The primary reason the Service could not initiate disclosure in all reported cases was that the return information was categorized as taxpayer return information. For example, during 1979, this was the case in 13 of the 15 reported cases. This explains why the 65.1% referral rate in 1979 was not higher. In the other two cases, the alleged violations were of nonFederal criminal laws.

A number of factors were advanced by the district directors in their responses to the questionnaires as contributing to underreporting of nontax Federal criminal violations. The most often cited reason was general unfamiliarity with and nonrecognition of nontax Federal crimes, especially among non-Criminal Investigation personnel. The percentage of reported violations initiated by non-Criminal Investigation personnel appear to support this contention. Table B is a breakdown of

the 158 reports made by district personnel by reporting function for 1977 through 1979.*

TABLE B

Reports of Nontax Federal Criminal Violations By Function

Criminal Investigation	129	81%
Examination	17	11%
Collection	9	6%
Taxpayer Service	3	2%

While nonrecognition appears to be the major factor, there are also indications of confusion among Service employees whether "evidence" or "information which may constitute evidence" of a nontax Federal criminal violation is sufficient for disclosure under IRC 6103(i)(3). In this regard, the study group notes that while IRM (28)70(2) states that "evidence of a violation of a Federal criminal statute ... will be reported ...". (emphasis added), the provisions of IRC 6103(i)(3) require only "... information which may constitute evidence ...".

The study group concludes that, to the extent that nonrecognition of nontax Federal crimes is contributing to underreporting, training of appropriate personnel should result in an increase in the number of reported violations. Training is discussed in more detail in Finding Seven.

The study group questionnaires asked the district directors whether they favored decentralizing disclosure authority to a responsible person in the district office. Their responses indicate that 72% favor such a proposal. Approximately three quarters of those district directors recommending decentralization believe that an increase in IRC 6103(i)(3) activity would result due to simplified procedures and time savings.

As stated in Finding One, with respect to IRC 6103(i)(1) and (i)(2), the study group finds the

* Table A indicates 167 reports were made. However, nine of these were initiated by National Office personnel.

level of field expertise in categorizing returns, taxpayer return information, and nontaxpayer return information is generally commensurate with that of National Office personnel.* As a result, the study group finds no compelling reason to retain centralization of IRC 6103(i)(3) disclosure authority in the National Office. Chief Counsel advises the study group that there is no statutory impediment to IRS decentralization of this authority. As the study group found with respect to Finding One, the appropriate placement of disclosure authority in any decentralization plan would be with district directors.

IRC 6103(i)(3) provides that the recipient of information indicating possible nontax Federal criminal violations shall be the head of the appropriate Federal agency charged with the responsibility for enforcing such laws. Chief Counsel advises that IRC 6103(i)(3) would not prohibit agency heads from delegating their authority to receive tax information. If the authority to receive information were to be delegated to an appropriate lower level, the disclosure process could be further expedited.

Decentralization of IRC 6103(i)(3) disclosure authority may result in some loss of National Office oversight and control; however, with close National Office monitoring of district performance, few problems are anticipated. Further, with decentralization to the district director level, employees will become more directly involved in the disclosure process and may feel greater responsibility to identify and report violations.

Recommendations to Finding Two

1. IRC 6103(i)(3) disclosure authority should be administratively decentralized to the district director level.

2. Training is recommended to assist appropriate employees in identifying more common nontax criminal violations. A short booklet should be developed giving examples of such violations. Such a booklet would indicate that information which may constitute evidence of a nontax criminal violation is sufficient for disclosure under this provision. Appropriate manual procedures should also be clarified to reflect this fact.

* This expertise is to be distinguished from the ability of district personnel to identify potential nontax Federal criminal violations.

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3. The Service should encourage heads of Federal agencies to delegate the authority to receive IRC 6103(i)(3) information to a level commensurate with the Service's district director.

Finding Three - The Service cannot disclose returns and return information indicating threats to life or personal safety except to the limited extent provided for in IRC 6103(i)(3).

In enacting the disclosure provisions, the Congress struck a careful balance between the need to protect a taxpayer's right to privacy and the need to use returns and return information for certain limited nontax purposes. The legislative history of IRC 6103(i) indicates that this provision was designed to provide essentially the same degree of privacy to information a citizen is compelled by the tax laws to disclose to the Service as those private papers in the citizen's home. The study group believes that under exigent circumstances, involving threats to life or personal safety, privacy rights are outweighed by compelling law enforcement needs and disclosure is warranted.

In the course of their official duties, Service employees sometimes obtain information indicating a crime outside the Service's jurisdiction. As has been previously discussed in Finding Two, the Service can take the initiative to disclose tax information which may indicate a nontax Federal criminal violation to the appropriate Federal agency under IRC 6103(i)(3), only if the information is nontaxpayer return information. This provision also does not permit the Service to reveal tax information indicating potential nontax criminal violations to State and local authorities.* Chief Counsel reviewed a sample of returns and return information indicating violations of Federal, State and local criminal laws which the Disclosure Operations Division determined to be nondisclosable under IRC 6103, and generally concurred with the Disclosure Operations' conclusion. The returns and return information indicated violations such as threats against the life of a government official, narcotics trafficking and

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* While IRM 1272 (35)00 contains procedures for disclosing nontax related information necessary for immediate investigative action in connection with crimes such as homicide, rape and robbery, returns and return information may not be disclosed.

embezzlement. Therefore, irrespective of the severity of the crime, if the information indicating the crime is a return or taxpayer return information, the Service cannot initiate disclosure of the information.

For example, recently the Director, Disclosure Operations Division, received notification that a taxpayer threatened the life of the President, on the taxpayer's return. While the United States Secret Service was immediately notified of the taxpayer's threat, technically there was no authority in IRC 6103(i), or in any other provision of the statute, to enable the Service to make such disclosure.*

As stated above, the legislative history of IRC 6103 is clear with respect to the intent of Congress to increase the confidentiality accorded return information and particularly returns and taxpayer return information. However, it is doubtful that the Congress intended the Service to be placed in a position where it cannot make disclosures necessary to protect a person's life or safety. Accordingly, the study group determined that disclosure authority should extend to situations which threaten a person's life or personal safety.

The study group next considered to whom this authority should be granted and the nature of the information to be disclosed. Chief Counsel advises the study group that restricting disclosure to Federal and State law enforcement authorities would appear reasonable since threats to life or personal safety presumably are crimes under Federal and State law, as opposed to local law. While it is recognized that Federal and State authorities may have jurisdiction over threats to life, there is some question among study group members whether this jurisdiction would be exercised by such authorities in a purely local matter. Therefore, the study group feels local authorities as well as State and Federal authorities

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* Review of the return in question by the study group indicated that there was some doubt as to whether the language on the return constituted a real threat to the life of the President. However, the disclosure was made in view of prior threats by this taxpayer and the fact that the Secret Service has orally advised the Director, Disclosure Operations Division, that it wants to be informed of any potential threat against the life of the president, including any which may appear questionable.

should have access to tax information indicating a threat.

With respect to the nature of the information to be disclosed, Chief Counsel advises the study group that it would appear necessary to disclose only return information. Limiting such authority to return information would still permit disclosure of the language on a return indicating a threat, through transcription and disclosure, as return information. In such case, if the Secret Service or Department of Justice needs a copy of the actual return for the purpose of a handwriting analysis or production in court, it could be obtained through the court order procedure set out in IRC 6103(i).

Access to return information indicating a threat to life or personal safety, by State and local authorities, would clearly assist State and local law enforcement. However, State and local authorities would not have a mechanism, such as IRC 6103(i)(1), available to them to access returns if they were needed to perform a handwriting analysis or for production in court. In view of this discrepancy, the study group feels that the statute should be amended to permit the IRS to disclose return information indicating a threat to life or personal safety directly to Federal, State and local authorities. Thereafter, if a return is needed, it could be made available to appropriate Federal, State and local officials upon proper written request containing the specific reason the return was necessary in the particular case.

The study group recognizes there are privacy concerns inherent in disclosing returns and return information to Federal, State and local law enforcement authorities. However, the study group, after weighing the privacy concerns with the compelling law enforcement needs, feels that limited disclosure is justified. Moreover, by designating specific individuals, such as district directors and the Director, Disclosure Operations Division, with the exclusive authority to initiate these disclosures, the potential for abuse would be minimized.

Recommendations to Finding Three

1. The provisions of IRC 6103(i)(3) should be amended to permit disclosure of return information to the extent necessary to apprise appropriate Federal, State and local law enforcement authorities of a threat to life or personal safety.

2. Following disclosure of return information, upon proper written request containing the specific reason a return is needed, returns should also be disclosable under this provision to appropriate Federal, State and local law enforcement authorities.

Finding Four - Generally, IRC 6103 lessens IRS' participation in the Government's Strike Force Program and in other programs where the taxpayer has income from illegal sources or corrupt practices.

The study group considered whether there is a need to discuss the progress of complex special enforcement investigations with the appropriate United States Attorney or Strike Force Attorney prior to formal referral of the case to the Department of Justice for prosecution.

The study group sought the advice of district directors on this issue. In their responses to the study group questionnaire, seventy-two percent advised that district employees should be allowed to make disclosures directly to United States Attorneys or Strike Force Attorneys in order to receive prereferral advice. The directors felt that this advice would make for stronger criminal tax cases, allow them to be developed more expeditiously, and result in a more efficient use of IRS resources. More specifically, the directors' replies indicate that the practical advice of the actual trier of a case is particularly helpful in connection with special enforcement, narcotics, and political corruption cases. Such advice is based upon the prosecutor's experience in trying these cases before the local United States District Court. As a result, it was observed that frank discussions of whether a prosecutor is interested in a particular type of case and, more importantly, whether the factual situation being developed represents a viable case in their judicial district is indispensable. Such discussions would lessen the problem of duplicate efforts by various Federal agencies and reduce the chance of the IRS facing the problems of dual prosecution or the abandonment of investigations where substantial staff power is already invested. Additionally, it was pointed out that prereferral advice is currently permitted in wagering tax cases in accordance with IRC 4424 and has been found most helpful.

The IRS and Department of Justice have tried unsuccessfully to work effectively within the current statute and regulations. While some members of the

study group felt that an amendment to the current regulations under IRC 6103(h)(2) to permit prereferral discussions with United States Attorneys and Strike Force Attorneys would be appropriate, Chief Counsel advises that there appears to be no basis in the statute for such an amendment. Alternatively, the study group explored whether IRC 6103(k)(6) would permit disclosures in prereferral situations. While IRC 6103(k)(6) can be used to a limited extent, it does not permit the frank discussions necessary in many cases. In this regard, the study group was advised that in Chief Counsel's view it was doubtful that the IRS would be able to justify to Congress an amendment to IRC 6103(k)(6), (h)(2), or any other provision of IRC 6103 to achieve the desired result since such a change was likely to be viewed by Congress as an attempt to circumvent the requirements of IRC 6103(i).

It is anticipated that decentralization of IRC 6103(i)(1), (i)(2), and (i)(3) authority would allow more cooperation and promote increased exchanges of information in the field between IRS and the Department of Justice. This increased cooperation in the nontax area may reduce or remove the problems of duplicate efforts and dual prosecution with respect to special enforcement, narcotics, and political corruption cases. However, if the necessary exchanges of information do not occur, the study group would recommend that the IRS seek the necessary authority through a change in the statute.

Recommendation to Finding Four

1. Any decentralization of IRC 6103(i) authority should be monitored to ensure that necessary exchanges of information result. If this is not accomplished through decentralization, the statute should be amended. In this regard, consideration should be given to amending IRC 6103(k)(6) or (h)(2) to authorize prereferral discussions.

Finding Five - The disclosure restrictions of IRC 6103 inhibit the effective participation of the IRS in the enforcement of the recordkeeping and reporting requirements of the Bank Secrecy Act.

Under the Treasury Department's present implementing regulations, the IRS shares the civil and criminal enforcement responsibility for the Bank Secrecy Act with

seven other Federal agencies, both within and outside of the Treasury Department. These agencies include the Comptroller of the Currency, the Securities and Exchange Commission, and the Federal Deposit Insurance Corporation, among others. The IRS' area of primary responsibility covers those requirements of the Bank Secrecy Act which are not specifically delegated to the other agencies. In addition, the IRS conducts criminal investigations on behalf of the regulatory agencies with primary responsibility under the regulations, but which lack criminal investigative authority. As a result of this enforcement scheme, many IRS employees' official duties include Title 31 activities in addition to Title 26 responsibilities.

Due to the nature of the recordkeeping and reporting requirements of the Bank Secrecy Act, IRS employees often establish during the course of their normal Title 26 activities the existence of transactions reportable under the Bank Secrecy Act as well as its violation. Generally, this information is protected by the disclosure restrictions of IRC 6103, since it has tax implications for the taxpayer who was under investigation. IRC 6103(h)(1), which authorizes the disclosure of return information within the Treasury Department, limits such disclosure to "tax administration" purposes. It is the present position of Chief Counsel that the enforcement of the Bank Secrecy Act is not "tax administration." Consequently, IRC 6103(h)(1) does not authorize IRS personnel to disclose this information to other Treasury Department employees, including IRS employees, for use in the enforcement of the Bank Secrecy Act. As a result, disclosure of return information for purposes of the Bank Secrecy Act may only be made in accordance with the provisions of IRC 6103(i)(1), (i)(2), and (i)(3). Use of these provisions in this context necessitates cumbersome internal procedures and requires differentiation between disclosures for criminal and civil purposes, since IRC 6103(i) does not permit the use of return information for civil purposes. This is significant since the primary enforcement mode of the Bank Secrecy Act to date has been civil.

To illustrate the problem, assume a revenue agent discovers evidence of a violation of the Bank Secrecy Act during the course of a Title 26 tax examination of a currency exchange over which the IRS has Title 31 responsibility. The agent cannot simply refer this information to the appropriate excise group in his

district for a Title 31 examination of the currency exchange since IRC 6103(h)(1) does not authorize the internal disclosure of return information for nontax purposes. IRC 6103(i) also would not authorize the disclosure since this provision applies only to nontax criminal violations. If the return information evidenced a criminal violation of the Bank Secrecy Act, it could be disclosed to the district's Criminal Investigation Division. However, this could only be accomplished in accordance with IRC 6103(i)(3) by routing the information through the Director, Disclosure Operations Division for referral to the head of the appropriate Federal law enforcement agency, which in this case would be the Treasury Department. The Treasury Department would then refer the return information through IRS' National Office to the appropriate district Criminal Investigation Division. In any case, such a disclosure could be made only if the return information in question is nontaxpayer return information. If the Criminal Investigation Division needed additional return information, IRC 6103(i)(1) or (i)(2) would have to be satisfied before the revenue agent could disclose additional return information.

Even if Chief Counsel changes its position on whether the enforcement of the Bank Secrecy Act constitutes tax administration, IRC 6103(h)(1) would still not provide a vehicle for disclosing return information to the five agencies with enforcement responsibilities that are not a part of the Treasury Department. The study group concludes that, under either interpretation, the existing law and procedures inhibit effective utilization of return information in Title 31 enforcement efforts. Additionally, there are basic problems in the distribution of Title 31 enforcement responsibility among numerous Federal agencies and in the overall administration of Title 31.

Recommendation to Finding Five

1. In order to pursue the complex problems inherent in Title 31 enforcement, it is recommended that an inter-agency task force be developed to fully investigate Title 31 issues.

Finding Six - There is no procedure in IRC 6103(i) for disclosing wagering tax information to other Federal agencies for the enforcement of nontax Federal criminal laws.

The IRS has responsibility for enforcement of the Federal wagering tax laws. The IRS has conducted wagering tax investigations, and in connection with these cases, has come across possible evidence of violations of nontax Federal criminal laws. However, neither IRC 6103(i) nor any other section of the Code currently permits disclosure of wagering tax information pertaining to nonfilers of wagering tax returns that indicates violations of nontax Federal criminal laws.

Before 1968, IRC 6107 required each district director to maintain an alphabetical listing of individuals who had purchased wagering occupational stamps. The law required that upon application and the payment of a nominal fee, officers of a State or local government would be provided with a copy of this list, as well as copies of the wagering tax returns. Disclosures in the wagering area were made at the discretion of the Commissioner as the disclosure regulations issued under IRC 6103 did not apply to Chapter 35, Taxes on Wagering.

In 1968, the Supreme Court in two landmark decisions, Marchetti v. U.S. and Grosso v. U.S., held that the IRS could not criminally prosecute an individual for failure to file wagering tax returns because filing such a return would involve a violation of the taxpayer's Fifth Amendment right against self-incrimination. This is because the wagering tax return required to be filed under Federal law was available to State and local prosecutors to use as evidence in the prosecution of the taxpayer for a violation of State or local anti-gambling laws. As a result of these decisions, and various other factors, IRC 6107 was repealed. In 1974, Congress enacted IRC 4424.

IRC 4424 provides specific restrictions on the disclosure and subsequent use of information pertaining to a taxpayer's compliance with Federal wagering tax laws. No official or employee of the Treasury Department may disclose, except in connection with the administration or civil or criminal enforcement of the internal revenue laws, any document or record supplied by a taxpayer in connection with wagering taxes, or any information obtained through the exploitation of such document or records. IRC 4424 also provides that certain documents may not be used against the taxpayer in any criminal

proceeding except in connection with the administration or civil or criminal enforcement of the internal revenue laws. Thus, IRC 4424 eliminates the potential self-incrimination problems raised in Marchetti v. U.S. and Grosso v. U.S.

The provisions of IRC 4424 were meant to protect the Fifth Amendment self incrimination rights of persons who filed wagering tax returns. The study group has been advised by Chief Counsel that in enacting IRC 6103(o)(2) as part of the Tax Reform Act of 1976, Congress caused all wagering tax information to be governed solely by the disclosure and use restrictions of IRC 4424. As a consequence, even in cases where no wagering tax return was filed but where the Service has obtained information through independent resources pertaining to a person's wagering tax liability, IRC 4424 prohibits its disclosure and use except in connection with the administration or enforcement of the internal revenue laws. However, nonfilers of wagering tax returns cannot validly claim a violation of their Fifth Amendment right against compulsory self-incrimination because they will have submitted nothing to the IRS pertaining to their wagering tax liability.

Since IRC 4424 was enacted in order to cure the Fifth Amendment problem presented in Marchetti and Grosso, it is quite likely that it's coverage of nonfiler information, caused by the enactment of IRC 6103(o)(2), was inadvertent. In any event, there does not appear to be a valid reason for treating nonfiler wagering tax information differently than other return information which may be disclosed under IRC 6103(i).

Recommendation to Finding Six

1. The study group recommends that IRC 6103(o)(2) be revised to permit disclosure of nonfiler wagering tax information indicating possible violations of nontax Federal criminal laws under IRC 6103(i).

Finding Seven - Generally, disclosure training has been adequate; however, training in specialized areas may be necessary.

Responses to the study group questionnaires indicate disclosure training generally has been both adequate and well received. Districts did indicate a need for

disclosure training for the Collection function similar to that provided to Criminal Investigation, Examination and Taxpayer Service personnel. This training is currently being developed. However, the responses also indicate additional training may be appropriate in specialized areas. As previously mentioned, there appears to be a need for appropriate personnel to be trained in the recognition of information indicating potential violations of nontax Federal crimes. The study group finds that training in the Title 31 area is also needed.

District employees continue to remain cautious when dealing with disclosure matters. However, there are indications the initial "chilling effect" that followed enactment of the civil and criminal penalties for unauthorized disclosure may be diminishing. The addition of clarifying terms to IRC 7213 and 7217, that lessen the degree of liability, appear to have relieved some of the overly cautious attitudes. Refresher training of appropriate personnel coupled with growing expertise in, and experience with, disclosure matters should change these attitudes.

The study group perceives a need for the Service to develop a disclosure law enforcement handbook for other agencies. In the past, the Service has assisted other agencies in preparing disclosure instructions for their personnel. For example, in 1979 the Service prepared a booklet designed to guide State and local child support enforcement agencies in their use of services offered by the Social Security Administration's Office of Child Support Enforcement and the Internal Revenue Service. The study group believes a similar handbook for law enforcement agencies would be beneficial.

Recommendations to Finding Seven

1. Provide specialized and/or refresher training to appropriate personnel in the following areas:

   a. recognition of information indicating potential violations of nontax Federal crimes;

   b. Title 31; and

c. refresher training regarding the impact of recent amendments to IRC 7213 and 7217.

2. As stated in the Recommendations to Finding Two, a short booklet should be developed giving examples of the more common nontax criminal violations.

3. Develop a disclosure handbook for law enforcement agencies.

Attachments

Attachment 1

Internal Revenue Service
memorandum

date: DEC 20 1979

to: All Regional Commissioners
All Assistant Commissioners

from: Deputy Commissioner

subject: Impact of Section 6103 on Service Activities

Last week the Senate Permanent Subcommittee on Investigations held hearings concerning illegal narcotics trafficking. Much of the testimony given by DEA, Justice and the General Accounting Office covered problems of Service disclosure of information which it had involving illegal activities. These problems as viewed by those agencies were created by the new tax disclosure law (section 6103). Commissioner Kurtz in his testimony stated that more could be done within the existing statute to exchange information with other law enforcement agencies.

The Service has done an outstanding job in affording the protection for tax information which was mandated by Congress. Nevertheless, it has been almost three years since the statute came into effect and we believe it's an appropriate time to again review the impact of the new disclosure statute with special emphasis on the impact the statute is having on our dealings with other law enforcement agencies. To accomplish this review I have appointed the following group:

Howard T. Martin, Director, Disclosure Operations Division, Chairman

Merle Heye, Assistant Director, Examination Division

Robert Potter, Assistant Director, Criminal Investigation Division

Michael Quinn, Assistant Director, Collection Division

Lem Roberson, Assistant District Director, Cleveland

Richard Wassenaar, Assistant Regional Commissioner (Criminal Investigation), Western Region

All Regional Commissioners
All Assistant Commissioners

The Commissioner and I would like to meet with this group on January 14, at 10:00 a.m. to outline our concerns. Since the immediate identification of any problems and resolution is of great importance to us as well as the Drug Enforcement Administration and Justice Department, I expect the study group to complete their deliberations around the last of February and furnish me a report on their findings shortly thereafter. The work of this group will require input from many of you and I ask you to give immediate attention to any request for assistance you receive from them so that we can very thoroughly examine the area and resolve the issues in the shortest possible time.

Attachment 2

DISCLOSURE REVIEW STUDY GROUP

QUESTIONNAIRE

(Note: This questionnaire should be considered confidential, and should not be disclosed to anyone outside the Internal Revenue Service)

DISCLOSURE REVIEW STUDY GROUP QUESTIONNAIRE

I. IRC 6103(i)(3)

1. How many non-tax criminal violations of Federal laws has your district reported?

2. Which function (CID, Examination, Collection, etc.) reported these violations?

3. Can you cite any specific causes for the limited number (only 28 nation-wide last year) of (i)(3) disclosures?

II. DELEGATIONS OF AUTHORITY

1. Should current 6103(i)(1) procedures be revised to permit a court order to be sent directly to a designated individual in the district office for response, without prior National Office review and approval? Please explain.

2. Should the 6103(i)(2) procedures be similarly revised?

3. Would you favor decentralizing the authority to disclose under 6103(i)(3) to a responsible person in the district office?

   Would you anticipate greater (i)(3) activity if this were to occur? If so, why?

III. RELATIONSHIP WITH U.S. ATTORNEYS, FEDERAL AGENCIES, AND STATE/LOCAL AGENCIES

1. Have you had discussions with the U. S. Attorney concerning the disclosure aspects of IRC 6103(i)?

2. If so, how knowledgeable do you think the U. S. Attorney is concerning IRS disclosure provisions and procedures?

3. Have you discussed the procedural aspects of 6103(i) with other Department of Justice field representatives or field representatives of other Federal agencies? If so, why?

4. What was the result of these discussions?

5. Do you think district employees should be allowed to make disclosures directly to Strike Force and U. S. Attorneys in order to receive pre-referral advice? If so, please explain the nature of such advice and why it is necessary.

6. Do you think the Service should seek authority to disclose certain types of information to state and local law enforcement agencies, such as that provided by 6103(i)(3) in regard to Federal agencies?

   If so, please give specific examples of any cases in your district where this would have been beneficial.

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IV. TRAINING

1. Do you think adequate training has been provided to employees of CID, Examination, Collection and Taxpayer Service, on the disclosure provisions of the Code, regulations, etc.?

   If not, what additional training would you recommend?

2. Do you think district employees are overly cautious when dealing with disclosure matters because of the civil and criminal penalties for making unauthorized disclosures? (IRC 7213 and 7217)

3. Do you think district employees are able to identify violations of Federal non-tax criminal laws?

4. Has adequate guidance been provided to field personnel for reporting violations of Federal non-tax criminal laws?

5. Is there a need for futher disclosure training concerning Title 31 violations and investigations?

6. Would it be burdensome to require the completion of a Title 31 investigation before starting a Title 26 investigation in a situation which would require both types of investigation? Please explain.

V. CHAPTER (35)00 of IRM 1272

1. Are the provisions of chapter (35)00 (the "murder Manual") working effectively?

2. If not, what specific procedural changes would you recommend?

VI. DISCLOSURE OFFICER

1. Do you think that adequate guidance has been given to the district Disclosure Officer in regard to IRC 6103?

   If not, in what specific area(s) is additional guidance required?

2. If there is a disagreement between the Disclosure Officer and the management of another function (CID, Collection, etc.) on the way to handle a situation or the approach to take on a particular problem, who resolves the dispute?

VII. COMMENTS

Have the disclosure laws, regulations, and procedures created specific problems in the law enforcement area which you think the study group should consider?

Questionnaire

1. Name of case ______________________________
   (As per (i)(1), (i)(2) authorization)

2. Date authorization (verbal or written) received by District ______________________.

3. Date final information furnished to U.S. Attorney or Department of Justice, or date request otherwise closed.______________________.

4. What problems, if any, were encountered in securing or furnishing the information to the U.S. Attorney or Department of Justice.

6103(i)(1) and (i)(2) Questionnaire

This questionnaire is to be completed for all (i)(1) and (i)(2) disclosures authorized in the years 1977, 1978, and 1979.

District Name__________________

Senator NUNN. Despite some changes that have been made by IRS, legislative action, however, is still necessary. My colleagues and I do not advocate scrapping the privacy safeguards which were written into the Tax Reform Act. However, 3 years' experience under the act have convinced us that a balance needs to be struck between the privacy of tax returns and the legitimate needs of law enforcement agencies.

We think and hope that our amendments to the disclosure provision strike that necessary balance. Under S. 2402, ordinary taxpayers may rest assured that a Federal judge will have to approve any disclosure of their tax returns and all other information that they are required by law to provide to the Internal Revenue Service. Now, that is, if this bill becomes law.

In order for a law enforcement agency to see this information, it still will have to get an ex parte order from the U.S. district court. It will have to convince the court that there is reasonable cause to believe that the information in the return is material and relevant to a lawful criminal investigation or proceeding.

On the other hand, drug traffickers and organized criminals may rest assured if this bill becomes law that nonreturn records which show unusual cash deposits and transfers into and out of their bank accounts will be called to the attention of the appropriate law

enforcement agency. Under our proposal, the DEA could get this type of nonreturn information from IRS by making a written request rather than being required to obtain a court order.

Under this proposal we would separate IRS information into two simple and distinct categories. The first category of return would cover tax returns and all other information the taxpayer is required to give IRS. This category of privileged information would require a court order.

The second category, called nonreturn information, would cover all other information IRS obtains in the normal course of its business. This category would require a specific written request procedure which would be monitored by the Justice Department and the IRS.

I realize that there are differing views with regard to how much information should be afforded the protection of a court order prior to disclosure. For example, I have read the General Accounting Office critique of our bill on this issue, and I think GAO will make some very good points before you today. I think their report is positive. I haven't studied it long enough to be able to say that I agree or disagree with each suggestion, but I think that they thoroughly understand the problem, and I think that the General Accounting Office report in sum is a very positive and constructive addition to this hearing.

Let me emphasize that our bills were drafted to provide concrete pieces of legislation which we can use to formulate solutions to the problems brought on by the Tax Reform Act, and we stand ready to assist your committee in refining these bills to the extent that it is desirable and necessary.

To eliminate the catch 22 snag, S. 2402 puts an affirmative burden on IRS to notify the Justice Department whenever it uncovers evidence other than from a tax return of crimes such as narcotics trafficking, bribery, and extortion.

IRS will be required to reveal enough about that evidence so that the prosecutor can make a written request to IRS for it. Admittedly, it will be easier for prosecutors to get information that IRS obtains from sources other than tax returns, sources such as banks and business records, accountants' and other taxpayers representatives, but it will not be easy for prosecutors to see a person's tax returns, nor would any agency other than the Justice Department be able to request access to tax returns.

Every such request will have to be made by a Justice Department lawyer who would exercise his own legal judgment that the return is material and relevant to a lawful investigation or proceeding, and the U.S. district judge will be the final arbiter of whether a tax return and its supporting information, such as a list of contributions to good will, will be disclosed outside the IRS.

Even when tax returns and other information are disclosed, they can be used only in connection with lawful criminal proceedings and investigations, certain types of civil litigation involving Federal claims and situations involving certified State felony violations.

The proposal also contains a provision that allows IRS to immediately release information in emergencies such as threats to life, property, and national security. This change would cure the situation that now exists, which requires IRS to pursue elaborate and

time-consuming disclosure procedures, even in such emergencies as assassination attempts.

While the disclosure provisions of the Tax Reform Act have caused problems, the IRS admits that the administrative summons section of that act is an impediment to effective law enforcement. Under that section, title 26 United States Code 7609, IRS is required to notify a taxpayer whenever it issues a summons to a third party, such as a bank, to get access to the taxpayers' records. The taxpayer then has a right to automatically stay the performance of that summons until IRS can take the issue to court.

To obtain this stay, the taxpayer does not have to establish any legal reason why IRS should not see his records. It is all automatic. This automatic stay provision has resulted in delays of more than 1 year. One automatic stay lasted 33 months. The average length of such stays has been 9 months.

We propose to change the automatic stay provision to make the summons procedure similar to the one Congress applied to every Federal investigative agency except IRS through the Right of Financial Privacy Act of 1978.

Under our proposal, a taxpayer still will be given notice whenever his records have been summoned by the IRS, and he will be able to contest the summons in court before the IRS can see his bank or other records held by a third party.

In keeping with the policy of the Right to Financial Privacy Act, however, the taxpayer will have to assert a legal argument and convince the court that IRS has no right to see his records. There will not be an automatic stay.

In terms of the civil damage provisions, as I pointed out earlier, the Tax Reform Act of 1976 contains several criminal and civil penalties for persons who disclose tax returns or related information in violation of the act.

Our proposed amendment to section 7217 provides that the Government will be liable for damages awarded against a Federal official or employee, so long as the disclosure occurred within the scope of his employment and was not done corruptly, maliciously, in return for anything of value, or willfully in violation of the disclosure provisions of the act.

The criminal penalties of the Tax Reform Act makes it a felony to willfully disclose tax returns or tax return information in violation of the act. Under existing law, there is no defense available for good faith, but wrong interpretations of the disclosure provision. In order to ease the minds of IRS agents and encourage them to report nonreturn information to possible crimes proposed in section 2404 that an affirmative defense provision be added to the criminal penalty section to relieve them of criminal liability when they can establish that they made the disclosure based on a good faith, though erroneous, interpretation of the disclosure provisions.

Mr. Chairman, in summary, for generations, the Internal Revenue Service led the way in this Nation's battle against organized crime and narcotics traffic, but since 1977, it has hidden behind the disclosure provision of the Tax Reform Act to stay out of the fray. Three years of inactivity by this once effective law enforcement agency is enough, particularly when you consider the huge, huge problem of narcotics in this country, of organized criminals in this

country, and of people making literally millions and hundreds of millions of dollars without paying 1 cent in taxes.

It is time for the Internal Revenue Service to use their considerable abilities against people who are making illegal profits and who are not sharing their burden for the tax load with the American taxpayer and American citizen.

Now Senator Chiles will speak further on the issue of the effects of what this narcotics trafficking is doing in particular areas like Florida, and I know Senator Percy will cover certain other aspects of the testimony. We have had a totally bipartisan effort in this respect on the Tax Reform Act, and I thank my colleagues for being here.

Mr. Chairman, again, I thank you for taking time from your very busy schedule to have a hearing on this very complicated, complex, but extremely important subject.

Senator BAUCUS. Thank you, Senator Nunn.

[The prepared statement of Senator Nunn follows:]

STATEMENT OF SENATOR SAM NUNN

Mr. Chairman, thank you for scheduling these hearings in such a timely fashion and for giving me an opportunity to testify on behalf of the four bills that I introduced along with Senators Percy, Chiles, Cohen, DeConcini, Long, Talmadge, Ribicoff, Jackson, Boren, and Schmitt.

These bills—S. 2402, S. 2403, S. 2404, and S. 2405—would amend the disclosure, summons, criminal sanction and civil penalty provisions of the Tax Reform Act of 1976, respectively.

This legislative package is the result of extensive hearings held by the Permanent Subcommittee on Investigations last December on illegal narcotics profits and the impediments faced by law enforcement authorities in eliminating those profits. We heard testimony from 35 witnesses and received 34 exhibits. Our printed hearings record, which I will supply for your information, totaled 507 pages.

A report on our investigation has been approved by a majority of our Subcommittee.

THE DECLINE OF IRS

Mr. Chairman, it has long been recognized that finanical investigations, relying on finanical and tax records, are one of the effective tools in piercing the veil of secrecy that protects those at the top of any organized crime ring—be it a drug smuggling operation or a traditional origanized crime family.

Today, when organized crime and narcotics trafficking are becoming bigger and more sophisticated than ever before, that one law enforcement agency that the kingpin criminals fear most—the Internal Revenue Sevice—has withdrawn from the battle.

The FBI testified at our December hearings that its cooperative efforts with IRS are down over 95 per cent since 1976.

IRS-initiated cases against origanized criminals are down more than 50 per cent during that same period.

During all of 1979, the IRS made just 10 or 12 cases against high-level narcotics traffickers.

In 1974, IRS had 927 employees working on narcotics cases. In 1979 that number had dropped to 163. The untaxed profits from narcotics and organized crime run into the billions of dollars ever year and are growing all the time, yet since 1976 the IRS has made only a minimum effort to tax these profits or help convict those who make them.

These untaxed dollars often leave our country, are laundered through overseas banks or businesses, and come back to America in the form of hidden investments which are having a tremendous inflationary impact. Consequently, honest businessmen and women have great difficulty competing against the criminal tax evader in the market place.

Since 1976, IRS has concentrated its efforts on the ordinary taxpayer while the criminal has gotten a relatively free ride. This has encouraged average citizens to get into the "underground" economy in which they pay little or no taxes.

Mr. Chairman, these are some of the findings which are contained in our Subcomittee's draft report. I point them out today to illustrate that the IRS has withdrawn as an effective weapon against organized crime and narcotics dealers.

I also point them out in order to emphasize that the beginning of this decline coincided with enactment of the disclosure provisions of the Tax Reform Act of 1976.

THE TAX REFORM ACT OF 1976

These disclosure provisions, which are found in 26 U.S.C. 6103, were passed in the wake of certain abuses that came to light during the various Watergate and intelligence gathering investigations.

For the most part, these abuses involved the loose dissemination outside IRS of individual tax returns for various purposes such as coercing campaign contributions or checking on groups which some agencies considered to be subversive.

To cure these abuses, Congress enacted section 6103, which makes tax returns confidential and subject to disclosure by IRS only in accordance with very strict procedures.

But the section goes much further and covers more than just tax returns. Also included in its proscription is most other information that IRS gathers in connection with tax investigations.

Under section 6103, IRS agents are forbidden to disclose, on their own intiative, not only tax returns but "tax-return information"—which is any information they gather in connection with a tax return—or "taxpayer return information"—which is any information they obtain from a taxpayer or his representative, such as his attorney or accountant.

In other words, the prohibition now applies to information gathered from such items as books and records, bank accounts, taxpayer interviews, and so forth. The other law enforcement agencies once relied on IRS to disclose to them evidence gained from these sources, but this is no longer true.

As a result, there is very little criminal information exchanged today between IRS and the other Federal law enforcement agencies. IRS has turned over an average of just 32 pieces of criminal evidence per year over the past 3 years. DEA officials testified at our hearings that they received *no* non-tax criminal evidence over the same period.

What happens to the non-tax criminal evidence that IRS agents come across during the course of their tax investigations? Apparently, it is buried somewhere in the IRS files.

For example, IRS agents told our Subcommittee that they found evidence of massive embezzlements when they audited a labor union's records, but they could not report this information to the Justice Department. Thus, Justice had no information upon which to begin a non-tax prosecution.

In another example, IRS agents found evidence in a taxpayer's business records that he had bribed a policeman. That evidence was never disclosed, and the policeman is still on the job.

These examples pale in comparison to an incident known as the "Case of the Trash Can" in which DEA was investigating a chemist suspected of concocting illegal drugs. DEA learned that an IRS agent had searched the chemist's trash can and had discovered evidence that the chemist indeed was making illegal drugs. However, IRS would not volunteer this evidence.

The prosecutor subpoenaed the IRS agent and the trash can documents, but IRS cited the Tax Reform Act and refused to let the agent answer the subpoena. IRS said the trash was gathered in connection with the chemist's tax return; therefore, the prosecutor needed a court order under section 6103 to see the documents.

In my mind, by keeping secret this evidence of criminal activity found in a taxpayer's books and records, bank account statements and checks stubs, we have legislated an exemption for criminals.

Our investigation has convinced me that the disclosure provisions of section 6103, coupled with the way they have been interpreted and enforced by IRS, have had a highly detrimental effect on our Federal law enforcement system.

That system is complex and sophisticated. We do not have a Federal police state. Instead, we have a series of agencies broken down by criminal jurisdiction that must operate with a high degree of coordination and cooperation. It is not unusual, in fact it is quite common, to combine the skills and information of many agencies to achieve any measure of success in criminal enforcement.

IRS has a fine tradition and history of being one of the most effective law enforcement agencies, especially in cases involving high echelon criminals. Obviously, since the purpose of criminal ventures is to make money, very few substantive crimes can be committed without some tax consequence. Therefore, IRS always

has been—and continues to be—a key agency both in terms of financial expertise and in terms of financial information.

The language and interpretation of the Tax Reform Act, however, have caused a severe breakdown in our delicate and complex Federal law enforcement system. It has taken up to 13 months simply to receive the assistance of IRS agents in joint investigations because the Tax Reform Act and its interpretation by IRS has caused a bureaucratic nightmare in cases where Federal agencies should willingly assist each other. Moreover, the Tax Reform Act and its interpretations by IRS have made, in effect, common criminals out if IRS agents who must ignore the dictates of justice for every other American, and refuse to turn over evidence of serious crimes to the appropriate authorities.

THE "CATCH 22"

It is possible, of course, for other agencies to obtain tax returns and other IRS-gathered information under section 6103. However, they must apply for a court order in order to get tax returns, and they must make written requests to obtain other IRS information about non-tax crimes such as forgery, bribery, or narcotics violations that comes from sources other than tax returns.

In either situation, the requesting agency must describe the information it seeks to obtain.

The court order and written request requirements have created a "Catch 22" situation. Since IRS agents are forbidden to tell the other agencies of the criminal evidence they gather, it is virtually impossible for these other agencies even to know that such information exists, much less to describe that information with such particularity that they can satisfy the requirement for a court order or written request.

In other words, section 6103 requires federal investigative agencies to go through elaborate request procedures to obtain information that they may not even know that IRS has.

This "Catch 22" situation has made it all but impossible for the FBI, DEA, and other agencies to receive the necessary information and cooperation from the IRS.

IRS ATTITUDE

Section 6103 is only a part of the problem. The bulk of the problem lies with the attitude of the top officials of the IRS and the policies and procedures they have adopted in interpreting and applying section 6103.

For the past 6 years, a series of IRS commissioners and their top aides have taken the view that IRS should stick to "tax administration"—by which they mean tax collection and only tax collection—and out of the general law enforcement arena.

They say that paying attention to ordinary taxpayers is a better way of keeping the voluntary tax collection system working than is cracking down on organized criminals who pay no taxes on their tremendous ill-gotten gains.

I beg to differ with that view of tax administration.

Obviously, IRS must be aggressive in collecting the Nation's taxes, but I can understand the skepticism of a small town waitress who is caught for under-reporting her tips when organized crime millionaires escape without reporting a cent of their illegal income.

I believe that if the average taxpayer knows that IRS can successfully collect taxes from the mob, he is a lot more likely to ante up his fair share—if for no other reason than the fear of being caught.

When he sees a drug pusher prosecuted for tax evasion, he is likely to have confidence in our voluntary tax collection system and feel that his taxes are being well spent, especially on law enforcement. On the other hand, if he sees criminals getting away with tax evasion on top of murder and extortion, his natural skepticism toward our tax policy will increase.

IRS' recent emphasis on ordinary taxpayers has not increased voluntary compliance with the tax laws. In fact, statistics compiled by both the IRS and the General Accounting Office indicate that voluntary compliance with the tax laws actually has decreased since passage of the Tax Reform Act of 1976 and the subsequent withdrawal of IRS from cooperative law enforcement efforts aimed at big-time criminals.

Other statistics indicate the extent of IRS' withdrawal: Between 1974 and the first 9 months of 1978, the number of organized crime cases which originated from IRS developed tax information dropped from 620 to just 221.

I do not mean to imply that IRS is totally unaware of the effect of the Tax Reform Act. Just last December, for example, the Deputy Commissioner of IRS appointed a special study group to assess the impact of the disclosure provisions. That group made a number of recommendations for administrative action. A copy of

the group's report has been provided to our Subcommittee, and I submit that for your consideration.

Despite some changes that have been made by IRS, legislative action is still necessary.

DISCLOSURE AMENDMENTS

My colleagues and I do not advocate scrapping the privacy safeguards which were written into the Tax Reform Act. However, 3 years' experience under the act have convinced us that a balance needs to be struck between the privacy of tax returns and the legitimate needs of law enforcement agencies.

We think that our amendments to the disclosure provisions strike that balance.

Under S. 2402, ordinary taxpayers may rest assured that a Federal judge will have to approve any disclosure of their tax returns and all other information they are required by law to provide the IRS.

In order for a law enforcement agency to see this information, it still will have to get an ex parte order from a U.S. district court. It will have to convince the court that there is reasonable cause to believe that the information in the return is material and relevant to a lawful criminal investigation or proceeding.

On the other hand, drug traffickers and organized criminals may rest assured that nonreturn records which show unusual cash deposits and transfers into and out of their bank accounts will be called to the attention of the appropriate law enforcement agency.

Under our proposal, the DEA could get this type of nonreturn information from IRS by making a written request rather than being required to obtain a court order.

Under this proposal we would separate IRS information into two simple and distinct categories. The first category of "Returns" would cover tax returns and all other information a taxpayer is required to give IRS. This category of privileged information would require a court order. The second category, called "Nonreturn" information, would cover all other information IRS obtains in the normal course of its business. This category would require a specific written request procedure which would be monitored by the Justice Department and IRS.

I realize that there are differing views with regard to how much information should be afforded the protection of a court order prior to disclosure. For example, I have read the GAO's critique of our bills on this issue, and I think GAO will make some very good points before you today.

Let me emphasize that our bills were drafted to provide concrete pieces of legislation which we can use to formulate solutions to the problems brought on by the Tax Reform Act. Mr. Chairman, I stand ready to assist your committee in refining these bills.

To eliminate the "Catch-22" snag, S. 2402 puts an affirmative burden on IRS to notify the Justice Department whenever it uncovers evidence, other than from a tax return, of crimes such as narcotics trafficking, bribery and extortion. IRS will be required to reveal enough about that evidence so that the prosecutor can make a written request to IRS for it.

Admittedly, it will be easier for prosecutors to get information that IRS obtains from sources other than tax returns—sources such as banks and business records, accountants and other taxpayer representatives.

But it will not be easy for prosecutors to see a person's tax returns.

Nor would any agency other than the Justice Department be able to request access to tax returns. Every such request will have to be made by a Justice Department lawyer, who would exercise his own legal judgment that the return is material and relevant to a lawful investigation or proceeding.

And a U.S. district court will be the final arbiter of whether a tax return and its supporting information—such as a list of contributions to Good Will—will be disclosed outside the IRS.

Even when tax returns and other information are disclosed, they can be used only in connection with lawful criminal proceedings and investigations, certain types of civil litigation involving Federal Claims, and situations involving certified State felony violations.

The proposal also contains a provision that allows IRS to immediately release information in emergencies such as threats to life, property, and national security. This change would cure the situation that now exists which requires IRS to pursue elaborate and time-consuming disclosure procedures even in such emergencies as assassination attempts.

In summary, as it amends the disclosure provisions of the Tax Reform Act, our proposal would—

First, require IRS to notify the appropriate law enforcement agency whenever it uncovers evidence, other than from a tax return, of a non-tax crime.

Second, once certain requirements are met and a written request made, IRS can release nonreturn criminal information directly to the Justice Department.

And third, Government attorneys can obtain tax returns and supporting documentation only by showing a Federal district judge that there is reasonable cause to believe that the returns are material and relevant to a lawful criminal investigation.

SUMMONS PROVISIONS

While the disclosure provisions of the Tax Reform Act have caused problems, the IRS admits that the administrative summons section of that act is an impediment to effective law enforcement.

Under that section, 26 U.S.C. 7609, IRS is required to notify a taxpayer whenever it issues a summons to a third party—such as a bank—to get access to the taxpayer's records. The taxpayer then has a right to automatically stay the performance of that summons until IRS can take the issue to court. To obtain this stay, the taxpayer does not have to establish any legal reason why IRS should not see his records. It is all automatic.

Let us say a person reports a modest income on his tax return for 1979, but it comes to the attention of IRS that he lives a very extravagant life style. Maybe has reported an income of $23,000—but during the year he bought a house costing $230,000 and two cars costing $19,000 apiece.

Suspecting that he is not reporting all of his income, IRS issues a summons to his bank to have a look at his account records, which may very well show that he has made a number of large cash deposits—a telltale sign drug pushing.

Under the existing summons provision, the suspected narcotics dealer can automatically stay the enforcement of that summons, and the IRS is stymied until it can go to court and establish why it needs to see those records. In the meantime, the pusher keeps on dealing drugs.

This automatic stay provision has resulted in delays of more than a year. One automatic stay lasted 33 months. The average length of such stays has been 9 months.

In addition, there is no limit to the number of automatic stays a tax evader can initiate. All investigators know that one set of records often creates the need for a second set. Consequently after a year's delay, IRS may find from the originally-summoned records that additional documents must be obtained. IRS then issues another summons, the tax evader invokes another automatic stay, and another year goes by.

In the meantime, witnesses may die, evidence becomes stale, and the Government's case is weakened.

An IRS study of this problem revealed that in more than 2,000 automatic stays, over 80 percent of the time the protesting taxpayers failed to show up in court. It is fair to conclude from this statistic that delay—and not a legal issue—was the purpose of most automatic stays.

In another survey, the General Accounting Office found that over 75 percent of all persons who took advantage of the automatic stay were known organized crime members, narcotics dealers, or persons who habitually protest paying their taxes.

We propose to change the automatic stay provision to make the summons procedure similar to the one Congress applied to every Federal investigative agency except the IRS through the Right to Financial Privacy Act of 1978.

Under our proposal, a taxpayer still will be given notice whenever his records have been summoned by the IRS, and he will be able to contest the summons in court before IRS can see his bank or other records held by a third party.

In keeping with the policy of the Right to Financial Privacy Act, however, the taxpayer will have to assert a legal argument and convince the court that IRS has no right to see his records. It will not be an automatic stay.

Ordinary taxpayers, with good legal arguments will have no fear of indiscriminate access to their records by the IRS. But criminals and tax evaders will find it much more difficult to delay, interrupt and impede a serious investigation for years on end.

In addition, under our proposal, the Government can present to the court, for in camera inspection, evidence indicating that a notice to the taxpayer could result in the destruction of records, obstruction of justice, threats to witnesses, or other similar acts. If the court agrees an order can be issued postponing the advance notice requirement.

We believe that by enacting our proposal and applying the same summons procedure to the IRS that is applied to all other Federal agencies, Congress will be improving law enforcement while continuing to provide adequate privacy safeguards for everyone's records.

CIVIL DAMAGE PROVISIONS

As I pointed out earlier, the Tax Reform Act of 1976 contains severe criminal and civil penalties for persons who disclose tax returns or related information in violation of the act.

The civil damage provision, 26 U.S.C. 7217, makes any person who willfully or negligently discloses a tax return or tax return information in violation of the act personally liable for civil damages in a suit brought against him by the taxpayer.

There is no liabilty for disclosures which result from good faith, but wrong, interpretations of the act.

Our proposed amendment to section 7217 provides that the Government will be liable for damages awarded against a Federal official or employee so long as the disclosure occurred within the scope of this employment and was not done corruptly, maliciously, in return for anything of value, or willfully in violation of the disclosure provisions of the act.

We do not believe that IRS agents should be personally liable for damages arising out of disclosures which are not done with wrongful intent, and S. 2405 spells this out.

CRIMINAL PENALTIES

The criminal penalties of the Tax Reform Act, 26 U.S.C. 7213, makes it a felony to willfully disclose tax returns or tax return information in violation of the act. Persons found quilty can be fined up to $5,000 or sentenced to jail for up to 5 years, or both, and assessed the costs of prosecution.

Under existing law, there is no defense available for good faith but wrong interpretations of the disclosure provisions. As a result, IRS agents testified before our subcommittee, they will always stay on the safe side of the law and not disclose any IRS information to other agencies except in the most serious situations. The disclosure provisions are not always easy to interpret in every situation when an IRS agent comes across evidence of a nontax crime. In fact, even though IRS has issued a number of "clarifying" interpretations and instructions, its agents testified that they never could be sure if they were violating the act when they disclosed information. In fact, IRS' own legal counsel had difficulty interpreting the provisions when asked questions at our hearings.

In order to ease the minds of IRS agents and to encourage them to report nonreturn information to possible crimes, we propose in S. 2404 that an affirmative defense provision be added to the criminal penalty section to relieve them of criminal liability when they can establish that they made the disclosure based on a good faith, though erroneous, interpretation of the disclosure provisions.

CONCLUSION

Mr. Chairman, for generations the Internal Revenue Service led the way in this Nation's battle against organized crime and narcotics trafficking, but since 1977 it has hidden behind the disclosure provisions of the Tax Reform Act to stay out of the fray.

As Fred Bonadonna, whose father was an identified member of the Kansas City mob, testified at our recent hearings, organized criminals—who once feared the IRS—now arrogantly display the wealth created by their criminal ventures, knowing full well that the IRS will do nothing about their ill-gotten gains.

Only part of the IRS withdrawal can be blamed on the existing law. In passing the disclosure provisions, Congress intended to provide greater protection for the privacy of each citizen's tax returns, but we did not intend for IRS to withdraw from this important fight.

It is now time for us to make a policy decision for the top-level administrators of the IRS, rather than having them make it for us. That decision is that the IRS should become once again the effective force for justice that it was in the days of bootleggers and rumrunners.

My colleagues and I believe that our proposals will send IRS a clear and unmistakable signal that it should do just that.

We have spent many long hours in drafting what we feel is very well-reasoned legislation. We will retain very important privacy safeguards that will prevent any repetition of Watergate—type abuses. At the same time, we put a duty on IRS to cooperate once again with the fight against the ever increasing organized crime and narcotics problems facing the Nation.

Three years of inactivity by this once effective law enforcement agency is enough. It is time to act.

Thank you very much.

Senator BAUCUS. Before we continue, I would like to ask each of you whether it would be more expedient for you to give your statements now before going to some of the questions, or would it be more useful for you to have questions now?

Senator CHILES. Mr. Chairman, that would be a little more useful for me. I have to go to another hearing that starts at 10 o'clock.

Senator BAUCUS. Fine.

Senator PERCY. I would prefer that also.

Senator BAUCUS. All right. If you could then stay, Senator Nunn, I have some questions I would like to ask.

Senator NUNN. I will.

Senator BAUCUS. Fine.

Senator Chiles, we welcome you here, too.

STATEMENT OF HON. LAWTON CHILES, A U.S. SENATOR FROM THE STATE OF FLORIDA

Senator CHILES. Thank you, Mr. Chairman.

I welcome very much this opportunity. I am delighted to be here with Chairman Nunn and Senator Percy, the ranking member of the Committee. I want to congratulate both of them on the work they have done in putting together a tremendously important package of bills to remove impediments that were created in the 1976 Tax Reform Act to the active and effective participation of Internal Revenue Service in combating organized crime, particularly narcotics trafficking.

I hope to brief my statement, and so I would like to enter it fully in the record.

Senator BAUCUS. It will be included.

Senator CHILES. A series of hearings by the Permanent Subcommittee concerning narcotics profits, and a hearing I chaired for the Appropriations Subcommittee on Treasury, Postal Service, and General Government, graphically illustrate both the explosion of drug trafficking in this country and the unique and indispensable function that IRS can perform in identifying and immobilizing narcotics traffickers.

Over the last decade, we witnessed such a growth in drug use and drug trafficking that narcotics now seem an integral part of the American scene. There is no segment of our society, no income level, no age group that is immune. In fact, the media recently reported on a study done by Health and Human Services that shows amazing increases in the use of marihuana, cocaine, and in fact, all of the major illicit drugs across the board in American society.

Our hearings portraying illegal drugs as a multibillion dollar worldwide business, which is so large and so sophisticated in its operations that present law enforcement efforts are simply overwhelmed in trying to combat it. It is a business that generates upwards of $50 billion in revenue per year.

For my own State of Florida, which has become a focal point for drug smuggling from Latin America, the dimensions of the narcotics trade are staggering. Marihuana and cocaine trafficking represent one of the State's largest commercial activities. It is a $7 billion a year industry which has a tremendous impact on our economy. Estimates are that the price of a house in south Florida

has been inflated over $2,000 as a direct result of untaxed drug money funneling into the real estate economy.

With the health and economic impact of the illicit narcotics trade also comes violent crimes. In 1976, in south Florida, there were 60 drug-related murders, and projections for this year are even higher.

The fact is inescapable that our present enforcement strategy is not successfully coping with the narcotics onslaught. If we are to reverse that situation, it is going to take a commitment of all the means and resources available. The financial investigative ability of IRS is certainly a major resource that in recent years has not been effectively employed in the drug law enforcement effort. There is an obvious need to use the tax laws and IRS in investigating the drug trade. The General Accounting Office has pointed out that the financial expertise and knowledge of money flow which only IRS possesses is vital in pursuing major narcotics traffickers. And yet the Justice Department has testified that the IRS has minimized, if not eliminated, its role in nontax enforcement, and devotes itself almost exclusively to the voluntary tax collection system.

That has meant a critical loss to the Federal Government's law enforcement capacity. A few relevant facts paint a very clear picture.

In 1974, IRS had $20 million and 779 positions in their narcotics program. The fiscal year 1981 request is for $8 million, and only 185 positions. Since its effective date of 1977, the organized strike force inventory of joint IRS cases has declined from well over 600 investigations to now less than 300. IRS now devotes less than 5 percent of its criminal investigative resources to narcotics matters.

Now, that is a startling figure, I think, Mr. Chairman, because when I point out that their budget has dropped from $20 million to $8 million, that is in the narcotics program. But then when you realize that in their total investigative resources, in criminal matters, they are only using 5 percent of that for narcotics matters, it gives you an idea of the importance that IRS is now attaching to combating narcotics trafficking.

Senator BAUCUS. At that point, do you know what the other 95 percent of its criminal investigation is devoted to, roughly?

Senator CHILES. Well, a good part of it is enforcing just the normal tax. You know, we talk about the waitress over and over, and perhaps we overdo that case, but just seeing that the regular and ordinary taxpayer is paying his taxes, and when they find a return that looks like it is out of balance, and it turns out to require criminal investigations, then most of those moneys would be going for that. They are not going either at organized crime targets or at the narcotics traffickers.

Senator NUNN. Mr. Chairman, on that point, if I could interject, if you talk to prosecuting attorneys around the country, which we have, some privately and some on the record, you will find that they are increasingly frustrated by what they call the IRS tendency toward going after the "ma and pa" type cases.

Now, that doesn't mean that you should excuse fraud at any level, but they are spending most of their investigative resources today on the very minor type cases in the views of the criminal

prosecutors. They are not going after the people at the top, and if the ordinary taxpayer believes they are being protected under this, or let's say the ordinary citizen who may fudge a little bit on their taxes, they are wrong, because they are the ones who are receiving the brunt of IRS's effort—babysitters who don't report, "ma and pa" grocery stores who have some problems, waitresses who may not report all their tips—that is where the vigorous arm of the Federal Government is coming down today, rather than on narcotics traffickers and people at the top.

We have exempted the top criminals, and are going after those at the very bottom. That is what is happening.

Senator CHILES. The breakdown is approximately 75 percent for ordinary taxpayers, about 20 percent to organized crime, and then 5 percent to narcotics. So you can see how they are spending that.

Senator NUNN. Thank you very much.

Senator CHILES. A special agent in the Criminal Investigative Division of IRS testified before the Permanent Subcommittee, and he said the enactment of the Tax Reform Act in 1976 has had a devastating and debilitating effect on the Criminal Investigative Division, particularly the provisions dealing with disclosure and summons enforcement. The ability of special agents to develop high level narcotics, organized crime, and white-collar investigations has been severely curtailed due to the rigid guidelines of the act.

The rigid guidelines for disclosure under the Tax Reform Act have for the most part halted the exchange of pertinent information between concerned enforcement agencies which has had an adverse impact on identification of major suspects, collection of evidence, and the pinpointing of huge sums of untaxed dollars controlled by criminal cartels.

I think a point that Senator Nunn made, but I think we need to continue to emphasize, is that the enactment of the Tax Reform Act of 1976 is what everybody pinpoints as the time in which the decline began. Also our hearings disclose that the Tax Reform Act is not the only cause in IRS's decline. There has been a general withdrawal from nontax law enforcement and it was not all caused by the Tax Reform Act.

That was just the point when they changed their whole strategy. Now I think their strategy is, or their rationale is, we are to be the tax collector. That is all we should be doing. The impartial tax collector. We are not supposed to go out and catch criminals. That is not our job. We are just supposed to see that people pay their taxes. So, we spend as much time on a waitress as we do on an organized crime kingpin.

That philosophy is one of the things that we have to change. I think it is awfully important that we take away the pretext, which was the act, that they used to change their philosophy. In addition, I think the Congress, as the public policy setter, and I hope the administration, too, by the voice of the President, speaks and says that we do expect IRS to not simply treat organized crime as it would an ordinary taxpayer, that it is and should be a major part of their role to try to combat the organized crime figures, and to try to do something about narcotics trafficking, which is having such a debilitating effect on our Nation.

Mr. Chairman, I know Senator Percy has his statement, and I know you have questions. I want to save a little more of your time. Senator Nunn has covered many of the points in regard to the act itself. I can just tell you that Florida is in a state of siege virtually by what is happening with illegal activities and the narcotics dollars.

We never know. They have war wagons now that the cocaine cowboys equip and drive around in, and one of those war wagons is a fancy new van that they put armor plating on, that they equip with slots that they can shoot out of the side of if they want to. They arm them to the teeth, and then they go and commit murders in broad daylight, in shopping centers, and they have terrorized the witnesses to the extent that our law enforcement people tell us that people don't want to testify against them.

Even the Mafia used to be a little more sophisticated in who they would decide to hit, and how they would carry out their crimes. But the so-called cocaine cowboys, which is basically a Colombian group, have no sophistication in that. They will go in broad daylight, and the fact that they are spraying a parking lot with hundreds of rounds of automatic weapons fire and hitting innocent people makes no difference to them whatsoever.

We had 60 drug murders last year, and it looks like we are going to have more than that this year. We are seeing that we have had a hit contract in which $1 million was offered to hit a Federal judge that was trying a case down there. We have had contracts out on the prosecutors that are trying to prosecute that. These offenders routinely carry $1 million in cash, in a briefcase, along with them, so that they can buy their way out of any situation they get into.

We are under water with the situation in Florida. We are trying desperately to find every way we can to deal with this problem. We know a major point is bringing the IRS back into the act with respect to the big time narcotics operators.

The local law enforcement agencies will tell us that the equipment that the smugglers have and that the drug dealers have is so much more sophisticated than theirs. The only thing they hope for is that they can seize a boat, that they can seize some communication equipment, and then try to use it against the traffickers.

So, we are almost like the ragged army in the field. We have got to take the weapons away from the enemy, and try to use them on the enemy, because we don't have their kind of dollar resources. They have the most sophisticated communications equipment and navigation equipment. They are using computers. They are using jamming devices. They monitor all of our radio channels. It is so organized that it is like they have taken over.

We desperately need help. Getting the IRS back into drug law enforcement is just one aspect of the help we need. But it is an important part.

I appreciate very much your holding this hearing today and giving us an opportunity to testify.

Senator BAUCUS. Thank you very much, Senator Chiles.

There is one question I have regarding the cocaine cowboys: To what degree will the accessibility of tax information stop the cocaine cowboys? It seems to me that there is a lot of illegal drug

trafficking—sophisticated drug trafficking, they are going to proceed, as much as possible, on a cash basis, and they will do what they can to hide a lot of this income.

I am wondering whether making tax returns more available will significantly reduce the incidence of the kinds of events you are describing.

Senator CHILES. Well, I think it has to help, because all of this money they eventually try to launder, and then channel it into legitimate business. They come in, try to buy property. They try to buy the businesses with those illegal gains. So only when you are able to seize the apparatus and seize the assets that they have been able to accumulate are you going to be able to do something with them.

You know, generally when you catch someone, a lot of times you are catching someone in the lower ranks, especially in a regular law enforcement job where you have a stakeout, where you catch the truck, where you catch a load of narcotics in that truck.

It is the only way you get to the people at the top, and there are people at the top of even the cocaine cowboys, which seem like a very disorganized thing—it is pretty well organized at the top. At the top, those people have literally millions of dollars. They are investing that money, they are buying equipment, they are increasing their drug operation. There are all kinds of assets there, and you have got to have IRS to help follow the paper transactions.

Their money goes into the offshore banks, where it is laundered in the Cayman Islands. It comes back in, and buys assets and buys property. So, I think it is very necessary that we get IRS, because they have got the people that can follow the bank transactions, the paperwork transactions. A lot of this money, as you have been reading about, has been taken to our banks in the form of cash, even, and deposited there, and put through two or three accounts.

Again, when you start trying to trace those accounts, it is IRS that has the people that know how to do that.

Senator BAUCUS. Before 1976, how many successful criminal prosecutions were there for evasion of tax laws compared with successful prosecutions of narcotics laws?

Once again, I am wondering the degree to which the availability of tax information will lead to a greater incidence of successful prosecutions for violation of the tax laws.

Senator CHILES. Well, I will have to furnish better information from the record, but I will just point out that when you really look at organized crime figures, the cases that we were able to make against some of the organized crime figures were tax cases. We only got Al Capone on taxes. We never could get him any other way. He insulated himself so much. Lucky Luciano we picked up on tax cases. And if you follow most of the organized crime figures, you see that net worth cases were the basis of the successful prosecutions. The same thing certainly can be used with narcotics traffickers.

Now, to start with the narcotics thing. It is fairly new, it started and got ahead of the organized crime figures. They weren't in it. Especially in the Florida operation, which I know a little bit more about. It came up through Latin America, and it was basically the Latinos that were involved in it, but now—we have got a black

Mafia, we've got a Dixie Mafia in Florida. There is a Jewish Mafia, and then we've got the Latino groups.

So, you know, we can find a place for everybody from the Presbyterians down that somewhat get involved in the trafficking business. But to start with, it was not the so-called organized crime figures, and by that I mean that traditional Mafia figures were not in it. But it was so lucrative and so big in the last several years, they have very definitely gotten into it, and are very much a part of it.

So, now it could be very, very useful to have tax cases and IRS people working on it.

Senator BAUCUS. Thank you very much, Senator Chiles.

[The prepared statement of Senator Chiles follows:]

STATEMENT OF SENATOR LAWTON CHILES

Mr. Chairman, I appreciate having the opportunity to testify this morning in support of legislation which I consider of paramount importance. The several bills under consideration by the Subcommittee are aimed at removing unnecessary impediments in the the 1976 Tax Reform Act to the effective participation of the Internal Revenue Service in combatting organized crime, particularly narcotics trafficking. In my view it is essential that the IRS play an active and aggressive role in the investigation of major narcotics traffickers and it is equally essential that the Congress rectify the provisions in current law that hamper the IRS in fulfulling that role.

A series of hearings by the Permanent Subcommittee on Investigations concerning illegal narcotics profits and a hearing I chaired for the Appropriations Subcommittee on Treasury, Postal Service and General Government graphically illustrated both the explosion of drug trafficking in this country and the unique and indispensable function the IRS can perform in identifying and immobilizing narcotics traffickers.

Over the last decade we have witnessed such a growth in drug use and drug trafficking that narcotics now seem an integral part of the American scene. There is no segment of society, no income level, no age group that is immune. What has become starkly clear in recent years is that we are losing the battle to stem the flow of illegal drugs.

Our hearings portrayed illicit drugs as a multibillion dollar, worldwide business which is so large and so sophisticated in its operations that present law enforcement offorts are simply overwhelmed in trying to combat it. It is a business that generates upwards of $50 billion in revenues a year. For my own State of Florida, which has become a focal point for drugs smuggling from Latin America, the dimensions of the narcotics trade are staggering. Marihuana and cocaine trafficking represent one of the State's largest commercial activities. It is a 7 billion dollar a year industry which has tremendous impact on the economy. Estimates are that the price of a house in South Florida has been inflated over two thousand dollars as a direct result of untaxed drug money funneled into the real estate economy.

And with the health and economic impact of the illicit narcotics trade also comes violent crime. In 1979 in South Florida there were sixty drug related murders and the projections for this year are even higher.

The fact is inescapable that our present enforcement strategy is not successfully coping with the narcotics onslaught. If we are to reverse that situation it will take a commitment of all the means and resources available. The financial investigative ability of the IRS is a major resource that in recent years has not been effectively employed in the drug law enforcement effort.

There is an obvious need to use the tax laws and the IRS in investigating the drug trade. The General Accounting Office has pointed out that the financial expertise and knowledge of money flow, which only IRS possesses, is vital in pursuing major narcotics traffickers. And yet the Justice Department has testified, "the IRS has minimized, if not eliminated, its role in non-tax law enforcement and devotes itself almost exclusively to the voluntary tax collection system. * * * This has meant a critical loss to the Federal Government's law enforcement capacity."

A few relevant facts paint a very clear picture:

In 1974 IRS had $20 million and 779 positions in their narcotics program. The Fiscal Year 1981 request is for only $8 million and 185 positions.

Since its effective date of 1977, the organized strike force inventory of joint IRS cases has declined from well over 600 investigations to the about 300.

IRS now devotes less than 5 percent of its criminal investigative resources to narcotics matters.

A primary reason for the IRS' lack of participation in non-tax law enforcement stems from the Tax Reform Act of 1976. In passage of this measure, Congress took necessary steps, in light of the Watergate disclosures, to insure the privacy of tax returns. However, the unintended effect of these provisions has been to greatly hinder cooperation and coordination between IRS and other law enforcement agencies.

A former Special Agent in the Criminal Investigations Division of IRS testified before the Permanent Subcommittee on Investigations that: The enactment of the Tax Reform Act of 1976 has had a devastating and debilitating effect on the Criminal Investigations Division, particularly the provisions dealing with disclosure and summons enforcement. The ability of Special Agents to develop high level narcotics, organized crime and white collar investigations has been severely curtailed due to the rigid guidelines of the Act. * * * The rigid guidelines for disclosure under the Tax Reform Act have for the most part halted the exchange of pertinent information between concerned enforcement agencies which has had an adverse impact on identification of major suspects, collection of evidence and the pinpointing of huge sums of untaxed dollars controlled by criminal cartels.

The law enforcement difficulties presented by the Tax Reform Act of 1976 became apparent soon after its enactment. In fact, in his 1977 Drug Message to the Congress, President Carter pointed out his concern that the disclosure and summons provisions may serve to unnecessarily impede the investigation of narcotics trafficking cases.

These provisions of the Tax Reform Act have contributed significantly to our present rather astounding situation that IRS is for all practical purposes not assisting other Federal agencies in investigating illegal narcotics operations. As a result of the Act and its implementation by the Service, a number of negative effects from an enforcement standpoint have developed:

The Service is now unable to adequately advise other Federal agencies of the cases it is working on, thus precluding close coordination and encouraging needless duplication of effort.

It has become unreasonably difficult for prosecutors and investigators from other agencies to obtain financial information held by the IRS that would significantly assist in the prosecution of major criminals.

It is extremely difficult for the IRS to provide to prosecutors or other Federal investigative agencies evidence concerning non-tax criminal violations which the Service obtains in the normal course of its investigations.

In those relatively few instances when other agencies are able to work with the IRS, the time delays involved significantly undermine the benefits to be derived.

The legislation (S. 2402, S. 2403, S. 2404 and S. 2405) introduced by Senator Nunn, myself and a number of cosponsors, seeks to strike a more appropriate balance between the individual right to privacy and legitimate law enforcement needs for information. It fully recognizes the primary function of the IRS of collecting taxes and the need of American citizens to be assured of the confidentiality of their tax returns. What it aims to eliminate are needless obstacles in the law to the effective detection and prosecution of criminals.

With respect to the disclosure provisions of the Tax Reform Act of 1976, the most significant problem arises in the section of the law dealing with disclosure of tax information from IRS to Justice for non-tax criminal cases. Our legislation would retain the important privacy requirement of a court order for release of tax returns or information required of the taxpayer by the Government. However, it would place the responsibility on IRS to notify the Justice Departemnt whenever its agents uncover information of a possible criminal violation. The IRS would be compelled to give the Justice Department enough information so that its attorneys could seek disclosure. This would serve to end the present Catch-22 situation in which prosecutors don't know that IRS has information which they could and should request.

In the case of third party information, our amendments would allow government attorneys to request this type of intelligence directly from IRS, which would be under a duty to disclose it unless the IRS Commissioner determines that disclosure would identify a confidential informant or seriously impair a tax investigation. In the latter case, IRS could apply to the courts to prevent disclosure.

On the question of the summons provision, existing law allows a taxpayer to prevent a third-party recordkeeper from complying with an IRS summons simply by serving notice on them not to comply. This provison has worked mainly to the

advantage of sophisticated criminal elements who invoke the automatic stay in order to delay the Government's case against them. Our proposal maintains the right of the taxpayer to contest an IRS summons. However, the taxpayer would be required to file a motion in district court to quash the summons. Thus, a taxpayer would no longer be able to delay an IRS investigation by automatic stay. This change would represent an important improvement in terms of facilitating timely and successful government prosecutions.

The final two bills, (S. 2404 and S. 2405) amend existing provisions of the Internal Revenue Code with regard to criminal and civil penalties for unauthorized disclosures. S. 2404 authorizes Federal employees an affirmative defense for disclosures that result from a good faith but erroneous interpretation of the law. This would serve to clarify that criminal sanction are to be applied only in the case of an intentional disclosure. S. 2405 would hold the government, rather than the affected employee, liable to civil damages in the event of a good faith disclosure.

I think the changes we are proposing in the Tax Reform Act are important from more than one perspective. As I have indicated, I believe that Tax Reform Act must be amended in order that the Internal Revenue Service can be a full and effective partner with other Federal agencies in the drug law enforcement effort. I also feel that passage of this legislation will serve as a strong signal to the narcotics traffickers that we are serious about stopping the drug trade and will employ all the resources of the Federal government to accomplish that goal.

I am very pleased that the Subcommittee is holding this hearing and I look forward to its serious consideration of these several bills. I do appreciate the opportunity to offer these comments.

Senator BAUCUS. Senator Percy, you have been waiting very patiently here, and as ranking member of the full committee, your patience is very much appreciated.

STATEMENT OF HON. CHARLES H. PERCY, A U.S. SENATOR FROM THE STATE OF ILLINOIS

Senator PERCY. I would like to comment first that Senator Chiles is acting here in two capacities, as a member of the current investigating subcommittee, but also as Chairman of the Subcommittee on Treasury, Postal Service, and General Government of the Committee on Appropriations. Senator Chiles requested that GAO study this legislation, and GAO has presented a report to us dated June 17. I would really recommend that all members of this committee read this report because it is extraordinarily good.

I am saddened to hear the story about organized crime in Florida, my native State. Florida seems to be in competition with the State I have spent most of my life in, Illinois. The activities of organized crime members in Cook County and Chicago have become very well known through the years.

It is indeed unfortunate that the tactics developed by Al Capone and others of his kind have now spread into Florida. I don't know whether narcotics trafficking is a $7 billion business in Illinois as well, but Chicago's image as a narcotics haven has lasted for scores of years, largely because of the flagrant activities of some of our hoodlums and gangsters in the past.

This same trend, now apparent in Florida, is an insidious one which can ruin a society, ruin the quality of life in an entire region.

Al Capone, under existing laws, could never have been caught. Even in the 1930's when IRS was cooperating closely with the Justice Department, Al Capone was able to dominate the Chicago crime scene. He had a hand in bootlegging, gambling, prostitution, and an estimated 200 gangland killings, yet he had a unique ability to always be miles away from the scene of the crime.

Al Capone never paid for anything by check. He never signed a receipt. Instead he kept a strongbox under his bed. He was indicted several times, once for over 500 prohibition violations, yet the charges were dismissed—witnesses kept disappearing. Not until 1931, after his conviction on tax evasion—and that was no easy task—was he ever jailed, after years of operation as one of the most notorious criminals this country has ever seen.

Today's criminals are using these same tactics, and the IRS has its hands tied. The Justice Department cannot obtain the kind of information needed to prosecute organized crime figures.

For this reason, the Senate Permanent Subcommittee on Investigations, on which I am the ranking majority member, held 5 days of hearings, and I do wish to commend very much the way in which the majority and minority staffs have worked together. The hearings were a major effort on the part of Marty Steinberg, chief counsel for the majority and I commend him, and Chairman Nunn for bringing him onboard. Jerry Block, our chief counsel, has been privileged to work with such a fine staff.

The legislation that we have before this committee now, which would amend the disclosure and summons provisions of the 1976 Tax Reform Act, is meritorious legislation, I would like to read a sentence from the GAO report requested by Senator Chiles.

GAO says:

> Basically, the Senate bills seek to strike a better balance than now exists between legitimate private concerns and equally legitimate law enforcement information needs. We support the overall thrust of the bills, because the record first indicates a need for legislative revisions aimed at strengthening the government's ability to detect and prosecute criminals.

I ask unanimous consent that the full text of my comments be incorporated in the record.

Senator BAUCUS. Without objection.

[The prepared statement of Senator Percy follows:]

TESTIMONY OF SENATOR CHARLES H. PERCY

Mr. Chairman, I am very pleased to accept your invitation to appear this morning to speak in support of S. 2402, 2403, 2404, and 2405, legislation which would amend the disclosure and summons provision of the 1976 Tax Reform Act. These are measures that Senator Sam Nunn, our distinguished Chairman of the Permanent Subcommittee on Investigations, along with myself, Senator Chiles, Senator Cohen, Senator Ribicoff, Senator Talmadge, Senator DeConcini, and your most distinguished Chairman of the Finance Committee, Senator Long, introduced in March of this year.

I believe that the Permanent Subcommittee on Investigations has established a need for this legislation. Last December, we held five days of hearings on the huge amounts of illegitimate profits being made by big-time narcotics traffickers, and on the role of IRS in investigating both narcotics trafficking and other aspects of organized crime. What we heard was far from encouraging.

In 1978, the government estimates that Americans spent $44 to $63 billion on illegal drugs. It is an incredible sum, rivaling in gross income all but the very largest corporations. We heard testimony from both federal and state prosecutors about the narcotics money flow that annually sends billions of dollars out of the country. Couriers walk into banks or currency exchanges in Florida, California and other states with hundreds of thousands of dollars in cash. The money is often carried brazenly in shopping bags, suitcases or even cardboard boxes. The money then may undergo a series of paper transfers through several fictitious accounts, ultimately destined to be wired to off-shore banks, or converted into cashiers checks to be carried out of the country.

Unless something is done to stop today's sophisticated drug pirates, we can expect serious damage to the economic and political fabric of the nation. Arresting the street corner pusher, although necessary, will not end the problem. The big money

is going to people who never touch the contraband. No matter how effective our drug interdiction program or trafficking laws may be, this upper echelon of crime operates with no fear of arrest. Yet, these people, who are orchestrating these illegal operations and are gleaning enormous profits, are the very ones we need to put out of business. The key to investigating, prosecuting and convicting them rests in the profits they make. They are vulnerable only to the most complex and detailed financial investigations.

A case in point is one of the nation's most notorious gangsters. For years, Al Capone dominated the Chicago crime scene, having a hand in bootlegging, gambling, prostitution, and an estimated 200 gangland killings. Yet he had the unique ability to be miles away from the crimes he masterminded. He was indicted several times, once for over 5,000 prohibition violations, but the charges were always dismissed, or the witnesses disappeared. He only went to jail in 1931 after a conviction of tax evasion, and that was no easy task.

Capone never maintained a bank account, never signed a check or receipt, never bought property in his own name. He paid for everything in cash out of a strongbox he kept under his bed. IRS went after him on the basis of his net worth and net expenditures. After combing sales records throughout Chicago, including the number of towels he took to the laundry, he was brought to trial on 22 counts of tax evasion. Despite his attempts to have the tax agents testifying against him killed, and to bribe and intimidate the prospective jurors, he was convicted and sentenced to 11 years in prison. It is no wonder that organized crime kingpins have always feared the IRS.

Federal, state, and local law enforcement officials believe that the IRS should be one of the most effective agencies in combatting narcotics traffickers and organized crime. Yet, these officials say the IRS has been virtually eliminated from the fight against crime.

The Subcommittee hearings revealed two major reasons for this. First, the change in leadership at IRS in the 1970's brought about a very different and negative attitude toward involvement in law enforcement activity. Second, the passage of the Tax Reform Act of 1976 severely limited the disclosure of personal and corporate tax information from the IRS to other law enforcement agencies, and reinforced the change in attitude at the top.

In 1974, the incoming Commissioner of IRS altered the existing policy of selective enforcement which placed a heavier emphasis on investigations of the more severe tax-evasion violation; for example, organized crime and narcotics traffickers. He prompted a policy of impartial enforcement, which meant more investigations of ordinary taxpayers. This change produced a dramatic shift in manpower away from pursuit of organized crime. In 1974, the 80,000-person agency applied 927 total staff years to tax investigations of suspected narcotics traffickers. Five years later, in 1979, the number of staff years was 300. What makes this reduction in resources even more upsetting is the dramatic increase in the flow of drugs into this country during that period.

I am certainly not suggesting that IRS fundamentally change its priorities. IRS is, first and foremost, the world's best and most efficient tax collector. We all recognize that this awesome task is the principal function of IRS. I applaud the extraordinary competence they display in monitoring and enforcing the world's largest voluntary compliance system of tax collection. The fact of the matter is, however, that in securing voluntary compliance, the best publicity that IRS could possibly receive is a front page headline announcing that IRS has obtained the conviction of a mobster who failed to pay his taxes.

The expertise that IRS agents possess in pursuing a complex paper trail of financial transactions is often essential in ferreting out white-collar crime, political corruption, and the upper levels of narcotics trafficking. This is a point that was stressed time and time again during our hearings by representatives of DEA, FBI, Justice, and present and former IRS agents themselves. Traditionally, the IRS has been the last resort in bringing sophisticated criminals to justice. By not being able to resort to the expertise of the IRS, the government is giving up the ultimate weapon it has.

This is, to me, an extremely important point. In order to prosecute the people at the top of the criminal syndicates who never involve themselves in the actual criminal acts, and in order to make the best use of the criminal forfeiture statutes we have enacted to strip away assets obtained through illegitimate sources, we must have the cooperation of IRS with federal law enforcement agencies. It is beyond dispute that those who earn their living through crime must pay taxes like anyone else. Every sale of narcotic drugs is potentially both a tax and non-tax crime. The coordination of government efforts to put a stop to this is imperative.

The disclosure provisions of the Tax Reform Act of 1976 were well intended to protect the privacy of the individual. Revelations during Watergate of the attempted use of IRS to harass and torment political foes shocked and angered the country. The Senate Select Committee to Study Governmental Operations with Respect to Intelligence Activities, chaired by Senator Frank Church—the Church Committee—reported on instances of government agencies abusing their intelligence gathering activities. IRS was, indeed, one of those agencies (see Final Report, Book III, pp. 835–920). Requests by other agencies for the tax returns of anti-war protesters and civil rights activists were granted routinely with no reasons stated for the need of such information, and no questions asked by IRS.

Additionally, the Privacy Protection Study Commission created by the Congress in the Privacy Act of 1974 urged the Congress to take note of the extraordinary power given to IRS to compel citizens and to provide detailed and personal information about themselves, and to prohibit the transfer and use of that information for non-tax purposes.

The Congress acted quickly to put an end to the abuses. In 18 U.S.C. 6103(i), the Congress set forth very tight and detailed restrictions on disclosures, including the obtaining of a court order for the transfer of most IRS gathered information.

We must not, and will not, abandon those protections intended to ensure the confidentiality of the tax return and the constitutional right of privacy. But, we must move vigorously to remove any unnecessary handicaps to effective law enforcement by making refinements in the existing law. In the 3 years during which the act has been in operation, the evidence demonstrates that the law has been too effective in limiting the transfer of information; it has practically put an end to cooperation between IRS and other law enforcement agencies. We must "fine tune" the Tax Reform Act and reach a balance between legitimate privacy interests and the equally legitimate need for effective law enforcement.

In our Subcommittee, we heard testimony from representatives of the Department of Justice, the Drug Enforcement Administration, the Federal Bureau of Investigation, past and present employees of the Internal Revenue Service, and the General Accounting Office. All of these witnesses felt strongly that adjustments were needed in the Tax Reform Act to permit IRS to share relevant information with other agencies and join with them in conducting complex criminal financial investigations. We were told of the Catch-22 situation which now exists whereby the person requesting the tax return information must swear that the information held by IRS is the best available evidence on a specific issue before receiving and evaluating that information.

We were told of delays of a year or more as requests for information worked their way up bureaucratic chains-of-command. We were told of instances in which IRS came across information in a taxpayer's records clearly indicating bribery and kickbacks but could not reveal that information to the FBI (and, of course, the FBI could not request that information because it remained unaware of it). We were told by one former IRS agent who resigned in frustration that several of the successful prosecutions for political corruption that he worked on prior to 1976 would have been stopped dead in their tracks by the Tax Reform Act disclosure provisions.

We should not be fighting organized crime with one hand tied behind our back. That is why I was pleased to join with Senator Nunn in co-sponsoring these four pieces of legislation.

Three of the measures involve the disclosure provisions of the 1976 Tax Reform Act. The first makes substantial changes in section 6103. Let me briefly describe what the measure would do.

The crucial element of section 6103 remains under our proposal; that is, before the Justice Department, FBI, DEA, or any agency can obtain a tax return (or any other taxpayer information required to be filed) from IRS, they must first obtain a federal court order to do so.

The criteria for granting such an order and the persons who may apply for it are different than under present law. Under the proposal, an attorney for the government, including the U.S. Attorneys and strike force chiefs, may seek the court order. They must prove to the satisfaction of the federal district court that their request to see a tax return is first pursuant to a lawful criminal investigation or proceeding, and second that they have reasonable cause to believe that the return is material and relevant to that investigation.

I believe that this standard, if rigorously applied by the court, is sufficient to ensure that the tax return information is not being obtained for corrupt political motives. However, in order to further ensure against any kind of "fishing expedition" for tax records, I would retain what is presently the first requirement for a court order, namely, that there is reasonable cause to believe a federal crime has been committed.

Allowing the request to be made by an attorney for the government rather than "the head of any federal agency," as present law reads, ensures review by an experienced prosecutor and removes a considerable amount of bureaucratic delay from present practice. To further ensure that seeking a tax return does not become an endurance test of months or even years, the measure sets forth strict time limits for ruling on and complying with the court order.

Under present law, IRS may turn over information it uncovers of a non-tax crime, if that information is not "taxpayer return information" (which includes not only the tax return, but virtually all books and records furnished to IRS by or on behalf of the taxpayer). Because of uncertainties about what is included under this definition, and because of severe penalties for unauthorized disclosure, very few IRS agents have been willing to take a chance, and risk running afoul of the new law.

Our proposal would essentially provide that IRS shall turn over to the appropriate agency any evidence of non-tax crimes that may be discovered, other than information coming from the tax return itself.

My own view is that IRS ought to be obliged to turn over prima facie evidence of a non-tax crime. I agree with the proposed procedure outlined by the GAO in their June 17, 1980 analysis of S. 2402 which would have IRS present any such information of a non-tax crime to a court before disclosing it to the Justice Department.

Mr. Chairman, in co-sponsoring this legislation, I noted that I had several reservations about certain provisions, such as the new definitions of "return" and "non-return information" which determine when a government attorney must seek a court order to acquire information in the hands of IRS. While I have not fully made up my mind on this particular issue, I am inclined to agree with the GAO, the American Civil Liberties Union and others that both individual and corporate books and records should be disclosed only upon obtaining a court order. We must be mindful of the tremendous power IRS has to compel all of us to reveal our lives through our financial transactions. This is not to say that these records shouldn't be made available upon a showing of specific need. But I an not yet convinced that we should allow disclosures of this kind without judicial review.

In order to enforce the provisions of the Tax Reform act, Congress provided in 26 U.S.C. 7213 and 7217 very stiff criminal and civil penalties for unauthorized disclosure. There should be severe penalties for a willful violation of the disclosure provisions. But, present law should be modified to the extent that an IRS agent who seeks in good faith to comply with the law need not fear a crippling lawsuit or even criminal prosecution with a maximum sentence of 5 years in jail. Our amendment to section 7213, the criminal violation, adds as an affirmative defense that a disclosure was based on a good faith (alebit mistake) interpretation of the disclosure provisions. Our amendment to the civil liability section provides that an individual agent would still remain liable for any willful, or malicious violation of the act. However, if an unauthorized disclosure were made, which was not willful, and which occurred while the agent was acting within the scope of his employment, the government would be liable for damages.

The final proposal would not affect the disclosure provisions, but would correct an incredible source of delay in the summons provisions of the act, 26 U.S.C. 7609.

During the course of a tax-related investigation, IRS agents may issue an administrative summons for a taxpayer's books and records which are in the hands of a third party, for example, a bank, an attorney or an accountant. Under present law, the taxpayer will receive advance notice and has an automatic right to stay performance for the summons until IRS can get a court order to enforce it. Until the summons is enforced in court, the investigation is delayed. Often that takes up to a year. One automatic stay lasted 33 months. The average is 9 months. Of course, when additional records are sought in an ongoing investigation, the same delays can occur. A routine case can be stretched interminably under these conditions. What is most disturbing about this is that an overwhelming majority of those who stay compliance never intend to challenge the summons in court. Indeed, over 80 percent of those who stayed compliance did not even appear in court to argue against enforcement.

The proposed bill still requires advance notice to the taxpayer. It still allows the taxpayer to challenge the summons in court. However, it is the taxpayer who must go to court to seek the stay. This can still be easily done by filing motion papers provided by IRS along with the notice. However, it is no longer an automatic delay. This proposed procedure is similar to what Congress provided for every other federal investigative agency under the Financial Privacy Act.

Mr. Chairman, I again thank you for the opportunity to appear and for holding these hearings. It is extremely important that everyone in the Congress, in the law enforcement community, and especially those individuals and organizations dedicated to protecting individual privacy and civil liberties have an opportunity to fully

and completed scrutinize these measures and express their respective concerns. This will allow us to make certain that we have correctly balanced our competing values. Finally, I want to thank Senator Nunn and his fine staff for the work they have put into this legislation. I support him in this undertaking, and I believe we can accomplish much in this area without jeopardizing our most basic and important individual rights.

Organized crime and big-time narcotics trafficking ought to rank high on this nation's list of law enforcement priorities. Every legitimate tool at the government's disposal should be used to end their criminal activities.

Senator PERCY. I would like to make a few more comments.

First, we must not underestimate the size of this illicit business. This was dramatically illustrated the day Peter Bensinger, head of the Drug Enforcement Administration, appeared as witness, and dumped $3.5 million in cash—representative of narcotics trafficking profits—on the table before us.

This money was found in a pickup truck, and was never claimed. This is the way drugs are generally paid for—in cash.

We can compare the profits of other industries to put narcotics profits in perspective. The tobacco business is a good sized business in this country, and profits now reach a total of $19 billion.

The total sales of the liquor industry total now equal $34 billion.

Profits of illegal drug business in this country, according to the Drug Enforcement Administration, are between $44 and $63 billion a year. Now, the combined profits of the tobacco and liquor industries are only $53 billion. Furthermore, the profit margins of the narcotics industry are astronomical compared to the profit margins under legitimate competitive enterprises are incredible, as virtually no taxes are being paid on narcotics earnings. If taxes are paid, they appear on return, indicating to the IRS that someone is engaging in illegal activity, and yet the IRS cannot inform the Justice Department of this activity.

Unless something is done to stop today's sophisticated drug pirates, we can expect serious damage to the economic and political fabric of the Nation. Arresting the street corner pusher, although necessary, will not end the problem. The big money is going to people who never touch the contraband. No matter how effective our drug interdiction program or trafficking laws may be, this upper echelon of criminals operates with no fear of arrest.

The key to investigating, prosecuting, and convicting these criminals rests in the profits they make. They are vulnerable only to the most complex and detailed financial investigations, and certainly most law enforcement officials, local, and State, are simply incapable of coping with the sophistication of this syndicate.

Federal, State, and local law enforcement officials believe that the IRS should be one of the most effective agencies in combating narcotics traffickers and organized crime. Yet these officials say the IRS has been virtually eliminated from the fight against organized crime.

The subcommittee hearings revealed two major reasons for this. First, the change in leadership at IRS in the 1970's brought about a very different and negative attitude toward involvement in law enforcement activities. Second, the passage of the Tax Reform Act of 1976 severely limited the disclosure of personal and corporate tax information from the IRS to other law enforcement agencies, and reinforced the change in attitude at the top.

The expertise that IRS agents possess in pursuing a complex paper trail of financial transactions is often essential in ferreting out white collar crime, political corruption, and the upper levels of narcotics trafficking. This is the point that was stressed time and time again during our hearings by representatives of DEA, FBI, Justice, and present and former IRS agents themselves.

The disclosure provisions of the Tax Reform Act of 1976 were well intended to protect the privacy of the individual. Revelations during Watergate of the attempted use of IRS to harass and torment political foes shocked and angered the country. Requests by other agencies for the tax returns of antiwar protestors and civil rights activists were granted routinely, with no reason stated for the need for such information, and no questions asked by IRS.

The Congress acted quickly to put an end to the abuses. In 18 U.S.C. 6103, the Congress set forth very tight, detailed restrictions on disclosure of tax information, including the obtaining of a court order for the transfer of most IRS gathered information.

We must not and will not abandon those protections intended to insure the confidentiality of the tax return and the constitutional rights of privacy, but we must move vigorously to remove any unnecessary handicaps to effective law enforcement by making refinements in the existing law.

In our subcommittee we were told, as Senator Nunn has mentioned, of the catch 22 situation which now exists whereby the person requesting the tax return information must swear that the information held by IRS is the best available evidence on a specific issue before receiving and evaluating that information.

We were told of delays of up to a year or more as requests for information work their way up the bureaucratic chains of command. We were told of instances in which IRS came across information in a taxpayer's records clearly indicating bribery and kickbacks, but could not reveal that information to the FBI, and of course the FBI couldn't possibly request the information because it really was unaware of its actual existence.

We were told by one former IRS agent who resigned in frustration that several of the successful prosecutions for political corruption that he worked on prior to 1976 would have been stopped dead in their tracks by the Tax Reform Act disclosure provisions.

The crucial element of section 6103 remains under our proposal. That is, before the Justice Department, FBI, DEA, or any agency can obtain a tax return or any other taxpayer information required to be filed from IRS, they must first obtain a Federal court order to do so. The criteria for granting such an order and the persons who may apply for it are different than under present law.

Under the proposal, an attorney for the Government, including the U.S. attorneys and strike force chiefs, may seek the court order. They must prove to the satisfaction of the Federal district court that their request to see a tax return is first pursuant to a lawful criminal investigation or proceeding; and, second, that they have reasonable cause to believe that the return is material and relevant to that investigation.

I believe that this standard, if rigorously applied by the court, is sufficient to insure that the tax return information is not being obtained for corrupt political motives. However, in order to further

insure against any kind of fishing expedition for tax records, I would retain what is presently the first requirement for a court order, namely, that there is reasonable ground to believe a Federal crime has been committed.

Allowing the request to be made by an attorney for the Government rather than the head of a Federal agency, as present law reads, insures review by an experienced prosecutor and removes a considerable amount of bureaucratic delay from present practice, and bureaucratic delay must be minimized. Such delay simply aids criminal activities.

To further insure that seeking a tax return does not become an endurance test of months or even years, the measure sets forth strict time limits for ruling on and complying with the court order.

Under present law, the IRS may turn over information it uncovers of a nontax crime if that information is not taxpayer return information. Because of uncertainties about what is included under this definition and because of severe penalties for unauthorized disclosure, very few IRS agents have been willing to take a chance and risk running afoul of the new law.

Our proposal would essentially provide that IRS will turn over to the appropriate agency any evidence of nontax crimes that may be discovered other than information coming from the tax return itself.

My own view is that IRS ought to be obliged to turn over prima facie evidence of a nontax crime. I agree with the proposed procedure outlined by the GAO in their June 17, 1980, analysis of S. 2402, which would have IRS present any such information of a nontax crime to a court before disclosing it to the Justice Department.

Mr. Chairman, and Senator Byrd, in cosponsoring this legislation, I noted that I have reservations about certain provisions, such as the new definition of return and nonreturn information, which determine when a Government attorney may seek a court order to require information in the hands of IRS.

While I have not fully made my mind up on this particular issue, I am inclined to agree with the GAO, the American Civil Liberties Union, and others, that both individual and corporate books and records should be disclosed only upon obtaining a court order. The business sector, for instance, will raise legitimate concerns that, unless a court order is mandated, capricious requests for information could require the revelation of confidential information of their stock and trade.

We must be mindful of the tremendous power IRS has to compel all of us to reveal our lives through our financial transactions. This is not to say that these records should not be made available upon a showing of specific need, but I am not yet convinced that we should allow disclosure of this kind without judicial review.

Mr. Chairman and Senator Byrd, we wish to thank you again for the opportunity to appear, and for holding these hearings. It is extremely important that everyone in the Congress and the law enforcement community and especially those individuals and organizations dedicated to protecting individual privacy and civil liberties have an opportunity to fully and completely scrutinize these measures and express their respective concerns.

This will allow us to make certain that we have correctly balanced our competing values.

I wish to thank again Senator Nunn and the fine staff of the subcommittee for the work that has been put into this legislation. I support him in his undertaking, and I believe we can accomplish much in this area without jeopardizing our most basic and important individual rights.

The morale of our law enforcement agencies has been damaged by the perception that the cards are totally stacked against them, and that many criminals are now insulated from prosecution.

Senator BAUCUS. I would like to thank you very much, Senator Percy.

I have only a few very general questions. If you have to leave, I certainly understand that.

Senator PERCY. I have just been handed a note that the Governmental Affairs Committee is waiting for me in room 3302.

Senator BAUCUS. Senator Nunn, I am wondering whether there is a different way to attack this problem. Your general point is that there is a high incidence of illegal drug trafficking, and that those who are active in law enforcement efforts are handicapped, handcuffed because of their inability to get adequate tax return information.

Is the problem, in your view, due to an insufficiency on the part of drug enforcement officials, or is it that there is an insufficient number of experts devoted to this area in the IRS? Or does the problem deal primarily with the necessibility of tax information?

Senator NUNN. I think it is all of the above. The Tax Reform Act is only one part of the problem. I believe it goes to the attitude of the Internal Revenue Service more than anything else. They have removed themselves from cooperation in law enforcement. The Tax Reform Act itself has severe criminal penalties for even good faith errors. And the interpretations of the act by IRS are horrendous. Nobody knows what it means. It is just an interpretive nightmare.

The agents are really not participating in any strike force activities like they were.

So, it goes far beyond simply the tax return. As you recognize, under our bill the tax return itself will be protected. It is not the tax return itself so much as it is the whole financial expertise of the Internal Revenue Service. The people at the top of organized crime and narcotics trafficking may not ever touch the narcotics, or commit the actual criminal activity, but they always touch the money. IRS agents are the most potent weapon in going after these kinds of people, and they simply aren't doing it now.

Senator BAUCUS. Do you think that if the DEA or the FBI or other Federal enforcement agencies develop much greater financial expertise, along with some additional access to IRS records, that that wouldn't sufficiently solve the problem?

Senator NUNN. I think that it would take 5 to 10 years to do it, and I think it would take an enormous amount of money. That is a different talent altogether, and the Internal Revenue Service has that talent, and DEA does not have it. If you wanted to double or triple the DEA budget, perhaps you could give it to them over a period of 10 or 12 years, but they don't have it now; and even then, you are always going to have the problem of DEA not being able to

make these net worth cases, for instance, or jeopardy assessment cases, and IRS can do that.

So, that would not cure the problem, even if you gave DEA that expertise, but I do believe that there shouldn't be a total reliance on the Internal Revenue Service here. I think DEA should strive within their resources and what they can get from Congress and the administration to increase their expertise in this area.

Senator BAUCUS. What is your reaction to the charge that these bills that you have introduced, if enacted, will significantly reduce voluntary compliance?

Some say, and I think the figures bear out, that voluntary compliance is in fact diminishing to some degree. Won't these bills further exacerbate that problem? Won't these bills reduce compliance because people just won't want to be volunteer information, realizing that it could go to other agencies—even to the State agencies?

Senator NUNN. I think just the opposite, Mr. Chairman. I understand that viewpoint, but I think all the evidence historically completely negates that viewpoint. If you talk to Internal Revenue Service agents, you will find that the whole image of the Internal Revenue Service being able to get Al Capone and put him in jail when nobody else could, has done more for Internal Revenue Service respect than all the other cases they have ever made.

That is the historical record of why the Internal Revenue Service commands so much respect, or did command respect. I think if you look at the record, we had more voluntary compliance before the 1976 Tax Reform Act than we have had since. Since then, the voluntary compliance has gone down.

Now, I don't believe it is just because of that act. I think it goes far beyond that. I think we are taking so much of the taxpayers' money in terms of percent of Federal taxes compared to the gross national product, that it is becoming a very painful experience for people to pay their taxes, combined with inflation. But I don't think there can be any case made that this kind of move will lessen voluntary compliance.

If the Internal Revenue Service gets the reputation of being able to require top criminals to pay taxes again and narcotics dealers to pay taxes, I think it is going to greatly increase, not decrease voluntary compliance.

Senator BAUCUS. What about the suggestion that because IRS does have greater compulsory process powers compared to other agencies, it therefore should provide greater privacy protection to individuals?

Senator NUNN. Well, I believe that is reflected in this proposal. I think we are giving a great deal of privacy to tax returns. I believe that we are giving a great deal of scrutiny to how and with what procedure information would be made available. I also believe it is important to remember that even under the Tax Reform Act we are not keeping this information strictly private. There are ways to get the information in the Justice Department now. It is just so cumbersome, so time consuming, and such a burden of proof that it has become more of a burden than a benefit.

So, we don't have absolute privacy now, and never have, and no one has ever proposed that. Even those who would criticize this

approach would never propose that under no circumstances could tax returns or tax return information be turned over to other agencies. Those who favor that view just want to make it so hard to do that it becomes a practical impossibility.

Now, I don't think that is what we want. We in some ways are making it more restrictive, and we are protecting the privacy better under this bill in some ways than the present law, because we are putting the burden on the Justice Department, and not letting other agencies come in and make these requests. We are putting the primary focus and responsibility on the Justice Department, which should have and hopefully does have some concern about these overall rights of privacy, too.

So, we don't see this as backing away from the concern that people have about privacy of tax returns. We believe we have adequately safeguarded that, and we have kept judicial protection in here which, I think, is appropriate.

Senator BAUCUS. You mentioned that agents in the field talk to you on and off the record about their frustrations, their inability to provide information to certain relevant law enforcement agencies. Would you elaborate?

Senator NUNN. Well, we had testimony from the agent who did the primary investigation on the *Agnew* case, for instance. He testified on the record, and that would be some interesting testimony for your staff to get out. He testified that the *Agnew* case could not have been made—it wasn't a tax case, but the IRS did the primary investigation—and it was a cooperative effort, and that that case could not have been made today under the Tax Reform Act and the interpretation of that act by the Internal Revenue Service.

I want to emphasize that and the interpretation, because IRS has interpreted that act in the most rigid and severe form, I think, far beyond the intent of Congress as it passed that act. They took that act as their excuse to do what they wanted to do anyway, which was to get out of law enforcement.

Senator BAUCUS. On that last point, some suggest that these hearings will send a message to the IRS to reinterpret the act. That is, the act itself may cause some problems, but it is the interpretation of the act which causes the greater problems. If the interpretations were relaxed significantly, with the law not changed significantly, would that, in your judgment, substantially solve the problem?

Senator NUNN. I believe even if the law were not changed, there could be some marginal improvements in the attitude and enforcement, and I think it is going to take both, though. I believe if the law is not changed, there will not be the kind of signal that is necessary, nor will the legal doubts be removed.

I mean, there are legitimate reasons for the Internal Revenue Service to say to themselves, we don't know what Congress meant, and with these kinds of criminal penalties, with no good faith defense at all, we had better, for our own protection, interpret this in the most rigid form, I can understand that viewpoint. I think they have gone overboard on it, but it is an understandable point of view.

So, yes, they can make improvements under the existing law. No; these improvements will not revitalize the agency and make it effective. It will take some changes in the law also.

Senator BAUCUS. Your primary problem seems to be illegal drug trafficking. Have you and your staff given any thought to tailoring your bills more to illegal drug activity or to illegal underworld activity rather than to formulating statutes which apply so broadly and generally to every taxpayer in the country?

Of course, there is a 14th amendment question here. The laws have to apply equally to all Americans. I am wondering whether you originally focused your efforts on drug trafficking, and having found that you couldn't, solve the problem, you came up with this solution?

Senator NUNN. I think that is what we have done. Let's say that you have a case of tax fraud. Say Senator Byrd makes more on his apples than he reports one year. Well, that is a tax case. Everybody in the Internal Revenue Service has got access to Senator Byrd's tax files. Thousands of people have access to his tax files. They can cross it anyway they want to. That is a tax fraud case.

It happens, though, that that is not a case the Justice Department gets involved in.

The cases that we are worrying about, and the cases that we are talking about, are the narcotics type cases, the non-tax-crime-type cases that the Internal Revenue Service can be of tremendous assistance in. Under those cases, the Justice Department is not going to be investigating Senator Byrd for making more on his apples than he turned in. That is the IRS role.

So, the ordinary taxpayer and even the person who is guilty of tax fraud is not affected by this. The people that are affected are the people who are committing other crimes that virtually are undetectable unless you have some financial expertise. So, it is the cooperative effort of IRS. It is the overall financial expertise they can bring to bear, and it is the access of the Justice Department in those very few cases to IRS tax information that is so crucial here.

So, we really are targeting, we think, on the narcotics dealers and on the organized criminals who are handling large sums of cash. Those are the targets of these changes. The ordinary taxpayer who commits fraud on a tax return is already violating the law, and they are already covered, and really and truly, this act doesn't affect those people.

Senator BAUCUS. I understand the administration basically supports your bills; although the administration's view changes virtually every hour

Senator NUNN. It is, on some days, evolutionary; on some days, revolutionary. [General laughter.]

Senator BAUCUS. Right. My understanding is, at least as of last night, the administration generally agrees with the approaches that you are taking regarding disclosure of records in the possession of the IRS, the administration makes a distinction between corporate taxpayers and individuals or corporate taxpayers and partnerships.

Would that position sufficiently, in your judgment, solve the problems that we are addressing this morning?

Senator NUNN. I would say this, Mr. Chairman. I know that this is a sensitive area, and we are not locked in concrete on it, and I think there is room for improvement of any bill, and certainly there is room for improvement of this bill.

We believe that we have adequately covered that, that you could make a distinction, for instance, between individual books and records turned over by an individual.

You could put that in what I call the more protected category, which would require a court order, because those are fifth amendment type documents. They could plead the fifth amendment and not turn them over if they wanted to, and distinguish between that and business records that are not subject to any fifth amendment right.

Businesses never have had the right to refuse records on the basis of the fifth amendment. There is no fifth amendment privilege on those, so you could make that distinction, and I think that is one thing the administration may be looking toward.

I think the General Accounting Office has a suggestion, which I don't want to endorse right here because I haven't studied all the ramifications of it enough. We think we have everything on our bill, so I will stick with that for the record. But GAO says, let's take this category 1, which is a more protected category requiring a court order, and instead of having the so-called Nunn bill, in which the definition is more narrow—let's make that definition broader, so that practically everything that is turned over by the taxpayer directly would be in that category 1 and would require a court order.

But—and this is a very innovative suggestion, I think—let's put the burden on the Internal Revenue Service when they find information, even in tax returns, indicating nontax crimes, to turn that information over through the court order procedure. So, they are broadening the protective category, but they are putting an affirmative burden on the IRS to turn that evidence over through the judicial system and through a court order when they believe there is a crime.

I think that is real food for thought, and perhaps would both strengthen the privacy provisions and also strengthen law enforcement.

Senator BAUCUS. I have a couple of more questions, but we haven't much time here.

I want to thank you very much. It has been a very constructive hour this morning.

Senator Byrd, do you have any questions?

Senator BYRD. I just want to say for the record that the apple business is doing so poorly these days that Senator Byrd is no longer in the apple business. [General laughter.]

I think you have raised a tremendously important problem in the presentation of these bills. I feel it is so important that we protect the law-abiding citizen and the integrity of his tax return, but at the same time that we make it possible in every appropriate and reasonable way to prosecute the non-law-abiding citizens, and I assume that you seek to provide a balance between those two in your legislation.

Senator NUNN. That is correct. We are trying to provide a balance here. And I think it is important that both of those goals be kept in mind as this process continues in the legislative arena, because they are both important goals.

We certainly don't want to create a situation where people believe that their tax returns are going to be shuffled all over the Government, and that is far from what we want to create, Our bill does not—absolutely does not—do that. There are far more protections in our bill than there were before 1976. That is the balance we strive for.

Senator BYRD. I am inclined to favor a court order. Would that unduly jeopardize what you are seeking to accomplish?

Senator NUNN. We agree with the court order. We think the court order should be necessary for all tax returns. I think the question is, How far do you go on that court order? Do you include all business records that are turned over? Do you include all individual records that are turned over?

I gave the example, I believe, before you came in where the Internal Revenue Service found some information in a trash can, and under the present law they interpret that information as being protected. Well, it is not only the question of the court order. That is important, but the present law is such that there is no way a court order can be obtained by the Justice Department in most cases, because first, they don't know the information exists. There is nothing that allows the IRS to tell them that they should seek a court order.

So, if the Internal Revenue Service finds something in a trash can today, under the present law, indicating that the mayor of a city is taking bribes, they can't do anything with that. They are not doing anything with it. But under this provision, we draw the line as to how much information is required under the court order, and then we do not have an absurd catch 22 situation about what information has to be demonstrated in order to obtain the court order.

Under the present law, the requesting agency must show, first, that there is reasonable cause to believe that a crime has been committed; second that there is reason to believe that the return information is probative evidence of an issue related to that crime; and third, that the information cannot reasonably be obtained from another source unless it is the most probative evidence.

What information? Remember, they don't know what it is. They haven't seen it. They don't have any idea. So, meeting these requirements can be totally impossible. So, it is not just a matter of the court order. It is the question of what the burden of proof is in getting that information, and second, how much is included under that.

We all agree that the tax return itself should require a court order. What the General Accounting Office is talking about is perhaps broadening our definition, but at the same time putting an affirmative burden on IRS to seek the court order when something comes to their attention that indicates evidence of a nontax crime.

I think that may be food for thought.

Senator BYRD. Thank you.

Senator BAUCUS. Thank you, Senator, very much.

Senator NUNN. Thank you, Chairman Baucus, Senator Byrd. I appreciate very much the opportunity of being here. And Senator Byrd, I can assure you that I recognize the complete honesty of your tax returns. I am not making any allusion to that. I don't want to start any rumors here. [General laughter.]

Senator BAUCUS. The next witness will be Senator Lowell Weicker.

We very much appreciate your coming, Senator Weicker——

Senator WEICKER. Senator, how are you?

Senator BAUCUS. Fine, thank you. We look forward to your testimony this morning.

STATEMENT OF HON. LOWELL P. WEICKER, JR., A U.S. SENATOR FROM THE STATE OF CONNECTICUT

Senator WEICKER. Senator Baucus, Senator Byrd, it is good to be with you.

I thank you for the opportunity to appear before the Subcommittee to discuss the tax privacy rights of Americans. I must confess to you, I did not think I would be in this forum discussing this matter so soon.

Usually legislation, and principles, last a little longer than 4 years before they are attacked and/or modified. But such is the case and, as I did on the floor of the Senate back on December 11 at about 9 o'clock at night, when I got sandbagged on this issue, I am here to do battle again.

In 1976, Congress reviewed the statutory rules governing the disclosure of tax information for the first time in 40 years. Prior to then, income tax returns and information were deemed to be public records. Federal law enforcement officials were able to obtain tax information simply by stating that in their discretion, it was "necessary in the performance of * * * official duties." The Internal Revenue Service, for all intents and purposes, operated a lending library.

Congress enacted tax privacy safeguards in the Tax Reform Act of 1976 as a result of, one, abuses uncovered during the Watergate investigations which documented the use of the IRS as an intelligence body to derive information harmful to the enemies of the Nixon administration and helpful to its friends. These abuses were summarized by the House Judiciary Committee in article 2, subparagraph 2 of the Articles of Impeachment of President Nixon, and I quote:

> He has, acting personally and through his subordinates and agents, endeavored to obtain from the Internal Revenue Service, in violation of the constitutional rights of citizens, confidential information contained in income tax returns for purposes not authorized by law, and to cause, in violation of the constitutional rights of citizens, income tax audits or other income tax investigations to be initiated or conducted in a discriminatory manner.

Two, violations of Americans' constitutional rights discovered by the Church committee. In its 1976 report, the committee concluded that, and I quote:

> The FBI used as a weapon against the taxpayer the very information the taxpayer provided pursuant to his legal obligation to assist in tax cases, and in many cases, on the assumption that access to the information would be restricted to those concerned with revenue collection and used only for tax purposes.

I want to make the statement here, just so that we all understand the ground on which we stand, the IRS is not—underline "not"—a law enforcement agency. It is a revenue collection agency.

Three, disclosures that special powers of the IRS were being misused to collect information for purposes well beyond tax administration but related to other law enforcement activities, which led to a series of congressional hearings on the propriety of various uses of tax information.

In the 93d Congress, the Senate Judiciary Committee held hearings, and numerous hearings were conducted by the Senate Finance Committee and House Ways and Means Committee in the 94th Congress. Law enforcement officials testified at length concerning the need for efficient enforcement procedures, raising a specter similar to that being raised today.

Four, recommendations made by the Privacy Protection Study Commission for more stringent safeguards with respect to disclosures of records made by the IRS. The Commission stated that the taxpayers' disclosures to the IRS:

> Cannot be considered voluntary, because the threat of criminal penalties for failure to disclose always exists. The fact that tax collection is essential to Government justifies an extraordinary intrusion of personal privacy by the IRS, but it is also the reason why extraordinary precautions must be taken against misuse of the information the Service collects from and ()()about taxpayers.

Mr. Chairman, I have taken the time to review this history because it is important to remember the events surrounding and consideration given, the formulation of the existing standards governing disclosure of tax information. Based upon this substantial record, Congress carefully drafted legislation which balanced the rights of Americans to certain privacy standards with the needs of Government in enforcing the law.

Now, less than 4 years after striking this balance, legislation is introduced which tips the scales in favor of law enforcement at the expense of taxpayers' privacy rights. What is this rationale for this new encroachment upon the rights of Americans?

It is done under the banner of the fight against organized crime, against mobsters and narcotics traffickers. And why? Because one is best able to obfuscate the true issues by arguing in an inflammatory way that a change in law is the only solution to these evils.

One must look behind the rhetoric to ascertain the reason for this legislation, and the reason is expediency. It is not that the Justice Department does not have the means of obtaining evidence other than from tax return information in its fight against crime. The Justice Department, as evidenced by the great number of its successful prosecutions, does. But it is far quicker and more expedient to go directly to the tax return and related information than to other sources.

Jerry Litton, the late Congressman from Missouri, who coauthored the disclosure protections in 26 U.S.C. 6103, succinctly rebutted the expediency rationale. In testimony before the House Ways and Means Committee in January of 1976, he said that, "If we are only looking for expediency, let's wiretap every 1,000 homes, open the mail of every 1,000 citizens, if we are only looking for expediency."

But this country does not look just for expediency when dealing with the rights of citizens. Our heritage is otherwise. Two hundred

years ago our Founding Fathers authored a Constitution premised on the principle that individuals—as human beings—are more important than the conveniences of society. A greater importance was placed on individual liberties than on governmental efficiency. That was the philosophy underlying the Bill of Rights.

The existing tax information disclosure provisions reflect the fact that Americans are compelled to surrender the constitutional rights guaranteed by the fourth and fifth amendments, which are the right "to be secure in their * * * papers, and effects, against unreasonable searches and seizures," and the right against self-incrimination. In order to facilitate the effective administration of our tax laws, each American voluntarily surrenders certain rights and assumes the duty of self-investigation, factfinding, and reporting.

This baring of private papers and matters is an accommodation by citizens for their government for tax purposes, not for non-tax justice purposes, not for scientific purposes, not as was the instant which brought Jerry Litton into this matter, when he found the IRS was roaming around the tax returns of farmers in his district in Missouri—for agricultural purposes, not for non-tax justice purposes, not for sociological purposes, not for political purposes, and not for statistical purposes.

The method in which taxpayers voluntarily comply with our tax laws and, in most cases, fully report their earnings is the envy of most other nations, where dishonesty is often the rule rather than the exception. If taxpayers become convinced that confidential data they submit each year is being used for other than tax purposes, how long will it be before cheating is commonplace?

Now, let me say to you right now that in those Finance hearings that were held back in 1975, the then IRS Commissioner and all of the past IRS Commissioners testified to a man that the amount of revenues collected was directly related to the degree of confidentiality of the tax returns. All of them, Democratic and Republican administrations alike, said so. That is the business of the IRS, to collect taxes. All of the Commissioners stated that as the confidentiality of the return eroded, the collection of revenues would decline proportionately. The resultant widespread cheating would be beyond the capacity of the IRS to control, and our entire system of voluntary self-assessment would collapse.

Now, if anybody wants to know, why there might be less in the way of compliance with the tax laws after the year 1976 than was the case before, I think I could give you a very good reason. That is, when the highest officer in the land, who is charged with enforcing the law, cheats on his income tax returns, one hell of an example is set for the rest of the country. That is exactly what happened, and that is exactly what the rest of the country found out. In short, distrust of Government and those entrusted with enforcing the laws, bred noncompliance with the laws.

The few years that have transpired since enactment of the Tax Reform Act have not shown that Congress erred in enacting needed tax reform legislation, or that provisions of the law have unfairly or unduly burdened law enforcement efforts.

What time and experience have shown us is not that the law is burdensome or wrong or unfairly restrictive, but that those who have interpreted the law have done so incorrectly.

For example, in testimony in December before the Permanent Subcommittee on Investigations, Peter Bensinger, the Administrator of the Drug Enforcement Administration, commented with respect to the opportunity afforded to IRS to disclose to other law enforcement agencies information it has regarding violations of criminal law that are not within its jurisdiction under 26 U.S.C. 6103(I)(3), astonishingly, his testimony revealed that DEA records do not show ever having received such disclosures from IRS.

This indicates not a problem with the law, but a problem with the agency empowered to act pursuant to the law. How can one profess that the provisions of the Tax Reform act prohibit effective law enforcement when a provision of the act designed to assist law enforcement is not properly utilized?

What the record justifies is a fine tuning of the provisions of the act to insure that law enforcement officials properly utilize the tools that are already available. Thus the provisions in the Nunn legislation which place time limits on court action and IRS's response, which allow a magistrate to act upon ex parte application, that limit those empowered to make applications, and which send a signal to the IRS, are justified.

However, those provisions which would expand the material available to the Justice Department without affording Americans the protection of a court order are simply not justified nor tolerable. And cutting through the rhetoric, that is the thrust of this proposal.

Now, gentlemen, I referred to my experiences of last December 11, 1979, at 9 o'clock at night, on the floor of the U.S. Senate. What was being proposed at that time? I ask you to remember. It was basically this legislation without any court order at all under any circumstances. Rather, the decision to disclose tax information would have been made by the Secretary of the Treasury.

So, those that come in here with this legislation have already had a run, if you will, at this proposal, removing the protection of any court order. Now, that seems to me to strain the credibility as to what it is that is really involved here. What is involved is expediency and convenience plain and simple. It is not law enforcement, and it is not, certainly, protection of Americans' constitutional rights. On a matter such as this, I am loath to throw the Constitution out the window for the convenience and for the expedience Government agencies that are either incapable of doing their own work or too lazy to do it.

I have found over the past several years, that when something goes wrong it is everybody else's fault—except those directly charged with a particular responsibility. It is said that the reason why the CIA can't operate is Congress fault, ever since we have been exercising our oversight responsibility. Now, it is being claimed here that the reason why the FBI can't work is the fault of the IRS.

To quote Mr. Shakespeare, "The fault lies not in the stars, dear Brutus, but in ourselves." That is, the fault lies in the law enforcement agencies, not in the IRS. If there is a matter to be corrected,

then it is in the procedures followed by IRS under the law, not the law itself, and certainly not the Constitution of the United States.

Section 6103 of title 26 of the United States Code presently requires that a court order be obtained by law enforcement officials before the IRS can turn over a taxpayer's return or any information supplied in support of the return. The Nunn proposal would grant court protection only to the tax return and information filed with it, nothing else. Therefore any information produced to substantiate the return, such as correspondence, sources of income, investments, any check ever written by the taxpayer, any bill ever paid and the reasons for doing so, will be routinely available to the Justice Department, who in turn could turn the information over to anyone it wants. This proposal constitutes an unwarranted invasion of the taxpayer's privacy rights, and it is unacceptable.

The Nunn bill further erodes the taxpayer's privacy rights by relaxing the standards necessary for the Justice Department to prove in order to obtain an ex parte order. Under the proposal, a tax return could be obtained by a court order, provided that application for the order is made in connection with a "proceeding"—and I put that in quotes—that pertains to the enforcement of a Federal criminal statute, or for investigation which may result in such a proceeding.

This substantially cuts back on the present standard which requires that there must be reasonable cause to believe that a specific criminal act has been committed. I might add that the law as it now stands does not afford the taxpayer his fourth amendment rights, which require proof of probable cause, as the Chairman has indicated.

In addition, the Nunn proposal eliminates the requirement that the Justice Department must exhaust all other sources before it can turn to the IRS to obtain information. This provision, which was suggested by the then IRS Commissioner, Donald Alexander, is similar to the requirement deemed necesary by Congress in 18 U.S.C. 2518(l)(C), that investigative procedures be attempted before a court may order a wiretap or other form of electronic surveillance.

I might also add that the provision in S. 2402 which would require the IRS to disclose to "the appropriate" agency any information under exigent circumstances, including "a possible threat * * * to national security," contains insufficient safeguards to insure that the taxpayer is not stripped of his privacy rights in the name of national security.

Just how short is everybody's memory? That term has been used for every possible abuse ever conceived by man. And yet all safeguards go out the window in this proposal as soon as the term "national security" is invoked.

The vague standards of this provision could give the IRS the unbridled discretion to turn over any information in their files to anyone in the Government, and if improperly used, would mark the return to the days of the lending library which the IRS formerly operated.

This proposal does not even afford the taxpayer the protections contained in 18 U.S.C., Section 2518(7) which requires notification to and approval of a court within 48 hours after a wire or oral

communication has been intercepted in an emergency situation. It doesn't have that kind of protection.

The loosely drafted provision in S. 2402 which would permit disclosure to State law enforcement officials concerns me. The abuses which I enumerated earlier in my testimony were not confined to high level Federal employees. There is ample documentation that state and local officials were responsible for equally appalling abuses. Indeed, the watergate investigations showed that the greatest area of leaks occurred once any information was turned over to the State governments.

Finally, I am worried about the provision which would authorize disclosure of information on American citizens to foreign countries. The thought that personal information on Americans would be disclosed to other countries which do not have the guarantees of individual rights which are contained in our Constitution is simply repugnant to the principles upon which our Nation was founded.

Now, Mr. Chairman, I understand the concerns of Senator Nunn, and I am in complete agreement with his desire to vigorously enforce our laws. However, I want it understood in this room that while this legislation is being advocated as being effective in the sense of organized crime, in the sense of drug traffickers, we don't have laws just for organized crime. We don't have constitutional rights and laws that just apply to organized crime and drug traffickers.

Whatever is enacted here applies to Senator Weicker, Senator Byrd, Senator Baucus, everyone on the street, and those in the media. There is no differentiation, in other words, as to against whom this law is going to be applied. Nor do we have a different set of rights depending on who we are.

That is why I say, be wary of in what name a law is advocated. The purposes in offering this legislation is unquestionably beneficent. However, too many constitutional safeguards are sacrificed here, and I am reminded of the observation of Justice Brandeis, and I will finish on this note, that—

> Experience should teach us to be most on our guard to protect liberty when the Government's purposes are beneficent. The greatest dangers to liberty lurk in the insidious encroachment by men of zeal, well meaning, but without understanding.

Thank you very much, Mr. Chairman.

Senator BAUCUS. Thank you very much, Senator.

Senator Nunn noted in his testimony that the number of organized crime cases which originated from IRS tax information dropped from 620 to 221 between 1974 and 1978. To what degree do you think that is attributable to the 1976 act?

Senator WEICKER. Nobody is going to disagree that there has been some confusion in the interpretation of the law by IRS. Nobody is going to dispute that. But that is an administrative problem, Mr. Chairman. That is an administrative problem that may need direction either your committee or the U.S. Senate or the President of the United States or the House of Representatives to correct, but it does not require legislation.

I think that this can be corrected administratively, and that is the reason I am here. I am not saying that there aren't some valid bases for trying to achieve a more effective line of communication

or liaison between the agencies. That should occur, but I don't think the law has to be changed.

Senator BAUCUS. Are the portions of the law that you object to most those that dispense with the requirement of a court order to obtain return information?

Senator WEICKER. Yes. Well, again, don't forget that under the proposal the protection of the court order applies only to the tax return itself, nothing that proceeds therefrom. That is a pretty big area that you are opening up to disclosure without the protection of a court order.

Senator BAUCUS. That's right, but that——

Senator WEICKER. But that bothers me.

Senator BAUCUS [continuing]. That bothers you most?

Senator WEICKER. That bothers me. Also, the provision with regard to national security concerns me. Whenever I see that term flipped around this town, my ears stand up. Also the idea that where there is a mutual assistance treaty information on an American citizen may be turned over to foreign countries bothers me.

What I suppose I am saying is that there were 40 years before there were any changes in the law, and then, as I recall, I started on this tax privacy question around 1973, just about at the same time of the Watergate hearings. So there were a full 3 years of Senate Finance and Judiciary Committee hearings, House committee hearings, and Privacy Commission hearings, before the law as we now know it was enacted. Now, the first thing we hear is screaming from the very agencies who abused their trust that they can't operate under the law.

I don't understand it. I really don't. I grant you the statistics which you have cited, given to you by Senator Nunn, would seem impressive, except I would like to know what the actual situation is after the law is practically in effect, and the various agencies have straightened out their acts.

Senator BAUCUS. What about the proposed change by Senator Nunn to change the requirements that the criminal law enforcement agencies would have to meet in order to get an ex parte order? Do you have problems with that? Assuming that an ex parte order is necessary, do you think that the standards should be changed, or are the present standards adequate?

Senator WEICKER. No, I think it is terribly important that the present standard be maintained, and not the far, far looser standard as proposed by Senator Nunn.

Senator BAUCUS. Under the present standard, the agency has to show that the information sought to be disclosed cannot reasonably be obtained from any other source. Do you think that this provision should be retained?

Senator WEICKER. Yes. I like the present standard. I see no reason why they shouldn't go ahead and utilize, or attempt to utilize, other sources before turning to IRS.

This is no different, I might add, from the precautions which have been taken in the electronic surveillance laws that sit on the books of this land at the present time.

Senator BAUCUS. What about requiring an affirmative duty on the part of the IRS to disclose information, according to GAO's recommendation?

Senator WEICKER. That interests me. That interests me. Through a court order. That interests me. That is something that may be able to be of assistance there. That doesn't bother me.

I want that buffer, gentlemen. I want that buffer of a court. I don't want the Secretary of Treasury making the determination. I don't want attorneys general, I don't want the Commissioner of IRS. I want that filtering system which protects all of us.

Senator BAUCUS. Well, I have no further questions. I think you have raised a lot of good points. I appreciate your presence here. Senator Byrd?

Senator BYRD. Senator Weicker, do you feel that the proposed legislation or any parts of the proposed legislation are acceptable from your point of view?

Senator WEICKER. Yes, as I have indicated, the limitation on the time in which IRS must respond to a court order is an important addition and is acceptable. That gets to the real issue here. They just can't sit on a matter, because by the time they get around to acting it will be too late.

I also have observed that the provisions of the Nunn legislation which place time limits on court action, which allow magistrates to act upon ex parte applications, that limit those empowered to make applications, and that send a signal to the IRS for its action, are all justified. I might add, the point raised by the Chairman with regard to the GAO recommendation of IRS initiating action, going through the court, has some merit to it.

Senator BYRD. So you feel we should not throw the bill out entirely?

Senator WEICKER. Mr. Chairman, I will tell you what I would like to see done. I would like to see whether or not this problem under the present law can be handled administratively. As I indicated to you, I think there is an administrative breakdown here. Now, that is a matter, I think, for your committee to elicit from the head of IRS, the head of DEA, and the Justice Department, as to whether or not there isn't something administratively that is hanging us up here rather than an inherent flaw in the law.

Senator BYRD. You put great stress on court orders.

Senator WEICKER. I put a great stress on the court standing between the individual and his government. Yes, I do.

Senator BYRD. I must say, I like that approach also. In regard to wiretapping, I think wiretapping is a dirty business and ought not to be permitted except through a court order. I take it that you put tax returns and the handling of the tax returns in that same category.

Senator WEICKER. Yes, I do. I do. When it comes to individual privacy, I do.

Senator BYRD. Thank you.

Senator WEICKER. I might add, Senator Byrd, that the devotion I have to the principles that I have espoused here today was nurtured to a great extent by the 3 years I spent at the law school of the University of Virginia and the principles espoused by the man who founded that institution.

Senator BYRD. Thank you, Senator Weicker.
Thank you, Mr. Chairman.

Senator BAUCUS. One question further. You are concerned, apparently, about delays. Under the present summons provisions, whenever IRS seeks information from a third party, the taxpayer has the right to ask for an automatic stay. According to the criminal division, this automatic stay results in long delays.

I am wondering if you have some suggestion to help speed up that process.

Senator WEICKER. I have no difficulty with the provision in the Nunn bill which requires the taxpayer to show why he should not comply with the summons. This conforms to the procedure in the Right to Privacy Act.

Senator BAUCUS. Thank you very much, Senator. We appreciate your being with us this morning.

Senator WEICKER. Thank you very much.

[The prepared statement of Senator Weicker follows:]

STATEMENT OF SENATOR LOWELL P. WEICKER, JR.

Mr. Chairman, thank you for the opportunity to appear before this Subcommittee today to discuss the tax privacy rights of Americans.

In 1976, Congress reviewed the statutory rules governing the disclosure of tax information for the first time in 40 years. Prior to then, income tax returns and information were deemed to be "public records". Federal law enforcement officials were able to obtain tax information simply by stating that, in their discretion, it was "necessary in the performance of * * * official duties". The Internal Revenue Service, for all intents and puuposes, operated a lending library.

Congress enacted tax privacy safeguards in the Tax Reform Act of 1976 as a result of:

1. Abuses uncovered during the Watergate investigations which documented use of the IRS as an intelligence body to derive information harmful to enemies of the Nixon administration and helpful to its friends. These abuses were summarized by the House Judiciary Committee in Article II, subparagraph 2 of the Articles of Impeachment of President Nixon: "He has, acting personally and through his subordinates and agents, endeavored to obtain from the Internal Revenue Service, in violation of the constitutional rights of citizens, confidential information contained in income tax returns for purposes not authorized by law, and to cause, in violation of the constitutional rights of citizens, income tax audits or other income tax investigations to be initiated or conducted in a discriminatory manner."

2. Violations of Americans' Constitutional rights discovered by the Church Committee. In its 1976 Report, the Committee concluded that: "* * * The FBI used as a weapon against the taxpayer the very information the taxpayer provided pursuant to his legal obligation to assist in tax cases and, in many cases, on the assumption that access to the information would be restricted to those concerned with revenue collection and used only for tax purposes."

3. Disclosures that special powers of the IRS were being misused to collect information for purposes well beyond tax administration but related to other law enforcement activities which led to a series of Congressional hearings on the propriety of various uses of tax information. In the 93rd Congress the Senate Judiciary Committee held hearings and numerous hearings were conducted by the Senate Finance Committee and House Ways and Means Committee in the 94th Congress. Law enforcement officials testified at length concerning the need for efficient enforcement procedures, raising a spectre similar to that being raised today.

4. Recommendations made by the Privacy Protection Study Commission for more stringent safeguards with respect to disclosures of records made by the IRS. The Commission stated that the taxpayer's disclosures to the IRS "* * * cannot be considered voluntary because the threat of criminal penalties for failure to disclose always exists. The fact that tax collection is essential to government justifies an extraordinary intrusion of personal privacy by the IRS, but it is also the reason why extraordinary precautions must be taken against misuse of the information the Service collects from and about taxpayers."

Mr. Chairman, I have taken the time to review this history because it is important to remember the events surrounding, and consideration given, the formulation

of the existing standards governing disclosure of tax information. Based upon this substantial record, Congress carefully drafted legislation which balanced the rights of Americans to certain privacy standards with the needs of government in enforcing the law.

Now, less than four years after the striking of this balance, legislation is introduced which tips the scales in favor of law enforement, at the expense of the taxpayer's privacy rights.

What is the rationale for this new encroachment upon the rights of Americans? It is done under the banner—which all good citizens willingly carry—of the fight against organized crime, mobsters and narcotics traffickers. Why? Because one is best able to obfuscate the true issues by arguing in an inflammatory way that a change in the law is the only solution to these evils.

One must look behind the rhetoric to ascertain the reason for this legislation. The reason is expediency. It is not that the Justice Department does not have the means of obtaining evidence other than from tax return information in its fight against crime. The Justice Department, as evidenced by the great number of its successful prosecutions, does. But it is far quicker—and more expedient—to go directly to the tax return and related information than to the other sources.

Jerry Litton, the late Congressman from Missouri who coauthored the disclosure protections in 26 U.S.C. § 6103, succinity rebutted the expediency rationale. In testimony before the House Ways and Means Committee in January of 1976 he said that "if we are only looking for expediency, let's wiretap every one thousand homes, open the mail of every one thousand citizens, if we are only looking for expediency." But this country does not look just for expediency when dealing with the rights of citizens. Our heritage is otherwise.

Two hundred years ago our founding fathers authored a Constitution premised on the principle that individuals—as human beings—are more important than the conveniences of society. A greater importance was placed on individual liberties than on governmental efficiency. That was the philosophy underlying the Bill of Rights.

The existing tax information disclosure provisions reflect the fact that Americans are compelled to surrender the Constitutional rights guaranteed by the Fourth and Fifth Amendments—the right to "be secure in their . . . papers, and effects, against unreasonable searches and seizures" and the right against self-incrimination. In order to facilitate the effective administration of our tax laws, each American voluntarily surrenders certain rights and assumes the duty of self-investigation, fact-finding and reporting. This baring of private papers and matters is an accommodation by citizens for their government for tax purposes—not for scientific purposes, not for nontax justice purposes, not for sociological purposes, not for political purposes, not for statistical purposes.

The method in which taxpayers voluntarily comply with our tax laws and, in most cases, fully report their earnings is the envy of most other nations where dishonesty is often the rule rather than the exception. If taxpayers become convinced that confidential data they submit each year is being used for other than tax purposes, how long will it be before cheating is commonplace? Widespread cheating would be beyond the capacity of the IRS to control and our entire system of voluntary self-assessment would collapse.

The few years that have transpired since enactment of the Tax Reform Act have not shown that Congress erred in enacting needed tax reform legislation or that provisions of the law have unfairly or unduly burdened law enforcement efforts.

What time and experience have shown is not that the law is burdensome, or wrong, or unfairly restrictive, but that those who have interpreted the law have done so incorrectly. For example, in testimony in December before the Permanent Subcommittee on Investigations, Peter B. Bensinger, the Administrator of the Drug Enforcement Administraton, commented with respect to the opportunity afforded to IRS to disclose to other law enforcement agencies information it has regarding violations of criminal law that are not within its jurisdiction under 26 U.S.C. § 6103(i)(3). Astonishingly, his testimony revealed that DEA records do not reveal ever having received such disclosures from IRS. This reveals not a problem with the law, but a problem with the agency empowered to act pursuant to the law. How can one profess that the provisions of the Tax Reform Act prohibit effective law enforcement when a provision of the Act designed to assist law enforcement is not properly utilized?

What the record justifies is a fine tuning of the provisions of the Act, to ensure that law enforcement officials properly utilize the tools that are already available. Thus, the provisions in the Nunn legislation which place time limits on court action and IRS's response, allow magistrates to act upon ex parte applications, limit those empowered to make applications, and send a signal to the IRS, are justified.

However, those provisions which would expand the material available to the Justice Department without affording Americans the protection of a court order are simply not justified—nor tolerable. And, cutting through the rhetoric, that is the thrust of the proposal.

Section 6103 of Title 26 of the United States Code presently requires that a court order be obtained by law enforcement officials before the IRS can turn over a taxpayer's return or any information supplied in support of the return. The Nunn proposal would grant court protection only to the tax return and information filed with it—nothing else. Therefore, any information produced to substantiate the return—such as correspondence, sources of income, investments, any check ever written by the taxpayer, any bill ever paid, and the reasons for doing so—would be routinely available to the Justice Department, who in turn could turn the information over to anyone they want. This proposal constitutes an unwarranted invasion of the taxpayer's privacy rights, and is unacceptable.

The Nunn bill further erodes the taxpayer's privacy rights by relaxing the standards necessary for the Justice Department to prove in order to obtain an ex parte order. Under the proposal, a tax return could be obtained by a court order provided that application for the order is made in connection with a "proceeding" that pertains to the "enforcement" of a Federal criminal statute, or for an investigation which "may result in such a proceeding". This substantially cuts back on the present standard which requires that there must be "reasonable cause to believe . . . that a specific criminal act has been committed". I might add that the law as it now stands does not afford the taxpayer his Fourth Amendment rights, which require proof of "probable cause".

In addition, the Nunn proposal eliminates the requirement that the Justice Department must exhaust all other sources before it can turn to the IRS to obtain information. This provision, which was suggested by then IRS Commissioner Donald D. Alexander, is similar to the requirement deemed necessary by Congress in 18 U.S.C. § 2518(1)(C) that investigative procedures be attempted before a court may order a wire tap or other form of electronic surveillance.

I might also add that the provision in S. 2402 which would require the IRS to disclose to "the appropriate" agency any information under "exigent circumstances", including "a possible threat . . . to national security", contains insufficient safeguards to ensure that the taxpayer is not stripped of his privacy rights in the name of "national security". The vague standards of this provision could give the IRS the unbriddled discretion to turn over any information in their files to anyone in the government, and, if improperly used, would mark the return of the days of the "lending library" which IRS formerly operated. This proposal does not even afford the taxpayer the protections contained in 18 U.S.C. § 2518(7), which requires notification to and approval of a court within 48 hours after a wire or oral communication has been intercepted in an "emergency situation".

The loosely drafted provision in S. 2402 which would permit disclosure to state law enforcement officials concerns me. The abuses which I enumerated earlier in my testimony were not confined to high level Federal employees. There is ample documentation that State and local officials were responsible for equally appalling abuses.

Finally, I am worried about the provision which would authorize disclosure of information on American citizens to foreign countries. The thought that personal information on Americans can be disclosed to other countries which do not have the guarantees of individual rights which are contained in our Constitution is simply repugnant to the principles upon which our nation was founded.

Mr. Chairman, I understand the concerns of Senator Nunn and I am in complete agreement with his desire to vigorously enforce our laws. His purpose in offering this legislation is unquestionably beneficent. However, too many Constitutional safeguards are sacrificed here. I am reminded of the observation of Justice Brandeis that: ". . . experience should teach us to be most on our guard to protect liberty when the Government's purposes are beneficent . . . The greatest dangers to liberty lurk in the insidious encroachment by men of zeal, well meaning, but without understanding."

Senator BAUCUS. The next witness will be Congressman Pete Stark.

STATEMENT OF HON. FORTNEY H. STARK, A U.S. CONGRESSMAN FROM THE STATE OF CALIFORNIA

Mr. STARK. Thank you, Mr. Chairman.

Senator BAUCUS. Welcome, Pete. Good to see you.

Mr. STARK. Senator Byrd.

As the author of section 7609 of the Tax Reform Act, I am somewhat awed and flattered to have it attacked by such an impressive array of your colleagues this morning, and supported by the eloquence of the Senator from Connecticut, with whom I could not agree more.

Not being an attorney, I would like to talk just about some general things that led to this particular restrictive provision in the Internal Revenue Code, if I may.

To follow up on a remark that Senator Byrd just made—before I came to Congress—I was a banker, and was a plaintiff in the original suit against then Secretary of the Treasury Shultz, when I suddenly found myself as a banker under Congressman Patman's old act, being responsible as a banker for having to report what seemed to me unusual transactions, and subject to criminal penalty if I didn't report my customers unusual transactions. When you come from the area of California where I come from, to determine unusual transactions was a responsibility that I did not want to undertake. Along with the ACLU and American Bankers Association and California Bankers Association, we challenged that. I found out subsequently that I didn't have standing to sue, but the Supreme Court did say that in their decision that this was something that we ought to legislatively correct.

In the course of working on that, I think we proved that with today's modern technology, opening an individual's financial records today is the equivalent of a wiretap. For those of you who don't recall the "60 Minutes" program that we instigated, we showed by taking a person who had formerly been a staff member of mine, who agreed to let his credit cards and banking records be looked at by a private investigator from New York, this man was able, just from his records, not ever seeing him or knowing anything about him, just to almost describe his every activity, tell you what doctor he went to, tell you what his health problems might or might not have been by finding out whether the physician was a specialist, how many children he had, whether he drank whiskey, where he was at what time of the year.

The interesting thing is that once you get into it, you will find that now with electronic transfer of information, for example, if I am a member of the ACLU, and Senator Byrd wanted a membership in the ACLU would take you 30 seconds to find out where my check for membership was deposited, and where the other membership checks were deposited, run the list of membership deposit checks for the past 3 years, trace that back to the name of the account holder, and come up with a list of the membership fees. Or the NRA. Depending on whose list you wanted to look at.

The information available because of commercially necessary transactions or procedures is limitless. So I would say that opening these records is the equivalent of a wiretap for individuals or corporations or associations, and I would urge you to think of it in that sense.

It is my feeling that as legislators, we have to moderate between two extremes. The one extreme is, as Senator Weicker mentioned, putting a wiretap on everybody's phone, and the other extreme is to not allow them at all. Obviously, neither of those situations is

acceptable. But as legislators, it seems to me we have to decide where between those two extremes we think is a fair invasion of privacy which we must sacrifice for some stability in our society.

I submit that where we are now is something that was determined by the Privacy Commission, made up of our own members, and after long deliberation, both from the standpoint of protecting ourselves from crime and also protecting our privacy.

I would also want you to think, when I talk about setting standards for ourselves, I would say to Senator Percy, not having seen a lot of cash in one place, if you were a Member of the House, many of my colleagues have seen that kind of cash, I understand, in recent months——

[General laughter.]

Mr. STARK [continuing]. And we talk about a section of the population with 535 Members in Congress slightly over 1 percent of us are now under indictment, and we hesitate to disclose our financial records in any way as thoroughly as we are suggesting the public might do this to the Internal Revenue. Perhaps we ought to put our own house in order.

I know that Senator Weicker has periodically introduced legislation to suggest that we file our income tax returns, as we now must make public our earnings and to some degree our assets, and we have resisted that in both branches of the legislature. I think we can understand as we begin to think about what we would like to divulge, why should we impose higher standards on our constituents?

One other thing that I would like to just comment on is the statistics of the problems involved. This flag has been run up the pole several times by both the Justice Department and the IRS. I think you will hear later, the bankers will testify that the last year when vest pocket subpenas were available, that about 100,000 summonses or subpenas were issued for tax records from banks.

In the first year of 7,609, which limited the IRS's ability to get into bank records, only 217 cases went to court, and I think that in maybe 2,000 out of 100,000 there was a letter protesting or asking for a 14-day delay were written. So, I don't think that when you get less than 1 percent of the people whose records are summoned putting up any resistance, that the agencies could make a case that this is a very burdensome problem for them.

I have prepared testimony which I have submitted to you this morning, and I would ask consent that that be included in the record. I would be glad to answer any questions that either of you have.

Senator BAUCUS. Thank you very much.

Your statement will be included in the record.

How are we going to get at the problem of narcotics trade and mob activity? I think most people in the country feel that the Federal Government has been inadequate in its efforts to solve this problem.

Mr. STARK. I think there are a lot of things that have been proposed. Representing a district that has, unfortunately, one of the highest incidences of heroin addiction and deaths among teenagers from overdose and misuse of drugs, my feeling has always been that one of the quickest ways is to take the profit out of the

narcotics, make it a medical problem, as we have seen other countries do. It is not a police problem. It is an education problem. It is a medical problem. Maybe it is a psychological problem.

I have served since its inception on the House Select Committee on Narcotics, and just throwing in more law enforcement officers or more borderguards doesn't stop it. It only seems to increase the profits as it increases the risk, and I submit that we have to take a whole different direction.

One of the financial problems that we know about has nothing to do, really, with records. Anybody remotely familiar with the narcotics traffic knows it is a cash business. It has been suggested that we stop issuing large denomination bills or that we register them as we are now going to register Treasury notes and Treasury bills. There will be no more bearer's certificates, I think, over $1,000 in denomination.

That might very well be a system, to start registering large certificates as we do bonds, as we should do with municipal bonds. We know that there are small banks in Florida who are being flooded with cash all out of proportion to what the normal commercial community might expect to be depositing in those banks. It seems to me that there are police methods for surveillance of who goes into the banks, and there are now laws about disclosing large cash transactions.

I think we could use our present system adequately to get at that.

Senator BAUCUS. I don't know if you have had a chance to examine each of the four bills that Senator Nunn has introduced. Are there any bills there that you agree with, or any portions of any of those bills?

Mr. STARK. I would concur, again, with Senator Weicker, that in terms of cooperating with the agencies to make the time delay operate more efficiently, I would concur.

I also would be interested in making the laws that apply down at the Internal Revenue Service and the Justice Department similar, so that the financial institutions and indeed the courts—we now have two sets. My 7609 applies only to the Internal Revenue Service. Under the Banking Act and the Privacy Act, we have a different set of laws if the Justice Department goes after financial records.

It seems to me reasonable to bring those two into harmony so that the financial institutions, the law enforcement agencies, and the courts are dealing with one set of protective standards, and in the spirit of revising them to make them simpler for the individuals, the corporations, the financial community, and the law enforcement community, I think, we could go and make what I would call technical adjustments to the law.

Senator BAUCUS. I don't know if I fully understand. You said that, to take your phrase, the IRS is like the telephone. That is, to open it up would be like putting on a wiretap.

Mr. STARK. Right.

Senator BAUCUS. Because of those special features of the IRS and also because of the greater compulsory process the IRS has, don't you think that the IRS should afford greater protection to individuals' privacy rights compared with other Federal agencies?

Mr. STARK. Absolutely. In other words, I think the statement of the Privacy Commission that information ought to be treated as if you and I held it ourselves, and indeed, up until the early fifties, that information was not available. Bank records were only kept numerically. You could get a transaction date and a transaction amount, but there was absolutely no record kept of the payee or the payor. Those records came back to you.

If you are like me, you kept them in a shoebox in the front hall coat closet, on the floor, for years. But those were my records. You could verify through bank records that a dollar transaction took place on a certain day, but you would have no way of finding out to whom it was paid out.

We are constantly, through information returns, we are constantly giving more of our information to the IRS, and I think that is a problem, but I don't think we should make it available to anybody else.

Senator BAUCUS.

Do you agree with Senator Weicker and Senator Nunn and GAO that we should expand the definition of taxpayer returns and then impose an affirmative duty upon the IRS to disclose potential criminal information to the appropriate agency?

Mr. STARK. I am going to beg off as a nonattorney, but it seems to me as a layman that if the IRS in its duty of collecting revenue comes across an obvious crime, there ought to be a way for them to shout, stop, thief. I mean, that makes good sense to me, and that if this filter of the courts, which I concur with, is enough to stop an abuse of that, I just think instinctively that when we see a crime being committed, we ought to do something to stop it. I think that is a duty, and I think if that is what Senator Weicker was getting at in one of the provisions in one of Senator Nunn's bills, I would certainly concur.

Senator BAUCUS. Thank you very much, Congressman Stark. Senator Byrd?

Senator BYRD. As I understand it, Congressman Stark, you would prefer to leave the law as it is now, with certain what you call technical changes.

Mr. STARK. Absolutely, sir.

Senator BYRD. Thank you.

Mr. STARK. Thank you.

Senator BAUCUS. Thank you.

[The prepared statement of Mr. Stark follows:]

TESTIMONY OF HON. FORTNEY H. STARK, JR.

Mr. Chairman, Members of the Committee, I appreciate the opportunity to appear before you this morning to discuss a matter of great importance—the privacy of taxpayer return information.

Unfortunately, the federal government must collect taxes. In order for the tax collection system to work, the Internal Revenue Service must gather a great deal of information on every taxpayer. The I.R.S. may well have more information about more people than any other government agency in this country. This information is not supplied voluntarily. There is a clear threat of criminal penalties for failure to disclose.

The extraordinary intrusion into the privacy of American citizens represented by the information reporting requirements of the tax code is justified to the American people on grounds that it is necessary for the proper administration of the tax laws. It is not justified on grounds that it is necessary to have information for a successful war on narcotics or organized crime.

Would the American people consciously acquiese in the use of this information for purposes other than tax administration? I think we can answer this question by asking ourselves another; would the American people—and their representatives in Congress—support legislation that would require that every taxpayer fill in a form from the Justice Department that asked for the same information they now supply to the I.R.S.? Of course not!

If we are not willing to pass this kind of legislation—and I would guess that we wouldn't, particularly in an even numbered year, then I don't think that we should be willing to pass S. 2402. Why? Because S. 2402 is the functional equivalent of requiring every taxpayer to inform the Justice Department of his or her identity, the nature, source and amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, and net worth.

S. 2402 would require the I.R.S. to inform the Justice Department of nonreturn information which may constitute evidence of a federal crime or which may be pertinent to a federal criminal investigation. Nonreturn information appears to be defined in the bill so as to include all the items of information that I have just listed—even though it does not include actual documents filed with the Service.

S. 2402 would also require the I.R.S. to disclose to the appropriate Federal investigative agency any information, including actual returns filed under 'exigent circumstances'. It is not clear what "exigent circumstances" are except that they include possible threats to persons, property or national security.

I understand that one of the reasons for the "exigent circumstances" rule is the fact that an I.R.S. official testified that the disclosure rules are now so strict that if he learned about a planned attempt to assassinate the President he would have to send the information through bureaucratic channels and that by the time it got to national headquarters the President could be dead.

This does sound foolish. On the other hand, are we ready to approve a bill that would require all tax information filed with the I.R.S. to be filed with the Secret Service on the grounds that it is necessary to protect the President?

The requirement that the I.R.S. pass on to Justice information found in tax returns that may be related to a criminal investigation is, in effect, requiring that all tax information be filed with Justice—except that Justice does not have to handle all that paper itself.

I would like to comment just briefly on the other bills on the schedule today.

S. 2403 would change the existing rules on third party administrative summons. Under current law a taxpayer can force the government to go into court to get hold of taxpayer records in the hands of a third party record keeper. S. 2403, would require, instead, that the taxpayer go into court and try and stop records held by a third party from being turned over to the I.R.S.

As I understand it, the chief argument made on behalf of the changes provided for in S. 2403 is that tax evaders are using current procedures to delay and obstruct I.R.S. examinations.

This same argument was made by the Justice Department back in 1977 before the current procedure went into effect. It was also made back in 1979 when the G.A.O. did a report titled: Disclosure and Summons Provision of the 1976 Tax Reform Act—Privacy Gains with Unknown Law Enforcement Effects. In that report, G.A.O. concluded that neither Justice nor I.R.S. had made the case for changing the law regarding third party administrative summons. As far as I know they still haven't come up with the data to make the case that changes are needed.

I have no objections to S. 2404 which would make it clear that criminal sanctions for unauthorized disclosure of tax information are to be applied only in the case of intentional violations of the statute governing disclosure. I thought that was the rule all along.

S. 2405 would appear to make the federal government and not the employee liable for actual damages caused by negligent disclosure of tax return information contrary to the statute, and for punitive damages as well where the federal employee is grossly negligent.

While I believe that the federal government should be liable in these cases, I see no reason why the federal government should not have the right to recover from the employee for any damages paid to an injured taxpayer.

The bills before the committee today were introduced because of the concern of a number of Senators about the ability of our law enforcement agencies to fight organized crime and the traffic in illegal narcotics with the tools now available to them.

Let me assure the committee that I am as anxious as any Member of Congress that we win the war against organized crime and narcotics. I think all of us recognize, however, that we can't win the battle by riding roughshod over the right

of Americans to be free of unwarranted government interference in their private lives and papers.

The Privacy Protection Study Commission was charged with the task of making recommendations regarding the disclosure of identifiable information by the I.R.S. to other Federal and state agencies. In its report the Commission suggested a rule that I commend to the Committee for purposes of measuring the extent to which this similar legislation is consistent with the concept of personal privacy that we are working with today. The Commission said: "The Commission believes that Federal law enforcement officials should not have easier access to information about a taxpayer when it is maintained by the I.R.S. than they would if the same information were maintained by the taxpayer himself."

I think if this guideline is applied to S. 2402, the bill fails to measure up.

I would be pleased to answer any questions you might have.

Senator BAUCUS. Our next witnesses will testify as a panel. First, Hon. M. Carr Ferguson, Assistant Attorney General, Tax Division, Department of Justice, the Hon. Irvin B. Nathan, Deputy Assistant Attorney General for the Criminal Division in Justice, and Hon. Jerome Kurtz, who is the IRS Commissioner.

Gentlemen, we appreciate your presence this morning. I take it that you generally have the same position with respect to the bills. To the degree you do not, I would appreciate it if you would indicate those differences, and as far as I am concerned, you can proceed in any order that you wish.

Why don't we just go ahead with each of your statements, and then we will follow up with questions after each of you has presented your testimony?

STATEMENT OF HON. M. CARR FERGUSON, ASSISTANT ATTORNEY GENERAL, TAX DIVISION, U.S. DEPARTMENT OF JUSTICE

Mr. FERGUSON. Is there any particular order, Mr. Chairman?

Senator BAUCUS. No, the order is yours.

Mr. FERGUSON. If I may, let me speak first. I am M. Carr Ferguson, Assistant Attorney General for the Tax Division. The subject of my remarks will be section 7609, the section which was addressed by Mr. Stark most recently. It is really one of the two separate concepts which the committee is considering today, and if we take it up first, perhaps we can get it out of the way and get on to the other one.

The two separate concepts, as I see them, are, first of all, access by the Internal Revenue Service for tax information and tax audit purposes, to the financial information maintained by third party recordkeepers. And then, second, and separately, access by the Department of Justice to tax information in the hands of the Internal Revenue Service. Now, I am going to speak to the first of those two problems, and then I think Mr. Nathan, from the Criminal Division of the Department of Justice, and Commissioner Kurtz and Mr. Cohen, both from the Internal Revenue Service, will address, primarily, at least, the second.

I know we all share the common goal of lessening the enormous delays which now exist in obtaining financial records necessary for tax audits and investigations. At the same time, all of us are eager to maintain taxpayers' interests to the maximum extent possible.

As you no doubt know, the current section 7609 was enacted by Congress in 1976. Its purpose was to give each taxpayer a notice that records pertaining to him had been summoned from a bank or other recordkeeper, and an opportunity to challenge the summons in court.

Shortly after the enactment of section 7609, it became apparent that these statutory procedures were causing unnecessary delays. Indeed, when the Right to Financial Privacy Act—which governs similar summonses issued by nontax agencies—was proposed in 1978, Congress recognized the infirmities in section 7609 and established new procedures which were designed to minimize delays in enforcing nontax summonses.

It is clear that the current section 7609 procedures excessively delay the activities of the Internal Revenue Service in obtaining records and proceeding with the tax investigation. These needless delays occur in litigating and obtaining court enforcement of the summons—the activity in which the tax division is directly involved—and also in obtaining the records and proceeding with the tax investigation—which of course are the responsibilities of the Internal Revenue Service.

Our aim is to find the proper balance between the interests of taxpayers with respect to their financial records, and the legitimate law enforcement needs of the Internal Revenue Service. We believe that the current section 7609 provisions unnecessarily delay the Service's access to financial records which are necessary for tax audits and investigations. At the same time, it is apparent that procedures could be drafted which allow taxpayers to protect their interests without delaying tax law enforcement.

The principal cause of delay under the present statute stems from the provision which allows a taxpayer merely to send a letter of objection in order to stay summons compliance, when records pertaining to him are summoned from a recordkeeper. This procedure encourages taxpayers to obtain letter-stays in all cases because the letter procedure is so informal, and no specific grounds for objection need be stated in the letter. The letter has the same effect as a judicial restraining order, and the Service is then faced with the task of reviewing the entire file and forwarding the case to Justice for the filing of an enforcement action in district court. In the meantime the revenue or special agent's investigation has been impeded if not halted.

Most of the letter objections are sent solely to obtain the stay and the resulting investigation delay, as is demonstrated by statistics set forth in a recent GAO report. GAO estimated that taxpayers stayed 2,313 summonses by letter in the 13-month period immediately following enactment of section 7609. Yet taxpayers only exercised their rights to intervene in 217 summons enforcement proceedings filed in court by the Government in that period. Thus an enormous number of investigations are halted by letter-stays, even though only a small proportion of the summonses are actually contested in court. This situation is aggravated because under present law, the statutes of limitations for criminal and civil tax purposes keep running during the letter-stay, and the running of the limitations period is not suspended until the Government formally files in court its enforcement petition.

The motion-to-quash procedure, which is used in S. 2403 and is derived from the Right to Financial Privacy Act, is the key to eliminating these stays by letter and the attendant unnecessary delays. Under the motion-to-quash procedure, a taxpayer would be notified as at present when records pertaining to him are sum-

moned from a recordkeeper. But the summons would only be stayed initially for 14 days. During this time, the taxpayer would have to file in Federal district court a motion to quash in order to obtain any further stay of compliance. S. 2403 also contains provisions designed to expedite the motion-to-quash proceedings, and thus cut delays in summons compliance to a minimum.

For the reasons which we shall set forth, we enthusiastically welcome the introduction of S. 2403 and support it. However, we believe several refinements of S. 2403 may enable it to better accomplish its objectives. With the chairman's permissions, I would like to submit for inclusion in the record a draft statute which formally incorporates these suggested refinements.

First, we agree with the S. 2403 requirement that the taxpayer's motion to quash contain sworn facts demonstrating his basis for objecting to the summons, but would add a provision allowing the court to deny the motion forthwith if the taxpayer's affidavits do not make out a prima facie case that the summons is unenforceable for any reason. This requirement would deter a great many taxpayers with frivolous or totally groundless objections from even filing a motion to quash. The result would be a speedier resolution of tax issues to the mutual benefit of taxpayers and the Government.

Second, S. 2403 should contain a provision specifically authorizing the district court to summarily deny those motions to quash which fail to establish a prima facie case—such as in most tax protester cases. This provision would cut delays considerably by eliminating the need for time-consuming hearings, briefs from the parties, and the like. S. 2403 does not specifically address this point.

Third, under current law a bank or other recordkeeper must often appear in court when the taxpayer challenges a recordkeeper summons, even though the recordkeeper has no objection to the summons. S. 2403 properly relieves recordkeepers of the burden by requiring the taxpayer to initiate and litigate the motion to quash. We suggest that a provision be added which would relieve recordkeepers of all liability to any person when they produce customer records in good faith compliance with judicial or administrative orders issued under the statute. Further, we would like to have an additional provision which would require the recordkeeper to intervene in the motion-to-quash proceeding if it wished to assert its own objection to the summons—for example, the alleged burdensomeness of the summons. Under S. 2403, it would be possible for the recordkeeper to sit out the taxpayer's motion-to-quash proceedings, and then delay the summons later by litigating its own objection in a separate proceeding. Of course, this suggested procedure would not require the recordkeeper to appear in any proceeding if it wished to comply with the summons.

Fourth, we would suggest adding a provision to make it clear that Federal magistrates may conduct all proceedings in recordkeeper summons cases, thus relieving the crowded dockets of the district courts and expediting the proceedings. With the consent of the parties, the magistrate would be allowed to enter the final decision without any review by the district court. In general, such a provision would apply the jurisdictional provisions of the Federal

Magistrate Act of 1979, Public Law 96-82, to tax recordkeeper summonses.

We believe that S. 2403, with these proposed refinements, would drastically decrease the number of recordkeeper summonses which are stayed and the number which are litigated. As a result of the enactment of section 7609 in 1976, the number of summons cases brought by the Justice Department tripled. While it is difficult to make anything more than rough estimates, we believe that adoption of these motion-to-quash procedures would dramatically decrease the number of recordkeeper summonses which are stayed, and would expedite the remainder. Figures appearing in a GAO report indicate that the Government obtained enforcement in 765 out of 771 recordkeeper summons cases in the first 16 months after section 7609 went into effect. Manifestly, the only benefit of forcing the Government to court in most of these cases was to impede and delay the Government's tax investigation. Few taxpayers will likely be willing to burden the courts with groundless cases if they could be disposed of quickly by a judge or magistrate, with little delay in summons compliance. Under a similar motion-to-quash procedure, only 15 motions to quash were filed under the Right to Financial Privacy Act in the first 8 months it was in effect.

I would like now to discuss the S. 2403 appeal procedures. The GAO statistics make it apparent that the appeal procedures would affect only relatively few cases. However, when appeals do occur, they can have considerable importance because of their potential for delaying the investigation for years, and because of the important substantive rights that may be involved. The appeals provisions must also be carefully considered because they raise other important issues respecting the administration of the revenue laws.

Under S. 2403, if a taxpayer is denied a motion to quash in a final decision of the district court, the recordkeeper is obligated to turn over forthwith the summoned records to the Government. The taxpayer may not immediately appeal the denial of his motion to quash. Instead, in order to appeal he must wait until either he or the Government files a substantive tax action—viz., a criminal proceeding or collection action filed by the Government; a refund suit or Tax Court action filed by the taxpayer; or bankruptcy proceedings. The taxpayer may then press the allegedly improper denial of his motion to quash as a basis for appealing the substantive tax action. If he prevails on the appeal, the taxpayer is entitled to damages and attorney's fees. If no substantive tax action is brought, the taxpayer would lose his right to appeal the summons question.

We submit for your consideration a somewhat different approach, which would allow every taxpayer an opportunity for immediate appellate review of the final denial of his motion to quash. After the district court denied the motion to quash, the taxpayer would be required to obtain a stay of the order from the court of appeals within 10 days in order to stop the recordkeeper from complying. The court of appeals would apply the usual stay requirements, which include a demonstration of the taxpayer's irreparable injury plus a showing that the taxpayer is likely to prevail. Only if the stay were granted could the taxpayer proceed with his appeal, because in the Government's view the turnover of the

records moot the appeals. The appellate stay—and thus the time period for deciding the appeal—would be limited to 6 months.

The appeal procedure we suggest would contain a valuable provision for expediting district court proceedings. S. 2403 has provisions requiring the court to enter its decision 10 days after the Government's response is filed. Similar deadlines in the Right to Financial Privacy Act and Code section 7429 have consistently been ignored, however. Accordingly, we suggest that, if the district court or magistrate does not issue a final decision within 30 days of the filing of the Government's response to the motion to quash, the Government should be able to issue an administrative order—a so-called certificate of compliance. If the taxpayer did not obtain an appellate stay of such certificate within 10 days, the recordkeeper would have to turn over the records to the Government. This procedure would be somewhat similar to that in section 3310 of the Internal Revenue Code, which provides for prompt enforcement by the Internal Revenue Service of certain orders of the Secretary of Labor, unless a stay is obtained from the court of appeals. This provision would provide extra assurance that the district court or magistrate would quickly adjudicate motions to quash.

We believe that the immediate appeal procedure which we suggest is preferable to the delayed appeal procedure in S. 2403 for several reasons.

First, we would like to see a continuation of the current procedure of allowing taxpayers an opportunity to have an immediate appellate review before any turnover of records to the Government, with certain expediting refinements. By contrast, S. 2403 follows the Right to Financial Privacy Act model, which requires deferred appeals in recordkeeper summons cases, even though immediate appeals would still be allowed in all other tax summons cases. We submit that it may be preferable to allow immediate appeals in all summons cases, and think it is possible to do so.

Second, we would prefer to have provisions which would give all taxpayers who lose in the district court an opportunity to obtain appellate review of the summons issue in recordkeeper cases, as they can in all other summons cases. We recognize that S. 2403 has departed from the Right to Financial Privacy Act in this regard, presumably in recognition of the difficulties in drafting and administering analogous appeal provisions because of the multiplicity of types of tax litigation. Nonetheless, the immediate appellate review which we suggest, which is somewhat more limited than that under the current section 7609, would seem to be workable while allowing all taxpayers and intervenors the right of appeal, and yet avoiding the difficulties which S. 2403 properly anticipates.

Third, we think that there is much merit in the current summons procedure of allowing taxpayers an opportunity to obtain appellate review in virtually all cases before the records have to be turned over to the Government, and suggest that this procedure be continued if possible in the appeals provisions. S. 2403 defers the taxpayer's appeal until after the records are turned over to the Government, which of course has the obvious effect of assuring that delays end when the trial court issues its decision. Nonetheless, we think that appellate stay provisions can be drafted which would dispose of groundless taxpayer appeals within a few days,

but which would assure that taxpayers, financial institutions, and the Government would have the benefit of a prompt appellate decision in taxpayer or intervenor appeals raising important and substantial issues.

Fourth, we think that it would considerably expedite summons litigation if the statute contained a provision allowing the Government to issue the administrative certificate of compliance requiring turnover of records within 10 days, if the district court unduly delayed its decision and the taxpayer or intervenor was denied an appellate stay of the certificate. We think that some such procedure is necessary, because experience under the Right to Financial Privacy Act and other statutes indicates that trial courts frequently do not heed time limitations on decisions, such as the 10-day limit in S. 2403. Such a certificate of compliance would probably only be practicable if the statute contained immediate appeal provisions along the lines which we recommend.

Two other points should be mentioned. Under current law, the statutes of limitations for tax purposes are suspended from the time the Government brings the summons enforcement action until the litigation has been concluded. S. 2403 would continue this pattern, suspending the limitations period for the period from the time the taxpayer files the motion to quash until such litigation has been concluded. Because frequently a significant amount of time elapses after conclusion of litigation before the records are turned over to the Service, we suggest that the suspension period be extended until such turnover is complete. Moreover, we urge that the S. 2403 statute of limitations period be applied to section 7602 nonrecordkeepers summonses as well. We fear that if S. 2403 eliminates delays from recordkeeper cases, taxpayers might try to delay investigations by protracting nonrecordkeeper summonses, absent a limitations suspension provision.

We also wish to note that S. 2403 defines the persons who are entitled to receive the notice and file a motion to quash somewhat differently from current law. S. 2403—like the Right to Financial Privacy Act—excludes from the terms of the statute corporations, and partnerships containing more than five persons. We agree with this exclusion, because such corporations and partnerships are normally more commercial in character, and have less basis for protecting their financial records from disclosure.

In conclusion, we believe that S. 2403—particularly if it can embody some or all of the refinements we suggest—will go a long way toward eliminating major delays in the tax investigation process, thereby enabling the Internal Revenue Service to make better use of its investigative resources. These changes should also reduce court congestion and expedite trial and appeal of cases challenging recordkeeper summonses.

Thank you.

Senator BAUCUS. Thank you very much, Secretary Ferguson.

[The attachment to Mr. Ferguson's statement follows:]

S. 2403 WITH PROPOSED REFINEMENTS

(a)(1):

(a) Notice.--

(1) In General.-- If--

(A) any summons described in subsection (c) is served on any person who is a third-party recordkeeper, and

(B) the summons requires the production of any portion of records made or kept of the business transactions or affairs of any person (other than the person summoned) who is identified in the description of the records contained in the summons,

then notice of the summons shall be given to any person so identified within 3 days of the day on which such service is made, but no later than the 14th day before the day fixed in the summons as the day upon which such records are to be examined. Such notice shall be accompanied by a copy of the summons which has been served and shall contain directions for staying compliance with the summons under subsection (b)(2). Such notice shall be accompanied by a copy of the summons which has been served and shall contain directions for filing a motion to quash the summons under subsection (b)(2). [Current law with last sentence as added by S. 2403.]

(a)(2):

(2) Sufficiency of Notice.-- Such notice shall be sufficient if, on or before such third day, such notice is served in the manner provided in section 7603 (relating to service of summons) upon the person entitled to notice, or is mailed by certified or registered mail to the last known address of such person, or, in the absence of a last known address, is left with the person summoned. If such notice is mailed, it shall be sufficient if mailed to the last

known address of the person entitled to notice or, in the case of notice to the Secretary under section 6903 of the existence of a fiduciary relationship, to the last known address of the fiduciary of such person, even if such person or fiduciary is then deceased, under a legal disability, or no longer in existence. [Current law.]

(a)(3):

(3) Definitions.

(A) "Third-party recordkeeper means--

(i) any mutual savings bank, cooperative bank, domestic building and loan association, or other savings institution chartered and supervised as a savings and loan or similar association under Federal or State law, any bank (as defined in section 581), or any credit union (within the meaning of section 501(c)(14)(A));

(ii) any consumer reporting agency (as defined under section 603(d) of the Fair Credit Reporting Act (15 U.S.C. 1681a(f));

(iii) any person extending credit through the use of credit cards or similar devices;

(iv) any broker (as defined in section 3(a)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78c (a)(4));

(v) any attorney; and

(vi) any accountant.

(B) "Persons entitled to notice" means any individual or partnership of not more than five individuals. [As amended by S. 2403.]

(a)(4):

(4) Exceptions.-- Paragraph (1) shall not apply to any summons--

(A) served on the person with respect to whose liability the summons is issued, or any officer or employee of such person,

(B) to determine whether or not records of the business transactions or affairs of an identified person have been made or kept, or

(C) described in subsection (f). [Current law.]

(a)(5):

(5) Nature of Summons.-- Any summons to which this subsection applies (and any summons in aid of collection described in subsection (c)(2)(B)) shall identify the taxpayer to whom the summons relates or the other person to whom the records pertain and shall provide such other information as will enable the person summoned to locate the records required under the summons. [Current law.]

(b)(1):

(1) Challenge to Summons.

Within fourteen days after the day notice is given in the manner provided in subsection (a)(2), a person entitled to notice of a summons under subsection (a) may file a motion to quash the summons with copies served upon the person summoned, upon the Attorney General and the United States Attorney for the district where the motion is filed, and upon such person and to such office as the Secretary may direct in the notice referred to in subsection (a)(1). Service shall be made under this subsection by delivering or mailing by registered or certified mail. A motion to quash a summons shall be filed in the United States district court for the district in which the person entitled to notice resides. Such motion shall contain an affidavit or sworn statement stating--

(A) that the movant is the person to whom the records sought by the summons relate; and

(B) the reasons that the records sought are not relevant to a legitimate tax inquiry or any other legal basis for quashing the summons. [Subsection (b)(2), paragraph one, of S. 2403, as modified.]

(b)(2):

(2) If the court finds that a person entitled to notice under subsection (a) has complied with subsection (b)(1), it shall order the United States to file a response within 20 days. The United States may file a response whether or not it is ordered to do so. [Subsection (b)(2), paragraph two, of S. 2403, as modified.]

(b)(3):

(3) Within ten days after the motion to quash is served, the person summoned may file a motion to intervene containing an affidavit or sworn statement setting forth the specific grounds therefor, with service upon the United States as prescribed in subsection (b)(1). Failure to intervene in the motion-to-quash proceeding shall be deemed a waiver of the objections of the person summoned to enforcement. The person summoned may object to the summons on any legal basis. The court may order the United States to file a response to the motion to intervene. The response shall be due within 20 days. The United States may file a response whether or not it is ordered to do so. [New.]

(b)(4):

(4) If the court is unable to determine the motion to quash or the motion to intervene on the basis of the parties' initial allegations and response, the court may conduct such additional proceedings as it deems appropriate. All such proceedings shall be completed and the motion or application decided within ten days after the filing of the response of the United States to the motion to quash, or the response of the United States to the motion to intervene, whichever is later. [Subsection (b)(2), paragraph two, of S. 2403, as modified.]

(b)(5):

(5) The challenge procedures of this section constitute the sole judicial remedy available to a person entitled to notice under subsection (a) to oppose disclosure of records summoned pursuant to this section. [Subsection (b)(2), paragraph four, of S. 2403, as renumbered.]

(b)(6):

(6) Nothing in this section shall entitle a person entitled to notice under subsection (a) to assert the rights of a third-party. [Subsection (b)(2), last paragraph of S. 2403, as renumbered.]

(c):

(c) Summons to Which Section Applies.--

(1) In General.--Except as provided in paragraph (2), a summons is described in this subsection if it is issued under paragraph (2) of section 7602 or under section 6420(e)(2), 6421(f)(2), 6424(d)(2), or 6427(g)(2) and requires the production of records.

(2) Exceptions.-- A summons shall not be treated as described in this subsection if--

(A) it is solely to determine the identity of any person having a numbered account (or similar arrangement) with a bank or other institution described in subsection (a)(3)(A), or

(B) it is in aid of the collection of--

(i) the liability of any person against whom an assessment has been made or judgment rendered; or

(ii) the liability at law or in equity of any transferee or fiduciary of any person referred to in clause (i).

(3) Records; Certain Related Testimony.-- For purposes of this section--

(A) the term "records" includes books, papers, or other data, and

(B) a summons requiring the giving of testimony relating to records shall be treated as a summons requiring the production of such records. [Current law.]

(d):

(d) Restriction on Examination of Records.--No examination of any records required to be produced under a summons as to which notice is required under subsection (a) may be made--

(1) before the expiration of the 14-day period allowed for the motion to quash under subsection (b)(2), or

(2) upon the filing of a motion to quash pursuant to subsection (b)(2) except in accordance with an order of the court, or a certificate of compliance issued pursuant to subsection (j). [S. 2403, as modified.]

(e):

(e) Suspension of Statute of Limitations.-- If any person is a party to a summons enforcement action brought under section 7602 or a motion to quash proceeding brought under subsection 7609(b), and such person is the person with respect to whose liability the summons is issued (or is the agent, nominee, or other person acting under the direction or control of such person, or the attorney, accountant, or partner of such person, or a corporation of which such person is a controlling shareholder), then the running of any period of limitations under section 6501 relating to the assessment and collection of tax) or under 6531 (relating to criminal prosecutions) with respect to such person shall be suspended for the period consisting of (1) the time when there is pending a proceeding, and appeals therein, with respect to any litigation relating to the summons, plus (2) the additional time until all production orders of the court, and any certificate of compliance issued pursuant to subsection (j), are satisfied. [S. 2403, as modified.]

(f):

(f) Additional Requirement in the Case of a John Doe Summons.-- Any summons described in subsection (c) which does not identify the person with respect to whose liability the

summons is issued may be served only after a court proceeding in which the Secretary establishes that--

(1) the summons relates to the investigation of a particular person or ascertainable group or class of persons,

(2) there is a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provision of any internal revenue law, and

(3) the information sought to be obtained from the examination of the records (and the identity of the person or persons with respect to whose liability the summons is issued) is not readily available from other sources. [Current law.]

(g)(1):

(g) <u>Special Exception for Certain Summonses</u>.--

(1) In the case of any summons described in subsection (c), the provisions of subsections (a)(1) and (b) shall not apply if, upon petition by the Secretary, the court determines, on the basis of the facts and circumstances alleged, that there is reasonable cause to believe the giving of notice may lead to attempts to conceal, destroy, or alter records relevant to the examination, to prevent the communication of information from other persons through intimidation, bribery, or collusion, or to flee to avoid prosecution, testifying, or production of records. [Current subsection (g), as renumbered.]

(g)(2):

(2) If the court or magistrate issues an order under subsection (g)(1), it shall have jurisdiction to enter an <u>ex parte</u> order prohibiting the recordkeeper from disclosing that records have been obtained or that a request for records has been made. [New.]

(h):

(h) <u>Jurisdiction of District Court</u>.--

(1) The United States district court for the district within which the person to be summoned resides or is found shall have jurisdiction to hear

and determine proceedings brought under subsections (f) or (g). The determinations required to be made under subsections (f) and (g) shall be made _ex parte_ and shall be made solely upon the petition and supporting affidavits. An order denying the petition shall be deemed a final order which may be appealed.

(2) Except as to cases the court considers of greater importance, a proceeding brought for the enforcement of any summons, or a proceeding under this section, and appeals, take precedence on the docket over all cases and shall be assigned for hearing and decided at the earliest practicable date. [Current law.]

(i):

(i) _Duty of Third Party_.-- Upon receipt of a summons described in subsection (c), the third-party recordkeeper shall, unless otherwise provided by law, proceed to assemble the records requested and must be prepared to produce the records pursuant to the summons on the day upon which the records are to be examined, or in the event a motion to quash has been filed, within ten days after entry of (1) the final order of the district court or magistrate, or (2) the issuance of the certificate described in subsection (j). Any third-party recordkeeper, or agent or employee thereof, making a disclosure of financial records pursuant to this section in good-faith reliance upon a certificate described in subsection (j), or an order of a court requiring production of records, shall not be liable to any customer or other person for such disclosure. [S. 2403, as modified.]

(j):

(j) If a final order of the district court or magistrate has not been filed within 30 days after the last response of the United States described in subsection (b)(4), the United States may certify in writing to the recordkeeper described in subsection (c) that it has complied with the applicable provisions of this section. The recordkeeper shall produce the summoned books or other data ten days thereafter, unless prior to that time the district court or magistrate quashes the summons or a stay is obtained pursuant to subsection (k). [New.]

(k):

(k) Denials of Motion to Quash; Jurisdiction of Courts of Appeals.-- The courts of appeals, or a judge thereof, shall have jurisdiction, pending a hearing by the court:

(1) to stay an order of the district court or magistrate under this section ordering or staying compliance with a summons;

(2) to stay a certificate of compliance issued pursuant to subsection (j); or

(3) to modify or dissolve an order staying a certificate of compliance issued pursuant to subsection (j).

Such order of the court of appeals shall be filed within ten days after there has been filed in the court of appeals either (i) an application for stay, or (ii) an application for modification or dissolution of a district court stay.

The total period during which the court of appeals may stay an order requiring compliance, or a certificate of compliance, shall not exceed 6 months.

(*l*):

(*l*) Jurisdiction of Magistrates.--

(1) A United States magistrate, when designated or requested pursuant to section 636(b)(3) and (c)(1) of Title 28, may exercise jurisdiction over all proceedings under this section, and submit a recommended final decision or final order to the district court.

(2) A United States magistrate, when designated or requested pursuant to section 636(b)(3) and (c)(1) of Title 28, may exercise jurisdiction over all proceedings under this section, and issue a final decision or final order, where the parties to the litigation consent to jurisdiction pursuant to the procedures in section 636(c)(1) and (2) of Title 28. [New.]

STATEMENT OF HON. IRVIN B. NATHAN, DEPUTY ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION, U.S. DEPARTMENT OF JUSTICE

Mr. NATHAN. Mr. Chairman, I am Irvin Nathan, Deputy Assistant Attorney General in the Criminal Division.

Senator BAUCUS. Mr. Nathan, before you begin, just in the interests of those who might be wondering, my intention is to continue straight on through with this hearing, not to break for lunch. There is another panel. GAO will follow your panel. Then there is another panel of ACLU and, I think, some other witnesses, so, for the interests of those in the room, we will continue straight on through.

I also encourage all of you to, if possible, summarize your testimony, and try to get to the main points you are trying to make. If you do want to read it, that is fine, but I would encourage you to summarize, if you can.

Mr. NATHAN. Mr. Chairman, I would like to do precisely that, to offer into the record the full statement which represents the administration's view with respect to these proposed changes, and if I may, to summarize those views.

Senator BAUCUS. All right. All of your statements will be included in the record.

Mr. NATHAN. Essentially, we support proposed changes to the present Tax Reform Act disclosure provisions which we think will aid us in effective law enforcement, and which we do not believe will adversely affect privacy interests or the administration of the voluntary tax system.

I think that you have heard today the competing considerations, and the record of this subcommittee is accurate. The tax disclosure provisions have adversely affected law enforcement over the last 3½ to 4 years since they have come into effect, and I think that as we go through the proposed changes, you will see that they will not adversely impinge on legitimate privacy interests.

Very briefly, just to give a little bit of a view of what the problem is, prior to 1976 it was possible for Federal prosecutors and criminal investigators to receive information in the hands of the Service which could be used in the investigation and prosecution of financial crimes. Since that time, it has become much more difficult to obtain access to the information. The hurdles that one has to go through are much more onerous. The time delays are significant, and the procedures that must be followed including, for example, having to come to Washington for approval rather than handling these matters in the field, have caused serious problems.

I think it is important to state at the outset that our review of the legislative history of the statute does not reveal that there were any abuses of the tax information in the hands of Federal prosecutors prior to 1976, and that the main focal point of the changes was to prevent the recurrence of political misuse of tax returns by certain political aides who had sought them to embarrass the political enemies of prior administrations.

We continue to believe a statute is appropriate to prevent such kinds of misuse, and it is also appropriate to insist that information which is provided to law enforcement officials be used exclu-

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sively in the investigation and prosecution of specific Federal crimes.

The GAO back in March 1979 found that the nondisclosure provisions had adversely affected coordination between the Department of Justice and the Internal Revenue Service, but indicated that it did not believe that at that point the adverse effects had been sufficiently documented.

Since that time, we have undertaken a massive survey, that is, the Tax Division and the Criminal Division have surveyed all Federal prosecutors to determine what effects the statute has had. We have received the information from across the country, and it has been compiled in a 50-page summary, and the basic data is available to this committee as well. We would be pleased to make the summary available to the committee, as well as the underlying data to the staff. I think this survey demonstrates the impediments which have been encountered, the investigations which have not been allowed to be consumated within the required time set by statutes of limitation and the Speedy Trial Act. I think you will see the serious effects that the provisions have had.

In the GAO report, they also point out that the IRS has presently in its possession significant amounts of evidence of nontax Federal crimes which, because of the statutory provisions, they have been precluded from providing to the appropriate law enforcement agency.

This evidence has included the fact, for example, that corporations have paid bribes to Federal officials. They have the names of the corporations, the names of the Federal officials, and we do not have that information at the FBI or in the Department of Justice. It resides in the files of the IRS.

Senator BAUCUS. Is that information apparent on its face? I mean, when the IRS receives a return, can it tell by looking only at the return that there is a probable bribe here?

Mr. NATHAN. I don't know. Of course, I haven't seen this information. It is in the hands of the Service. And I don't know that it comes from the return as opposed to underlying books and records of the corporation that reveals it, but I gather that on its face, it indicated at least to experienced IRS investigators that bribes have been paid to Federal officials by that corporation, and that is not available to us.

The IRS also has evidence that individuals had defrauded the Customs Service of hundreds of thousands of dollars, evidence that corporations had made substantial payments to union officials, had violated the Taft-Hartley statute. In the last 2 months, we have been informed by the IRS that they have evidence of nontax crimes in their files that they have received only recently that has come from the field to headquarters at IRS suggesting that possibly this should be disclosed to the Department of Justice. The disclosure office, complying with the Tax Reform Act, has said that it cannot submit that information, and this information indicates that there is wire and mail fraud, perjury, embezzlement, concealment of a large Government overpayment, illegal political contributions, even the location of a homicide suspect. This information cannot be provided to us because of the provisions of the Tax Reform Act.

I think that I would like to turn to the changes in this statute we propose, which I think will show you how we can fine-tune the legislation without undermining its essential purpose, without undermining the privacy interests of individuals, without undermining our tax collection system, and still assist law enforcement in making sure that crimes such as I have just described do not go undetected, undetected by the agencies who are by law required to prosecute.

In the first place, we support the notion that there be a court order to obtain the income tax returns of all Americans, individuals and corporations. The tax returns themselves should be protected, and there ought to be a judicial, a neutral judicial arbiter to decide that the Department of Justice should obtain those tax returns.

We also believe that underlying books and records of an individual, the books and records that an individual supplies to the Service to support his return when he is audited, should also be given substantial protection and should be protected by the court order requirements.

But presently, the court order requirements make very little sense. They don't protect privacy. They simply harass and burden the prosecutors and investigators who are seeking to use the procedure.

In the first place, a U.S. attorney who is appointed by the President and confirmed by the Senate cannot seek the court order. He has to come to Washington, to the Attorney General or to an Assistant Attorney General, to get permission to make the application to the court.

That process alone, on the average, according to our survey, takes approximately 3 weeks before it can be accomplished, from the time it is sent from Washington until it is received back in the field. Then, when the U.S. attorney is authorized to go to court, and he invariably is authorized because he has met the requirements, the present statute has three stringent requirements. The first of these we do not disagree with, and that is that there be a showing that a specific Federal crime is being committed or has been committed or there is reason to believe that.

But the second two standards are extremely difficult to establish. One is that the evidence is going to be probative of a matter in issue. Now, this is in the early phases of investigation. It is hard to establish evidentiary standards and know exactly what are the matters that are going to be in issue. Beyond that, the third requirement is to establish either that the evidence is not available elsewhere or that it is the most probative evidence in proving that fact.

Now, this is an extremely difficult standard, one which simply is almost impossible to meet, and it may explain why the number of tax returns sought since the passage of the act is down very significantly. It is down to 10 percent, approximately, of what it was in the year prior to the effective date of the Tax Reform Act.

We propose, first of all, that this matter be decentralized, that a U.S. attorney in the field be allowed to go to court to seek the court order. Further, we propose that the court order requirement be simply that we have an investigation, and that we have reason to

believe that a specific crime has been committed, and that information on the tax return is relevant to that investigation. Of course, the papers would show the relevance to the investigation.

Now, once we have met those standards, then we think that a magistrate who presently can issue search warrants and arrest warrants ought to be authorized to allow the Department of Justice to obtain both the tax returns and, where appropriate, the individual books and records that underlie the tax return.

Senator BAUCUS. On that point, are you suggesting that the court order also be required to obtain return information?

Mr. NATHAN. Yes; if return information means the books and records, the financial books and records of the individual, his correspondence and so forth, which he has supplied to the Service in order for them to audit his tax return, then that, we think, should be covered. In this way, we differ from the Nunn proposal, which would provide only judicial protection for the returns themselves. We would go beyond that.

With respect, however, to corporate books and records——

Senator BAUCUS. Before you go into that, if you don't mind——

Mr. NATHAN. Yes.

Senator BAUCUS [continuing]. How many requests are there by U.S. attorneys in the field for the Commission to seek the permission of the court for IRS information? Are any turned down?

Mr. NATHAN. Well, with respect to turndowns by the Assistant Attorney General, I am not aware of any that have been turned down. There are approximately 100 requests for tax returns made a year. This is under the statute. These are ones that we think can meet these stringent standards, and there were well over 1,000 per year in the years prior to the Tax Reform Act.

There have been a number, a small number that have been turned down by the courts. I would say it is less than 2 percent of the orders that have been sought, in part because the courts apply a commonsense standard. They do not apply too rigidly the third standard that I mentioned, that the information be unavailable elsewhere or the most probative. They don't force us too hard to focus on why it is probative of a matter in issue.

We think it is important that all prosecutors and all judges understand that that commonsense standard is, in fact, the right standard to apply. It would clarify the situation considerably.

Senator BAUCUS. Is it your view that there are fewer requests because the standards are higher?

Mr. NATHAN. Yes, because I think there are a lot of hoops we have to go through, and because the standards appear on their face to be too onerous to meet. The survey we have taken, which is available to the committee, demonstrates or indicates that that is in fact the case.

As I started to say, we don't believe that the same stringent protections should be necessarily applicable to corporate books and records. With respect to that, of course, we are not talking about wholesale disclosure of the records that are in the hands of the IRS.

What we propose is that when the Internal Revenue Service on its own finds evidence of nontax Federal crimes in the books and

records of the corporation, that it be required to turn that evidence over to the appropriate law enforcement agency.

Obviously, they don't turn over all the records. They only turn over that portion which demonstrates or indicates the commission of a serious Federal, nontax offense.

In addition to that change, we would also make it mandatory that the Service turn over evidence in its possession which comes from third parties. This does not come from the taxpayer himself, but is information they receive either from tips from an informant or that they receive from another individual or the books of a bank or other entities which indicate that another person is committing a serious Federal crime.

Under the present law disclosure of such evidence is discretionary. The Commissioner has the authority to turn over such information to the appropriate law enforcement official. However, we have received very little of that information. I would say that we have received less than two referrals a month since the Tax Reform Act has been in effect.

We think it important that it be mandatory. When there is serious evidence of nontax crimes that come to the attention of the Service, not from the taxpayer's tax returns, not from his underlying books and records, but from other sources, that just like any citizen whom we would ask to turn over the evidence of criminal conduct to a law enforcement official, the Service should be required to do so.

Senator BAUCUS. What is your reaction to the GAO suggestion of the court order?

Mr. NATHAN. Well, I would leave that to Commissioner Kurtz. I assume that GAO is not referring to third party information. I think that the GAO, as I understand it, supports the provision which would make it mandatory for the Service, without intervention of the court, to turn over third party information indicating nontax crimes. As I understand the GAO's proposal, it is that with respect to taxpayer return information——

Senator BAUCUS. What is your reaction to that?

Mr. NATHAN. Well, I think that the administration is not in favor of that requirement. We do not want to make the Service go through the protected books and records of the individual or the return looking for evidence of crimes, and going to the court to turn it over.

It would undermine, in the administration's view, the kind of privacy interests that are involved when an individual does turn over his return and his books and records.

Let me explain what I think is the policy here. We have asked taxpayers to reveal all of their income, the sources of their income, to the Internal Revenue Service, and to pay their taxes fairly on that, and we are exacting a price. We are asking them essentially to waive their fifth amendment privilege with respect to that information, to disclose it to the agency to collect taxes, so that we can have the taxes.

The administration believes, and I know that the Service very deeply believes that in order to encourage that policy, the taxpayer must be assured that the Service itself is not going to use that

information, which we have asked him to provide, against him in a nontax context.

So, I think the GAO requirement raises that problem.

We propose the following with respect to taxpayers, for example, who do not live up fairly to their tax obligations. When a taxpayer does not honestly report his income tax, and the Service refers the matter over to the Department of Justice for tax prosecution, then at that point all the information which the Service has on that individual indicating nontax crimes in the materials which the Service has reviewed to make its tax case should be turned over to the appropriate law enforcement agency.

We think that if that policy is pursued, then we will effect the overall policy of insuring that there is honest compliance with the tax returns and with the tax service, and when there is not honest compliance with the tax service, then we will have access to the information revealing nontax crimes.

Senator BAUCUS. Do you think that requiring a court order is additional protection to the taxpayer?

Mr. NATHAN. We don't support the turnover of the information, with or without a court order. When the information comes, either from the tax return or from the individual's books and records, we think that the Service's responsibility there is to collect the taxes, and not to turn over that information.

We say that information should be provided in two situations. One is, if we have evidence of a nontax crime, we can go to a court and say, we have evidence of a nontax crime, we think the returns would be relevant to that crime. Then the court can direct that the Service provide to us the returns and the return information.

The second way is, if the individual does not comply with the tax laws, has been cheating on his income tax return, such that the Service thinks that he should be prosecuted for a tax violation, then the information would be provided to the law enforcement agencies on the nontax crimes.

Finally, we think that with respect to third party information, not the taxpayer's return and not return information from individuals, but third party information and corporate books and records, where that does show evidence of nontax crimes, that should be provided to the appropriate law enforcement agency by the Service, and the Service should be required to provide it.

There are other changes that we propose in the legislation which I think come under the heading of fine tuning, which essentially would decentralize the requesting of information. For example, presently, in order to request third party information from the Service, when we have reason to believe they have third party information that relates to the crime, we have to again come to Washington, seek the head of agency approval in order to make a letter request to go over, and there are serious standards that one has to meet in order to get that information.

We think that this should be relegated to the field, that prosecutors and supervisory investigators should be permitted to write to the local IRS office to ask for such third party information on a showing that it is relevant to a criminal investigation.

We also think there are other amendments that can be made with respect to improving the admissibility of the tax return infor-

mation. Presently the statute establishes different standards, more onerous standards than the general Federal Rules of Evidence. This is for information which is already in the hands of the prosecutor. We don't think that is warranted.

We also think it is important to establish in the legislation that pursuant to mutual assistance treaties, we can provide, through a court order procedure, tax return information about American citizens to foreign countries.

The reason is that we have found in negotiating mutual assistance treaties with foreign countries that they will not provide us information on, for example, narcotics traffickers from their countries or from overseas unless there is a mutuality.

They have said they will provide us, for example, their tax information so that we can use that in this country in prosecutions against foreign born drug traffickers, but not unless we would also agree to have some kind of mechanism whereby American tax information could be provided to them.

We think that pursuant to the court order procedure, once we have a treaty with a country, that we should be allowed to go to court to get the tax information and provide it to those prosecutors and investigators from other countries.

That in essence is the proposal. The sum and substance of it is that we very much support the major thrust of Senators Nunn and Chiles' bills that would enable us to obtain freer access to this information. We have some significant differences with it. One is the protection for individual books and records. Another is access by State and local authorities, which we do not think is warranted. Another is access for civil purposes.

We would limit the access to criminal law enforcement purposes or those civil forfeiture proceedings which are ancillary to criminal proceedings.

Thank you.

Senator BAUCUS. Thank you, Mr. Nathan.

[The prepared statement of Mr. Nathan follows:]

STATEMENT OF IRVIN B. NATHAN, DEPUTY ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION

Mr. Chairman and members of the subcommittee, I appreciate this opportunity to provide you with the views of the Department of Justice regarding proposed modifications in the nondisclosure provisions of the Internal Revenue Code. These proposals, although in the nature of technical and perfecting amendments, are critically important to remove serious impediments to effective federal law enforcement, particularly in such priority areas as the prosecution of narcotics trafficking, organized crime and white-collar offenses.

At the outset, I emphasize that we share the commitment of this Committee and the Congress to proper safeguards for the privacy interests of taxpayers. I am pleased to report that the disclosure amendments supported by this Administration have been developed after close consultation between the Internal Revenue Service and the Department of Justice and are endorsed by both of those agencies. We are confident that the proposals will enhance our law enforcement capacity without adversely affecting privacy interests or the administration of our voluntary federal income tax system.

THE PROBLEM

Prior to 1976, the Internal Revenue Service was an integral part of federal law enforcement, coordinating its efforts with other agencies, such as the Federal Bureau of Investigation, the Drug Enforcement Administration and the Organized Crime Strike Forces. Trained criminal investigators from the Service provided leads and assistance to investigators from other agencies who were not as well trained in sophisticated accounting matters. When information developed during the course of

IRS investigations showed serious violations of non-tax federal criminal statutes, the IRS agents routinely provided this information to the appropriate law enforcement agency. Such information often formed the cornerstone of successful prosecutions of serious white-collar or other sophisticated crimes.

This coordination and assistance were badly disrupted when Congress enacted the non-disclosure provisions of the Tax Reform Act of 1976. A thorough review of the legislative history of those provisions reveals that they were passed to prevent the kind political misuse of tax returns that had been perpetrated by White House aides working for President Nixon. You will recall that it was widely reported in the press that in the early 1970's some White House aides had obtained the tax returns of political enemies of the Nixon Administration whom they desired to embarrass. There is no question that such abuses were improper and this Administration shares the sentiment of the Congress that legislation should prohibit access to tax returns for political purposes.

Unfortunately, the statute passed went far beyond that salutary purpose. the Act's complex web of substantive and procedural restrictions on the disclosure of any information in the possession of the Internal Revenue Service has severely limited access to essential information for perfectly legitimate law enforcement purposes. At a time when our society uniformly seeks to combat and bring to justice high-rolling narcotics traffickers, entrenched organized crime kingpins and sophisticated corporate swindlers, the front line federal agencies must fight without the benefit of crucial data in the hands of another federal agency. It must be emphasized that nowhere in the legislative history of the 1976 statute were there any reported instances of abuse by federal prosecutors of information theretofore provided by the Service. The information provided to federal prosecutors prior to 1976 was used exclusively in a lawful manner to investigate and prosecute serious federal crimes.

However, as enacted in 1976, subsection 6103(i) of the Internal Revenue Code established needlessly severe, ambiguous, and cumbersome restrictions upon law enforcement access to tax information necessary in non-tax criminal investigations. Generally, the statute provides that all tax information is confidential and cannot be disclosed to law enforcement agencies unless one of the express—and highly complicated—exceptions applies, and then only pursuant to complex procedures. Moreover, the 1976 law establishes civil and criminal sanctions for any violation of its provisions, whether wilful or inadvertent. An IRS employee who makes a mistake in disclosing information to the Department of Justice risks up to five years in prison, a criminal fine of up to $5,000, and civil damages by the aggrieved taxpayer of at least $1,000, or more if any actual damages can be established. Of course, these sanctions are all in addition to any administrative sanctions, including dismissal, which may be imposed by IRS.

The effect of these new provisions was immediate and dramatic. Recognizing the consequences of mistaken disclosure of information, IRS took prompt steps to implement the statute and adopted internal procedures, definitions and regulations to protect taxpayers and IRS employees. A 1979 General Accounting Office Report concluded that as a result of the 1976 law, "coordination between IRS and the Department of Justice has suffered."

We have now had the experience of three and a half years of operating under the nondisclosure provisions, and I can state unequivocally that federal prosecutors and criminal investigators are convinced that no legislation is a greater handicap on our ability to contain serious financial crimes than the nondisclosure provisions of the Tax Reform Act.

MANIFESTATIONS OF THE PROBLEM

With sharply limited access to tax information and the expertise of highly trained IRS personnel upon whom we had long relied for assistance in unraveling complex financial transactions, we have found it extremely difficult to investigate and prosecute complex financial crimes. This loss has been felt in many areas of criminal law enforcement, but is particularly severe in the investigation of narcotics trafficking, organized crime syndicates, fraud against the government, foreign corrupt payments, corporate bribery, illegal currently transactions, and public corruption. In many of these cases, our investigations require us to follow a complex and purposely circuitous paper trail of financial transactions. Tracking down all of the key transactions to establish a complete picture of what occured is like piecing together a puzzle. Not only are IRS personnel among the world's best at assembling such puzzles. IRS often has the missing pieces among its records.

Generally, the 1976 law creates four major problems: (1) IRS is unable to advise us of the cases on which it is working with the result that there is sometimes duplication of effort; (2) it is unduly difficult to obtain IRS information which would materially assist in development of important criminal cases; (3) the statute makes

it difficult for IRS to provide other law enforcement agencies even with evidence developed based on sources independent of tax returns; and (4) in those few circumstances where prosecutors are permitted to work with the Service, the delays caused by the intricate and cumbersome mechanisms of the Act often stall investigations interminably.

The statute has caused a number of concrete problems which are frustrating to prosecutors and criminal investigators. In its 1979 Report, the GAO found that the IRS Disclosure Office literally has a file drawer full of evidence of serious federal nontax crimes which the Service has uncovered in the last three years but which the statute prevents from being transmitted across the street to the Department of Justice for investigation and prosecution. Included in this material revealed by the GAO Report were evidence that a corporation had paid bribes to a federal official, evidence that an individual had defrauded the Customs Service of hundreds of thousands of dollars; and evidence that corporations had made substantial payments to union officials and politicians which violated the Taft-Hartley and Corrupt Practices Acts. In the last two months alone, we have been informed that such serious nontax crimes as wire and mail fraud, perjury, embezzlement, concealment of a large government overpayment and illegal political contributions, as well as the location of a homicide suspect, have been reported by IRS agents to headquarters, which has been barred by the Tax Reform Act from doing anything but adding them to these file drawers.

In my testimony before the Senate Permanent Investigation Subcommittee last December, I described several specific cases in which prosecutors had been denied access, as a result of the statute, to important incriminating information in the possession of the Service. I will not rehearse those examples here.

Those examples were anecdotal in nature and were offered merely to serve as illustrations of the problems caused by the Act. In an effort to provide the Congress with comprehensive documentation of the impact of the Act on law enforcement, we developed and distributed a detailed questionnaire to all federal prosecutors late last year seeking to assess their experience under the Tax Reform Act. The questionnaire consisted of 60 specific questions and sought information on virtually every case in which Department attorneys have attempted to obtain information or assistance from the IRS in connection with nontax cases and joint tax/nontax grand jury investigations, as well as on the use of tax information in criminal tax cases.

A total of 355 responses to the survey were received, representing the experience of 105 different offices. These responses were carefully reviewed and analyzed, and the results compiled into a report of over 50 pages. For your ready reference, the summary section of the report is appended to my statement. We will, of course, provide the entire report to the Subcommittee upon request and can arrange for your staff's review of the individual responses to the questionnaire if you desire. Additional examples of the unfortunate consequences of the statute were contained in the report.

This report represents the first comprehensive effort to document the problems arising from the Tax Reform Act. Its 50 pages are filled with examples of serious difficulties with obtaining access to information, confusion over complex and ambiguous statutory standards, and—the factor most readily quantified—the enormous delays in obtaining either tax information, technical assistance, or the participation of the Service in joint tax/nontax grand jury investigations.

Perhaps the most revealing finding is that more than 50% of those surveyed sought information from the Service on only one of two occasions in the last three and a half years because they claimed their experiences and those of other prosecutors indicated that the statutory procedures were too cumbersome, too time-consuming and too restrictive. Even those offices which have continued to struggle with the disclosure procedures have sought tax records relatively infrequently. Total requests for tax information by federal prosecutors have plummeted from 1,816 in the year before the Act took effect to 255 in the most recent 12-month period for which statistics are available. It is, of course, impossible to quantify precisely the effects of this reduced access to tax information, but we believe that many investigations and presecutions of complex financial criminal cases have been jeopardized or frustrated for want of information known only to IRS.

The report's statistics on delay point up why so many prosecutors have given up on seeking to obtain information from the Service under the Tax Reform Act. In one case it took over two years to obtain a defendant's tax returns. In 1979-80 an average of 65.8 days elapsed before tax information sought pursuant to court order—and which we were entitled to obtain under the statute—was received by prosecutors. A significant part of this delay resulted from the requirement that the prosecutors in the field seek permission from the Assistant Attorney General in Washington before they can even file their papers with the court. Unlike delays

within the Service, which have recently been addressed by administrative charges, this aspect of the delay must be corrected by legislation. The cumulative effect of these delays in major investigations can be disastrous. Faced with Speedy Trial Act deadlines, statutes of limitations, and the demands of fast-moving investigations, delays produced by the 1976 law often foreclose the opportunity to obtain needed information under the disclosure provisions of the Internal Revenue Code.

Internally, the Administration has addressed these problems and the serious effect of these difficulties on federal law enforcement activities. For the past six months, IRS has worked closely with the Department in an effort to narrow the gap between us created by the statute. After a series of high level meetings, we have created a permanent IRS-DOJ Coordinating Committee which convenes every other week. These meetings have been productive and have resulted in administrative measures which should lessen some of the problems caused by the Act. These administrative changes are detailed in Commissioner Kurtz' testimony.

In addition to these administrative changes, the Administration is convinced that there must be legislative amendments in order to achieve an acceptable level of coordination and effectiveness on the part of federal law enforcement.

THE EMERGING CONSENSUS FOR REFORMS

With the documentation of Tax Reform Act problems developed by the Department of Justice, and through hearings by Senator Nunn's Permanent Investigation Subcommittee, Senator DeConcini's Subcommittee on Judicial Machinery, and Senator Chiles' Appropriation Subcommittee, support for corrective legislation has emerged. Chairman Long has joined Senator Nunn and six other Senators in co-sponsoring proposed amendments, which are now before this Subcommittee. Similar legislation has been introduced in the House of Representatives.

The General Accounting Office, which in 1979 concluded that adverse effects of the Act on law enforcement had not been sufficiently documented, now endorses corrective legislation. The Administration supports amendments to the Tax Reform Act developed by the Department of Justice, the IRS and the Domestic Policy Staff of the White House. Major national and local news organizations have reported on the problems created by the Act and advocated fine-tuning of the 1976 law. In short, support has developed in the Congress, the Administration and among the public generally for legislation to establish a proper balance between taxpayer privacy interests and the need for the proper administration of justice.

THE REMEDY TO THE PROBLEM: SUMMARY AND ANALYSIS

Our proposed revisions of the disclosure provisions would (1) redefine with precision those materials in the hands of the Service which are to be accorded confidential protection; (2) simplify and expedite the processes for obtaining the available information; (3) mandate the disclosure of evidence of serious nontax crimes coming to the Service from nonprotected sources; and (4) facilitate closer cooperation between the Service and other agencies for legitimate law enforcement purposes. As I have noted and will explain further as we proceed, we believe that all of these revisions can be accomplished without invading the legitimate privacy interests of taxpayers of impairing our voluntary tax collection system.

We believe that the information which should be protected are the tax returns themselves and the financial books and records which an individual keeps and submits to the Service to support the accuracy of his or her return. We do not believe that the Service should be required by law to withhold from any appropriate federal law enforcement agency (1) incriminating information provided about the taxpayer by third parties; or (2) evidence obtained by the Service from corporate records which are maintained for nontax purposes.

Tax returns which are required by law to be prepared and filed should clearly be given confidential protection. The Administration believes taxpayers will report their income more fully and honestly if they are confident that the information they report will not be used to incriminate them. Further, the Administration believes that in order to encourage an individual to maintain and retain accurate underlying financial records, these too should be accorded confidential treatment when they come into the possession of the Service. Accordingly, under the revisions we propose, no tax return and no individual's financial books and records in IRS possession could be disclosed to a federal law enforcement agency except upon a properly obtained court order.

Consistent with this policy, our propoosed revisions provide that if a taxpayer engages in fraud upon the Service by wilfully filing false returns, then the confidential protection for his return and underlying books and records is lost. Thus, we propose that once it becomes clear that a taxpayer has engaged in tax evasion, all of

the information developed by the Service in that case involving non-tax offenses committed by that individual would be turned over at the same time to the appropriate Federal law enforcement agency. We believe it makes no sense to continue to provide to a tax evader the benefits of the policy of confidentiality which was designed to encourage honest compliance in the first place. We would also provide that information in the possession of the Service, regardless of its derivation, which reveals the imminent commission of a crime involving bodily harm, could be disclosed. We believe that society's interest in preventing the harm is greater than any theoretical damage to the voluntary tax assessment system which could result from such a narrow exception.

Under present law, the Service may provide to appropriate law enforcement agencies evidence about non-tax crimes which comes to the Service's attention from third parties. Thus, if an informant tells an IRS agent that a taxpayer is engaging in tax fraud by deducting bribes paid to a Federal official, the Service may inform the Department of Justice about the allegation of bribery.

There are other kinds of information about individuals who do not derive from third parties but which we believe should also be turned over by the IRS to criminal investigators. This would include, for example, contraband obtained in a lawful manner by the Service. We are confident that the present statute does not mean to give protection to this category of information but some doubts appear to have arisen because of field-level interpretations of the statute. We believe that either in the revised definitional section of the statute or by administrative regulations, we should make clear that materials, such as contraband, are not protected by the disclosure provisions of the statute.

In a similar vein, we believe that evidence of non-tax crimes in the possession of the Service which comes from the books and records of corporations or other commercial entities should be reported to the appropriate Federal authorities. To reach this conclusion, we start from the premise that evidence of crime in the possession of a Federal agency should be made available to the agency responsible for investigating and prosecuting that offense, unless there is a clear overriding policy reason for maintaining the confidentiality of that material. As we have seen, there is such an overriding policy reason for tax returns and for protection of an individual's underlying financial records.

However, the reasons which support providing confidentiality to tax returns and individuals' financial records do not obtain with respect to a corporation's books and records. In the first place, corporations and other commercial entities are required by many non-tax Federal and local laws to maintain accurate books and records. Second, these records are available for production and inspection by Federal and local agencies other than tax authorities. Third, corporations and commercial entities, unlike individuals, have no Fifth Amendment privilege against self-incrimination. Thus, there is no overriding reason which justifies giving confidential protection to evidence of non-tax crimes which the Service finds in the books and records of corporations or other commercial entities. Under our proposed revision of the disclosure provisions, if the Service finds evidence of non-tax federal crimes in the books and records of a corporation, it will be required to report such information to the appropriate law enforcement agency, much as we would expect any citizen to report evidence of crime coming to his or her attention.

By requiring the Service to turn over incriminating information from all sources—other than tax return and an individual's underlying financial records—we will eliminate an important source of problems under existing law. Presently, if third-party information alone does not constitute ()evidence of a crime, but must be added to corporate financial data in the hands of the Service to make out the offense, the Service cannot turn over any information, including the "tip" of the third party. Under our proposed revision, experienced Service personnel can combine the third-party information and the corporate financial data, and if they add up to a non-tax offense, the Service will be free to transmit it to the proper authorities.

Having now explained our views concerning which categories of information should be protected and which should not, I would like to proceed sequentially through the statute and explain the nature of each of our proposed revisions and the reasons for them.

SPECIFIC AMENDMENTS NEEDED

Section 6103(i)(1) establishes the mechanism and standards by which we can seek a court order to obtain from the Service tax returns and other protected information which may be necessary in a criminal investigation. We support the principle that an ex parte court order should be necessary for seeking access to this type of protected information, but believe that the standards and procedures can be substantially refined.

Under the present statute, the application for such an order must show (1) reasonable cause to believe that a specific crime has been committed; (2) reason to believe the information sought—which the applicant hasn't yet seen—constitutes probative evidence of a matter in issue related to the commission of the crime, and (3) reason to believe the information sought cannot be obtained from any other source or that it is the most probative evidence available. This standard is a Catch-22 test; normally an applicant cannot attest that the tax information is the most probative evidence of a matter in issue without access to the information itself. Yet he cannot see the information until he obtains the order. Further, it is often difficult to predict at the early stages of an investigation what matters will be "in issue" by the time of trial. Such a standard does not protect privacy. It merely confuses applicants and courts, creates grave uncertainty over permissible disclosures, and in the end deters most prosecutors from seeking tax information.

Because federal judges are familiar with the realities of criminal investigation and prosecution, most federal courts interpret the statutory standard of § 6103(i)(1) in the light of reason and experience and accept a factual showing limited to the information that common sense indicates a prosecutor can reasonably be expected to develop through investigation: that a specific crime has been committed and that independent reasons exist to support a belief that the tax returns or financial data sought are relevant to the criminal investigation or prosecution. We believe this logical standard should be codified to eliminate the confusion and deterrent effect of the current statute and to insure uniform determination of disclosure applications by the courts. As this standard is in fact the one now followed by most courts, we believe codification would have no practical adverse effect on taxpayer privacy interests or tax administration.

A second problem with § 6103(i)(1) is that federal prosecutors cannot now file applications for disclosure orders without approval form Washington. The statute requires all applications for (i)(1) orders to be signed by an Assistant Attorney General. Thus, federal prosecutors must mark time while their applications are sent to Washington for the required signature and then returned for filing with the court. This is a time-consuming and pro forma process; rarely, if ever, does an Assistant Attorney General refuse to permit an application for return information to be filed with the courts. The requirement of approval in Washington significantly delays the process and makes the procedure more cumbersome for federal prosecutors. Its contribution to privacy or tax policy is unclear because a neutral and detached magistrate must review the application. We believe § 6103(i)(1) should be modified to authorize United States Attorneys, who are appointed by the President with the advice and consent of the Senate, to approve applications in the field.

We also believe that the order should be obtainable from United States Magistrates as well as district court judges. Magistrates are authorized to enter analogous orders, such as search and arrest warrants, and it would expedite the process if the application could be filled with and ruled on by them as well as by busy district court judges.

Section 6103(i)(2) applies to information relating to a taxpayer obtained by IRS from third parties rather than from the taxpayer or tax returns. The law permits this information to be disclosed pursuant to a formal written request to IRS specifying identifying information and "the specific reason or reasons why such disclosure is or may be material to the proceeding or investigation". As with (i)(1), we believe it is unreasonable to require a showing of materiality when the applicant has not yet seen the information which IRS has in its possession. Moreover, any expectation of privacy in such information gleaned from third parties is far less than exists as to information which the taxpayer himself has furnished to IRS. We believe, therefore, that (i)(2) should be revised to permit disclosure of such third-party information upon a certification that the material is sought exclusively for use in the investigation of a specified crime. This procedure effectively protects against abuse by creating a paper trial in connection with such disclosures; all (i)(2) disclosures would be documented and individual accountability estalished. As with (i)(1) applications for court orders, the (i)(2) request letters must now be signed by an Assistant Attorney General necessitating that every disclosure be routed through Washington. We recommend, therefore, that (i)(2) requests be permitted by field prosecutors and investigators disignated by the Attorney General. Finally, (i)(2) should authorize disclosure of whether a tax payer filed a return for particular year and whether there is or has been a criminal investigation of a taxpayer.

Section 6103(i)(3) governs situations in which IRS agents come across evidence of non-tax crimes in the course of their tax investigations. We are often unaware of the existence of this information and have no reason to request it under (i)(1) or (i)(2). The Service cannot pursue the matter itself because its investigative jurisdiction is limited to tax offenses. Section 6103(i)(3) permits, but does not require, the

Service to disclose the information to us if it was obtained from third parties. The limited disclosure mechanism established by (i)(3) has not worked well. The flow of (i)(3) information has been a mere trickle—about two referrals per month.

We believe that there should be two fundamental changes made to 6103(i)(3). First, the Service should be required to transmit to appropriate federal law enforcement agencies the unprotected information which reveals evidence of serious non-tax crimes. Second, as I have explained earlier, the unprotected information should include all information in the possession of the Service, except tax returns themselves and an individual's financial records which were retained and submitted to the Service to support the return. These changes are necessary to eliminate the anomalous and unhealthy present situation in which one federal agency is prohibited from initiating disclosure of evidence of serious crimes to other agencies responsible for investigating and prosecuting those offenses. Finally, in addition to making (i)(3) disclosures mandatory and establishing a broader category of information which may be disclosed, we believe the law should be amended to require (i)(3) disclosures to be made to the appropriate official in the district involved rather than to the agency head in Washington as is now the case.

Along with the changes to (i) (1), (2), and (3) I have suggested, the other major revision to the statute should be the modification of the penalty provisions. The sanctions of present law chill disclosures under the statute. The minor revisions to the penalty provisions made in November of 1978 have proven indequate to reverse the prevailing attitude, and extreme caution persists.

We recommend that where a disclosure is made inappropriately by an IRS employee, any civil action for damages must be brought against the Service rather than the individual employee. This approach is consistent with the Right to Financial Privacy Act of 1978, 12 U.S.C. 3417, and the Administration's proposed amendments to the Federal Tort Claims Act. If the court hearing the civil damage action finds that the violation was wilful, the Office of Personnel Management would be required to initiate administrative disciplinary proceedings against the responsible employee.

With respect to criminal sanctions, the Nunn bill would establish, as an affirmative defense to criminal prosecution, that the unauthorized disclosure resulted from a good faith, but erroneous, interpretation of the law. We are not certain that this would made any significant change in existing law as interpreted by the courts. We would note that § 1525 of S. 1722, the proposed Federal Criminal Code Revision, makes it an affirmative defense to criminal prosecution for disclosure of private information submitted for a governmental purpose that the disclosure was made to report a potential violation of law and was made to a law enforcement officer charged with investigating or prosecuting such a violation. The Administration supports that provision of the proposed Criminal Code bill. Of course, we are prepared to discuss with the Committee or other interested parties whether there are reasons why this proposed general principle is not appropriate in the area of tax disclosure.

The Administration also proposes minor amendments to § 6103(i)(4) governing admissibility of tax information into evidence in trials. We propose that admissibility of tax information be governed expressly by the Federal Rules of Evidence and that admission should be authorized in connection with civil forfeiture and other proceedings related to criminal cases. Furthermore, (i)(4) should make clear that tax information used in criminal cases is available to defendants under the Jencks Act and discovery provisions of the Federal Rules of Criminal Procedure. This is necessary to protect the due process rights of criminal defendants.

Finally, we favor an amendment to § 6103(k)(4) to clarify that federal tax information can be obtained for use by law enforcement authorities of foreign governments who provide United States authorities with similar information pursuant to mutual assistance treaties. Such international exchanges are presently authorized in connection with tax investigations and proceedings and should, we believe, be authorized pursuant to court order in connection with non-tax criminal matters as well. Of course, reciprocity is essential in dealing with foreign governments and any inability to furnish tax information to foreign governments in connection with their legitimate non-tax investigations will make it impossible for us to obtain foreign tax information in connection with our investigations. Because many complex criminal cases do require access to foreign tax information, this issue should be addressed in any disclosure amendments.

We believe the revisions I have outlined to § 6103(i), § 6103(k) and the penalty provisions will not undermine taxpayer privacy or our tax system and, they would substantially reduce the impediments to effective law enforcement created by the 1976 law.

COMPARISON OF ADMINISTRATION AND SENATE PROPOSALS

The proposals we endorse, after months of careful analysis and consultation between IRS and Justice, are remarkably similar to the proposals co-sponsored by Senators Nunn, Long and six others. Their proposals, based on the extensive hearings held in the last six months by Senators Nunn and Chiles and others, help resolve the major problems we have experienced with current law. The major differences between our proposals and those of the Senate bills relate to the protection of an individual's financial records which underlie the tax return. The Nunn bill would permit access to this information without a court order and would require the Service to report evidence of non-tax crimes revealed in those records. We recognize that the Nunn proposal would greatly assist law enforcement, but we believe that this involves an area where the taxpayer has a legitimate expectation of privacy and could adversely impact on the tax collection system. Accordingly, we do not endorse that aspect of the Nunn bill.

I should also add that the Senate proposals for reforming the penalty provisions are somewhat at odds with my suggestions. We believe our proposals more effectively address the problem. Finally, the Senate bills do not contain provisions with respect to admissibility of tax information or mutual assistance treaties. The Senate bills, do, however, provide for limited access to Federal tax information by State law enforcement authorities. It is our view that the Senate proposal for State access should be deleted as one which unjustifiably compromises taxpayer privacy interests.

CONCLUSION

In conclusion, let me emphasize that legislation to amend the Tax Reform Act will have an impact much more important than mere resolution of the specific disclosure problems I have discussed. We hope that such legislation will serve as a signal that Congress intends the Internal Revenue Service, the Department of Justice and other federal law enforcement agencies to work as cooperating partners in the enforcement of federal law. After three and one-half years of experience, we believe that our fully documented legislative proposals will significantly reduce the impediments to such cooperation without jeopardizing privacy protection or our self-assessment tax system. On behalf of federal prosecutors, I deeply appreciate your prompt consideration of these proposals and assure you that they are imperative to effective federal law enforcement efforts.

Thank you.

Enclosure.

VII. Summary of Responses to Part V of the Questionnaire

This section summarizes the responses of the replying offices to the open-ended request in Part V of the questionnaire for comments and additional information regarding the impact of Section 6103 on the Department's law enforcement activities. Fifty-six of the 105 responding offices provide additional information or general comments in response to Part V of the survey.

A. TAX CASES—SECTION 6103(h)

The following additional information was provided by the responding offices regarding the impact of Section 6103(h) on tax cases. This information was furnished in the form of specific examples of problems encountered in the utilization of Section 6103. The following summaries are based solely upon the information provided by the responding offices, and should be considered together with the data set forth in Section III of this report. Nine offices provided additional information in Part V of the survey regarding the impact of Section 6103 on tax cases.

Two offices noted that IRS's fear of violating Section 6103 frequently causes that agency to fail to provide to the Government attorney all the tax information needed to prepare adequately for the trial of a civil tax case.

One office noted that in 26 U.S.C. 6672 cases, where all the parties are not before the court (the ordinary situation in the Court of Claims), a problem exists in learning what, if anything, has been collected by IRS from the other assessed persons. Although payments by these other persons have no effect on the liabilities of the parties in the suit, the Government's policy is to collect 100 percent only once in such cases. Thus tax information regarding collection activity with respect to assessed nonparties is very useful to the Government attorney, but difficult to obtain under Section 6103.

One office raised the question of whether Section 6103 permits the disclosure of tax information to outside experts specially hired by the Government in civil tax litigation to handle special issues such as valuation.

One office pointed out that, after the passage of the 1976 amendments to Section 6103, tax protesters have attempted to "trap" Government attorneys into making allegedly unlawful disclosures of tax information relating to them by submitting fictitious powers of attorney or revoking existing powers of attorney, and then challenging the attorney's disclosure to the lawyers that the attorney believed were actually representing the protesters.

One office noted that in summons enforcement cases, IRS agents, fearful of violating Section 6103, have neglected to tell the Government attorney handling the proceeding that Section 6103(i)(1) orders had been obtained by offices seeking tax information regarding the taxpayer for nontax purposes. In other cases agents have neglected to report that, by the time of trial, they had already recommended to their superiors at IRS that a grand jury investigation of the taxpayer be conducted. In some cases the Government attorney has learned this information from opposing counsel. Information regarding both is extremely important on the issue of improper criminal purpose (see *United States* v. *LaSalle National Bank*, 437 U.S. 298 (1978)).

One office noted the need for better coordination with FOIA units within the Department, which make determinations whether requested information may be disclosed consistent with the restrictions of Section 6103. This office reported that, in a civil tax case, the Government attorney disclosed information which she believed was disclosable under Section 6103(h)(4). However, the attorney subsequently learned that plaintiff's counsel had made an FOIA request before instituting the tax suit, and that some of the information which the plaintiff was requesting—information which the Government attorney disclosed under § 6103(h)(4)—had not been disclosed by the individual handling the FOIA request, on the ground that disclosure would violate Section 6103.

Two offices stated that Chief Counsel of IRS directs disclosure of wagering tax information to the Department of Justice under 26 U.S.C. 4424(b), but is very reluctant to disclose information under Section 6103(h)(2), although the language of the two statutory provisions is essentially the same.

B. NONTAX CASES—SECTION 6103(i)

Twenty-five offices provided additional information in Part V of the survey regarding the impact of Section 6103 on nontax cases. The following summaries are based solely upon the information provided by the responding offices, and should be considered together with the data set forth in Section IV of this report.

Thirteen offices commented that the procedures for obtaining tax information under Section 6103(i) for nontax criminal purposes are simply to cumbersome and too time-consuming, especially, as some offices noted, in view of the requirements of the Speedy Trial Act. These offices offered the following proposals for improving the procedures for obtaining disclosure:

"Return information" should be redefined so as to include only the information which is contained on a tax return, and should not be interpreted to encompass information obtained through an investigation. (One office)

The distinction between "return information" and "taxpayer return information" should be abolished. (One office)

Authorization to seek disclosure from IRS under § 6103(i)(1) and § 6103(i)(2) should lie with the United States Attorney. (One office)

Department procedures should be amended so as to eliminate the need for the second "request letter" to IRS which accompanies the signed ex parte order obtained pursuant to § 6103(i)(1). This office noted that there is no need to again set forth "probable cause" for obtaining the information, when the grounds justifying disclosure are already set forth in the application and the court order. (One office)

Procedures under § 6103(i)(1) should be amended so that returns, taxpayer return information, and return information can all be obtained using the ex parte order procedure—then IRS would not be required to separate out return information when responding to a disclosure request under Section 6103(i)(1). (One office)

The Government attorney should not be required to utilize § 6103(i)(1) simply to learn that the taxpayer in question has not filed tax returns. (Two offices)

One of these offices also noted that, in nontax cases, the restrictions of Section 6103 conflict with the requirements of the Jencks Act, where the Government attorney is aware that IRS has interviewed an individual who is a Government witness in a nontax case.

Two offices reported having disagreements with IRS over which documents or information is covered by an order under § 6103(i)(1), or a request under § 6103(i)(2). In one case an additional order had to be obtained in order to get the remainder of the needed information from IRS. One office reported that IRS frequently requires separate orders when information is sought regarding more than one taxpayer.

Another office stated that if a typing error or misspelling of a name appears in either the court order or the authorization letter from the Assistant Attorney General, Criminal Division, IRS refuses to produce the returns, even though the addresses, social security numbers, and other identifying information on the documents clearly indicate that the error is clerical and not substantive. One office reported that after the court had issued a § 6103(i)(1) order, IRS stated that it did not believe thast the order was adequately supported by the reasonable causes showing required in § 6103(i)(1)(B), "and even went so far as to 'request' that additional 'probable cause' be added to the order and the application." One other office also had problems when it learned that IRS was not satisfied with the language of the order issued by the court.

Two offices complained of internal delays at IRS in the processing of court orders authorizing disclosure; one of these offices cited IRS's requirement that the orders be sent to its National Office in Washington, D.C. before being served on the appropriate Service Center as one cause for the delays.

One office reported that it was required to get a § 6103(i)(1) order before IRS would permit an agent to testify in a civil habeas corpus proceeding (28 U.S.C. 2255), where the agent had investigated the defendant for potential criminal tax violations, and was asked to testify as to defendant-petitioner's use of pseudonyms in conducting his real estate transactions. Delays encountered in obtaining the order in turn delayed the habeas corpus proceeding.

One office reported that, after a court requested an in camera inspection of a return that was the subject of an application for a § 6103(i)(1) order, the IRS disclosure officer refused to let the tax returns out of her presence when being reviewed by the judge, and forbid any discussion of the returns with the judge's law clerk—a procedure which disturbed the court.

Finally, three offices reported that they have not encountered any difficulties thus far in the utilization of Section 6103(i), and another office stated that while the procedures under § 6103(i) are time-consuming, "[m]ost Assistants probably exaggerate the difficulty and amount of work that is required to secure disclosure."

C. GENERAL COMMENTS REGARDING SECTION 6103

Twenty-two offices provided additional information in Part V of the survey regarding the impact of Section 6103 generally on their law enforcement activities. The following summaries are based solely upon the information provided by the responding offices.

Fourteen offices expressed the view that Section 6103 has had a "chilling effect" on law enforcement, in that it makes IRS investigating agents apprehensive of making disclosures, and restricts information sharing between federal investigatory agencies. Four offices noted that the procedures under Section 6103 for obtaining needed tax information are so complex and/or time-consuming that frequently Government attorneys do not view the information as worth the effort of attempting to obtain it.

One office reported that it has had no difficulty utilizing Section 6103, and has found both IRS and the Department of Justice quite cooperative in processing its requests for tax information.

One office suggested that uniform instructions should be given to IRS agents, and made available to courts and Government attorneys, regarding the scope of permissible disclosures under Section 6103, so as to minimize possible contempt problems that might arise if a court, in either a federal or state case, should insist on the agent appearing and testifying regarding certain tax information. In this regard, this office noted that in 1979, a subpoena duces tecum was served on an IRS special agent to appear in state chancery court and bring the joint tax return of a husband and wife for use in a divorce proceeding. After much debate between IRS Regional Counsel and the attorney representing the wife involved in the divorce proceeding, the attorney was persuaded to withdraw or cancel his subpoena.

Another office complained that IRS does not take uniform positions regarding disclosure requests: in one case, this office sought tax information regarding 3 defendants from IRS, the requests being submitted at various times. One request was granted, but an identical form request as to another defendant was rejected.

One office has noted what appears to be a problem regarding what types of information come within the scope of Section 6103. Specifically, this office reported that during the course of executing search warrants for evidence of wagering tax violations, IRS agents discovered certain weapons in the possession of a convicted felon then on probation. An attempt was made to revoke the felon's probation, but an attorney in the office of IRS Regional Counsel prohibited the agents from discussing the discovery of the weapons with the United States Attorney's office on the ground that this would violate Section 6103. This attorney was also reluctant to

permit the agents to discuss anything that was included in the affidavit for the search warrant. The probationer eventually pled guilty to the probation violation charge.

One office reported that IRS takes an unduly restrictive view of the information that it may disclose to the Department of Justice under Section § 6103(i)(3).

One office reported the following situation: In a prosecution of X for bribery of an FBI employee, the employee testified for the Government that X had asked if she could obtain information relating to the criminal tax investigation that was being conducted regarding X by the Criminal Investigation Division of IRS. (It was generally known that IRS had issued a large number of summonses throughout the city seeking evidence of X's tax liability.) To corroborate the testimony of the employee, the prosecuting Government attorney wanted an IRS special agent to testify that X had been the subject of a criminal tax investigation during the period in question. IRS prohibited the agent from testifying on the ground that this would violate Section 6103, even though the IRS agents, when conducting witness interviews, had already disclosed to third parties that X was under investigation.

Finally, one office stated that most Assistant United States Attorneys are unfamiliar with Section 6103 and its procedures, and therefore usually do not make use of the statute to obtain tax information. This office stated that the Department of Justice can and should take steps to educate Government attorneys regarding Section 6103, either through the Attorney General's Advocacy Institute or through a separate seminar.

Senator BAUCUS. Mr. Kurtz, welcome. We are glad to see you here this afternoon.

STATEMENT OF HON. JEROME KURTZ, COMMISSIONER OF INTERNAL REVENUE, ACCOMPANIED BY N. JEROLD COHEN, CHIEF COUNSEL, INTERNAL REVENUE SERVICE

Mr. KURTZ. Thank you. I am pleased to be here.

I am accompanied by N. Jerold Cohen who is the Chief Counsel of the Internal Revenue Service.

As you know, ours is a self-assessment tax system that depends substantially on voluntary compliance by taxpayers. The Secretary of the Treasury has broad authority to require all taxpayers to file returns and to keep records necessary to a determination of their tax liability. In addition, the Secretary is authorized to examine books, papers, records, and other data relevant or material to the determination of tax liabilities.

These powers are essential to enable the Internal Revenue Service to obtain by administrative action information necessary for tax administration.

The scope and complexity of the tax laws require the Internal Revenue Service to make a broad range of inquiries of taxpayers, both on the returns they file and during examinations and investigations. Last year we received more than 136 million tax returns from taxpayers, and audited more than 1,800,000 individuals. We also initiated nearly 9,800 criminal investigations.

As a consequence, the Service probably has more information concerning the lives and affairs of individuals than any other agency of the Federal Government.

The needs of law enforcement and the needs of tax administration are in some respects difficult to reconcile, and the balancing of these considerations is a very delicate process. We acknowledge that it is difficult to strike a precise balance between these competing policy considerations, but believe that the balance struck by the administration is appropriate and preferable to the other proposals before your subcommittee.

The Administration believes that S. 2402 fails sufficiently to protect the legitimate privacy interests of individuals in that it would require evidence of criminal activities contained in individual taxpayers books and records to be given to law enforcement agencies by the Internal Revenue Service.

We believe that individuals are entitled to a high degree of privacy protection in these records which they are required to maintain to meet their tax obligations, and therefore that they should be available only under a court order proceeding initiated by the Justice Department.

Corporations generally do not have privacy interests equal to those of individuals, and therefore the administration's proposal, as would S. 2402, requires such disclosure of criminal activities to be made in the case of certain corporations.

Furthermore, the administration would propose amendments to section 6103 which would have the effect of decentralizing from the Washington offices of the Department of Justice to responsible law enforcement officials in the field the authority to request information, thus significantly improving the timeliness and the responsiveness of such requests.

Another significant improvement proposed by the administration is to correct a problem in the existing statute which could be interpreted to require law enforcement officials to know in advance the contents of taxpayer return information before making a request for disclosure.

We also believe that the administration's position to improve the summons legislation by requiring taxpayers who oppose process against third party recordkeepers to contest those summonses in courts. We believe it will alleviate unwarranted delays in tax examinations and investigations.

The administration's proposal would alleviate a substantial burden on Government, with no impact on legitimate taxpayer interests.

In their testimony, the Tax and Criminal Divisions of the Department of Justice have presented a general explanation of the administration's position on the four Senate bills. In the remainder of my testimony, I would like to mention two differences between S. 2402 and the administration's position that are of particular importance to tax administration.

The administration proposal continues the existing prohibitions on disclosure of returns or return information to the States and local governments for nontax, criminal, and civil enforcement purposes. Under present law, returns and return information may be disclosed to the States only in connection with the administration of State tax laws.

Similar restrictions were contained in the law before 1976. To assure the tax information given to the States for tax administration purposes was not used for other purposes, Congress required States to adopt safeguards to protect the tax information they receive and to permit a review of the safeguards they established.

The administration opposes the provisions of S. 2402 that would permit redisclosure of returns and return information to State law enforcement agencies for investigations and proceedings involving State felonies. There are more than 19,000 State and local police

agencies in this country. Such a widespread dissemination of tax information for nontax purposes would be extremely unwise, particularly since most police agencies are very small—more than 50 percent have 10 or fewer employees—and would be ill equipped to provide even minimal protections for the security of the information they receive. Accordingly, we believe the longstanding prohibition on disclosure to state agencies for nontax purposes should be maintained.

With certain specific exceptions, section 6103 now prohibits the disclosure of returns and return information for Federal nontax civil enforcement purposes. The administration's proposal would continue the general prohibition of disclosure of tax information for Federal civil purposes, but would make clear that such disclosures could be made to provide evidence in any administrative or judicial proceeding involving a civil forfeiture related to the enforcement of a Federal criminal statute. There has been no showing that any broader change is necessary.

In its testimony on April 22, 1980, before the Treasury, Postal Service, and General Government Subcommittee of the Senate Committee on Appropriations, GAO noted that IRS could reduce the time required to process requests for returns and return information pursuant to court orders issued under 6103(i)(1) by decentralizing our disclosure approval authority.

GAO made a similar suggestion regarding decisions to disclose evidence of possible nontax crimes obtained from third parties pursuant to 6103(i)(3). Under the then existing procedures, all such disclosures required review and approval by the Disclosure Operations Division in our National Office.

Although GAO had found that the Service was generally as timely as possible in its response to court orders and requests for disclosures under 6103(i) (1) and (2), it found this National Office review needlessly delayed the dissemination of requested information.

On June 1, 1980, a few weeks ago, we revised our Delegation Order 156 to permit district directors and assistant district directors to make direct disclosures of return and return information to the Department of Justice and other Federal law enforcement agencies without national office approval. In the same delegation order, we authorized regional commissioners to make disclosures of possible violations of Federal nontax criminal statutes under 6103(i)(3), that is, third party information. These changes in procedures are also reflected in revisions to the Internal Revenue Manual published on June 16.

Among other things, these revisions establish specific time frames for responding to both routine and emergency requests for returns and return information, and require district, regional, and national office officials to become personally involved when those time frames are not met.

I have attached to my statement a chart which compares the procedures now in place with those that were used before June 1. To facilitate the transition to the new procedures, we have trained our regional and district disclosure personnel, coordinated our planning efforts with the Department of Justice, and established a

hot line between the Department of Justice and our disclosure operation division to handle any problems that may arise.

In addition, we have established an IRS Department of Justice Coordinating Committee to assure active and ongoing cooperation between the agencies, and instructed our field officials to contact their U.S. Attorneys and offer to brief them on the new procedures.

Finally, we are establishing procedures to identify all requests for returns and return information under 6103(i) (1) and (2) as priority items in requests to Federal record centers, where much of the information requested is stored.

To improve the efficiency of our cooperation with other law enforcement agencies in joint criminal investigations, we have also revised our grand jury approval procedures. Time frames have been established for each level of managerial approval of the request. Approval authority for grand jury requests has been delegated to our regional commissioners, who may redelegate that authority to assistant regional commissioners for criminal investigations. These approvals must receive the concurrence of regional counsel. Expansion of existing grand jury authorizations may be approved by district directors with the concurrence of deputy regional counsels.

In addition, we believe the recent and anticipated changes in our criminal enforcement program will result in increased Service participation in the prosecution of those whose criminal activity involves both tax and nontax laws.

Our limited criminal enforcement resources are allocated, like other service enforcement resources, to all segments of our society, in an attempt to assure compliance by all taxpayers. In the past, 70 to 75 percent of our total criminal enforcement effort has been devoted to our general enforcement program, and 25 to 30 percent to special enforcement programs. The latter, the special enforcement programs, includes investigation of organized crime figures, strike force targets, and narcotics traffickers. In the next fiscal year, we are considering increasing the special enforcement program allocation to somewhere between 35 and 45 percent of the total program, with particular emphasis on the narcotics program and an increased utilization in appropriate cases of interagency grand jury investigations.

Moreover, we have recently revised our Memorandum of Understanding with the Drug Enforcement Administration to increase the volume and quality of DEA referrals to our Criminal Enforcement Division. Under the revised agreement, DEA is to furnish the Service quarterly listings of all high level drug traffickers and financiers who are identified by the Drug Enforcement Agency as class 1 or class 2 violators. On June 5, 1980, DEA furnished us a list of approximately 14,000 leads. We are now in the process of distributing these referrals to our field offices for association with available information and evaluation as to their tax potential. These leads will be tracked under established procedures to permit us to assess the value of the expanded referrals.

We are also working with DEA to improve the liaison between our respective field offices.

In the aggregate, Mr. Chairman, we believe that these changes will result in a substantial increase in the level and quality of

assistance and cooperation between the Internal Revenue Service and other Federal law enforcement agencies. We also believe that the administration's legislative proposals will enhance cooperative law enforcement efforts.

Thank you.

Senator BAUCUS. Thank you very much, Commissioner.

I take it that you generally agree with everything that your compatriots have said. Is that correct?

Mr. KURTZ. That is correct.

Senator BAUCUS. To what degree do you think the IRS should be more in the area of collecting tax information as opposed to aiding or taking a direct involvement in law enforcement activities?

Mr. KURTZ. Let me say, Mr. Chairman, that has frequently, in the series of hearings that I have attended on this subject, been set up as if they are alternatives. They are really not alternatives. We know that those involved in criminal activities are not usually very compliant taxpayers, and an enforcement effort of tax laws would include a significant emphasis on those whose incomes are from illegal sources, because we believe they are among our least compliant taxpayers.

However, at the same time, we cannot ignore other taxpayers whose only crimes may be tax crimes. That is, we feel it essential in overall administration of the tax laws to have a presence among all types of taxpayers, those, as I say, whose income is from legal as well as illegal sources. But even today, our allocation of those resources does on a per capita basis, certainly, provide greater resources to those whose income is from illegal sources. We are spending approximately 30 percent of total criminal investigation resources on those whose income is from illegal sources. Certainly those people do not represent 30 percent of society.

Senator BAUCUS. Are you then saying that the IRS involvement in law enforcement activities, does not diminish overall national compliance?

Mr. KURTZ. Well, I am saying that it is consistent with our obligation to administer the tax laws, to be involved with those who have violated the tax laws and other laws as well, whose income is from illegal sources, and that is a significant emphasis in our programs.

Senator BAUCUS. What is the reason for diminished voluntary compliance? Do you think there is a bigger show problem here?

Mr. KURTZ. I have read that, and I know that that feeling is around. We did a comprehensive study of compliance, as comprehensive as we could do, which was released last summer. It covered the year 1976 only. We do not have a time series which would indicate whether compliance is in fact diminishing. We do not know that it is not, but we do not know that it is, based on our own research.

Senator BAUCUS. You mean, you just don't know?

Mr. KURTZ. We just don't know. We are doing further research, which we hope will tell us something about that.

Senator BAUCUS. What is your best guess?

Mr. KURTZ. I hesitate to guess for the record. [General laughter.] We really don't know.

Senator BAUCUS. I am not going to hold you to it, but I am just curious as to what your sense is.

Mr. KURTZ. We really don't know. There is clearly, I agree with you, a perception that compliance is declining. I think part of that perception, however, is based on the fact that we now know a lot more about patterns of compliance than we ever did, or patterns of noncompliance.

Our study covering the year 1976, which was released last summer, was the first attempt the Internal Revenue Service had ever made to measure overall levels of individual compliance. We had always measured pieces of it, but never an overall measure, and that study and other studies that economists, outside independent economists have done, have indicated more noncompliance, I believe, than many people thought or focused on.

So, I don't know whether it is increased publicity or whether it is actually increasing noncompliance. I wouldn't speculate on it.

Senator BAUCUS. Well, I know this doesn't establish a trend, but as far as this one person sitting here is concerned, I note an increased number of people not complying as much with the tax code as they might have in previous years. Now, maybe there is a kind of cognitive dissonance here—because there is more publicity, people are just saying that they are not complying.

Mr. KURTZ. I was going to say, I would not speculate as to whether they are more forthcoming today or less compliant.

Senator BAUCUS. To what degree do you agree with Congressman Stark's analogy of wiretapping, that is, that people voluntarily turn over information to the IRS because they feel that it is private, and the IRS will maintain privacy?

Mr. KURTZ. I feel very strongly about that. I think it is an extremely important protection, and the administration's bill would continue that protection in the case of individuals where access to tax information, returns or taxpayers' tax data, which we see on examination, would be protected, and would not be disclosed spontaneously by the Service, could not be used to implicate the taxpayer in a crime.

If the law enforcement agency independently—and I think this is the real difference—independently has a criminal investigation of an individual in process, and goes to a court and convinces the court that there is such an investigation, and that the tax information may be relevant, then they can get it, and that is the kind of a standard, roughly—I mean, the wording isn't the same, but it is the kind of a standard, roughly, that a law enforcement agency needs to get a search warrant.

We are all entitled to the protection of the privacy of our homes, but nevertheless, there is such a thing as a search warrant on an independent showing that there is reason to believe that evidence is there, and I think much the same standard should apply to tax returns.

Mr. NATHAN. May I comment, Senator?

Senator BAUCUS. Certainly.

Mr. NATHAN. I agree with Mr. Kurtz that there ought to be protections, and protections even perhaps analogous to interceptions and searches. The irony is, however, that the standards that are applied in 6103, which are to get information which is already

in the hands of the Government agency, are more onerous than the standards to get a search warrant.

Senator BAUCUS. I was going to ask that question.

Mr. NATHAN. In other words, to get a search warrant, you don't have to come to Washington, to an Assistant Attorney General, and you don't have to go to a district judge, and the assistant U.S. attorney can go to a magistrate, file an affidavit, show his probable cause, and obtain the search warrant.

Similarly, you don't have to show that the evidence that you are going to get in the search warrant is going to be the most probative evidence of that point that you can't get it elsewhere, and it seems to me that there ought to be some reasonable standards, and that is why we are proposing this kind of fine tuning that is in the Nunn bill.

Senator BAUCUS. Therefore, you agree with the attempts in 2402 to lower the standard.

Mr. NATHAN. To make them realistic standards, to permit law enforcement to operate, to get this information.

Mr. KURTZ. I think the essential difference, though, is between whether by filing an honest tax return, a taxpayer runs the risk of incriminating himself for other crimes where there is no independent investigation going on. We are the source.

Senator BAUCUS. Let me ask another question of a different sort, and I guess Mr. Nathan and Mr. Kurtz can answer it jointly. How are we going to get at these big-time criminals?

Mr. NATHAN. It is a very difficult process, and I don't think that we mean to suggest that if these restrictions that are in the nondisclosure provisions of the Tax Reform Act are modified to make them more realistic and to allow Justice and IRS to cooperate better, that that is going to solve the problem. It is simply, obviously, one factor only.

Senator BAUCUS. My question is, how are we going to solve the problem?

Mr. NATHAN. Well, I think that we have to have, first of all, increased intelligence, increased information about where the problems are, and certainly one important source of that information is some of the information that the Service has, and the Service in the past has been a very important source of cooperation with the investigative agencies, and we would like to see a return to that system, but that in itself, of course, is not going to be the entire solution.

We are going to have to have assistance from private enterprise as well. We can't have banks which take large amounts of cash deposits and close their eyes to where that is coming from. I think that they, too, will have to comply with the statutes that we have, which require filing of forms that declare currency in large amounts that are filed by unknown depositors to them.

We will have to have a lot of additional cooperation among the investigative agencies. We are going to have to have improvement in the investigative agencies. For example, we need additional trained financial investigators within DEA and within the FBI, so that they can come up to the level of the IRS.

Those are long-term prospects.

Senator BAUCUS. That all sounds very good but how are we going to get all those things accomplished?

Mr. NATHAN. Well, I think we are going to have to sensitize the people who appropriate the funds for these agencies and the people who head these agencies to try and develop that expertise. It is a long-range process.

Senator BAUCUS. I am not being critical. I have only been in this body a short period of time, and I am certain that many others holding these kinds of hearings and asking these kinds of questions have heard those kinds of answers for a long period of time.

Mr. NATHAN. Well, I think that first of all, you shouldn't assume that we are not making progress at this point. I think that, for example, in the organized crime area, which I supervise within the criminal division, we have made substantial progress in the last several years. We have returned indictments and secured convictions of some of the highest level organized crime figures in this country. That was done only this last week.

Senator BAUCUS. Can you show a diminished criminal incidence on a percentage or an absolute basis?

Mr. NATHAN. Of course, it is very difficult. We are dealing with a secret environment. A lot of what we are dealing with are unreported crimes. We are dealing with extortion, kickbacks, those kinds of things.

Senator BAUCUS. I don't think you are making progress—you are not making progress until you can show fairly convincingly a diminished amount of narcotics traffic rather than just saying you are doing better and better. I want to see less of it.

Mr. NATHAN. I am not suggesting a rosy picture. I think we have a lot of problems, and there is a lot of work to be done. All I mean to suggest is that we have made some inroads. We are convicting some large drug dealers.

For example, in Miami, we convicted the Black Tuna Organization, which was reputed to have been dealing in $300 million of marihuana. The leaders of that organization were sentenced to over 60 years in jail, and substantial fines and forfeitures were sought.

So, we are making some progress. It is not as much as we would like, and it is very difficult to measure it on a percentage basis, whether it is improving or not improving, but what we are asking this committee is to lend its assistance to fine tune the statute to permit us access to very important sources of information and sources of expertise so that we can aid in that battle.

Senator BAUCUS. Well, the premise behind that statement and these bills is that the IRS presently has access to information that will lead to the successful prosecution of serious felonies. Is that true, Commissioner Kurtz? Does the IRS now have information which, if it were available to the Criminal Division, lead to the successful prosecution of serious felonies.

Mr. KURTZ. Senator Baucus, again, you have to differentiate between two sources of the information. In any situation in which the Department of Justice has an investigation, is investigating a crime or particular person, and it is a financial type of crime, I think in those situations by and large whatever information we have is available.

I might say in many situations in the organized crime and narcotics area the investigations are conducted under the auspices of a grand jury, joint grand jury, tax, nontax, in which our agents actively participate, so that a number of the major cases—I don't know the particular ones that Mr. Nathan was referring to—but in a number of the large narcotics and organized crime cases, the Service is deeply involved in the investigation, because the grand jury covers both tax and nontax crimes.

Do we find information in the course of an examination which would indicate high level criminal activity of someone about whom the Justice Department is unaware? It is very difficult to say. I am sure it occurs on occasion, but with what frequency, I don't know.

Senator BAUCUS. It seems to me that if these bills are necessary, it follows that the IRS does have information presently which prevents or at least impedes the prosecution of certain crimes.

Mr. NATHAN. Yes. I think that that is absolutely right. Let me explain what we mean. In the first place, of course, the GAO study, which did do an examination of IRS's files, found the evidence that came from corporate books and records that I described earlier, but let me describe a concrete situation and tell you how we can use the information that the Service has, if we can obtain it in a fairly ready fashion.

In the *Nicky Barnes* case—he was one of the largest drug dealers in New York City—we sought his income tax returns. We showed to the court that we had reason to believe that he was engaged in narcotics trafficking, and that the information on his income tax return would be relevant.

There was a very substantial delay in getting the income tax return. In fact, it didn't show up until halfway through the trial, when fortuitously there was a recess. We did receive it. When we received it, we found on his return and on the returns of other codefendants listings for a number of years of $250,000 in miscellaneous income, that is, income which he did not describe the source of.

Now, obviously, that proved very helpful to be able to show to the jury that here was a man with no visible means of income who was reporting in order to avoid a net worth case being made by the IRS, who was reporting a quarter of a million dollars of income a year and couldn't explain where that came from.

That was probative of the fact that this income came from illegitimate sources, and of course, it was one of the factors that led to his conviction and a very substantial sentence which he is now serving.

So, income tax information which shows great amounts of unreported income, and conversely, if income tax returns show little income for a year, and the prosecutors can show by other means large amounts of cash going in to that individual from questionable sources, that tends also to show the failure of this individual, obviously, to comply with his tax return, and failure to report it, because he knew it was illegitimate income.

So, there is a host of types of information available on tax returns and available in the records that the Service has. We do think we should meet standards to obtain it, but we think that

they shouldn't be so onerous that we are precluded effectively from obtaining it in a timely and efficient manner.

Senator BAUCUS. I might say, though, Mr. Nathan, that there is nothing in anybody's legislation that would change that result. I mean, those returns were available at that time, and were in fact obtained.

Mr. NATHAN. Yes, but what I am saying is that the standards that are in the Nunn bill and that the administration supports for obtaining income tax returns which would minimize the burden, which would not require you to go to Washington, which would reduce the delays, which would make it clear what the standards are, that would give a neutral magistrate an opportunity to give us that return without the delay that was involved in the *Barnes* case, where we almost lost it. We only got it as the result of a fortuitous recess in the trial.

Senator BAUCUS. Do you agree with Senator Chiles' figures that there is a $50 billion illegal drug trafficking business in America?

Mr. NATHAN. I think it is very difficult to assess those figures. It is obviously a very substantial amount. I don't think that anyone knows with any precision. I have some doubts about estimates of that type.

Senator BAUCUS. I have no further questions.

I want to thank you all for coming. We appreciate it very much.

[The prepared statement of Mr. Kurtz follows:]

STATEMENT OF JEROME KURTZ, COMMISSIONER OF INTERNAL REVENUE

Mr. Chairman and Members of the Subcommittee; I am pleased to appear before you this morning to discuss the disclosure and third party summons provisions of the Internal Revenue Code. Accompanying me is Mr. N. Jerold Cohen, Chief Counsel of the Internal Revenue Service.

INTRODUCTION

As you know, ours is a self-assessment tax system that depends substantially on voluntary compliance by taxpayers. The Secretary of the Treasury has broad authority to require all taxpayers to file tax returns and keep records necessary to a determination of their tax liability,[1] In addition, the Secretary is authorized to examine books, papers, records, or other data relevant or material to the determination of tax liability.[2] These powers are essential to enable the Internal Revenue Service to obtain by administrative action information necessary for tax administration.

The scope and complexity of the tax laws require the Internal Revenue Service to make a broad range of inquiries of taxpayers, both on the returns they file and during examinations and investigations. Last year, we received more than 136 million returns from taxpayers, and audited more than 1,800,000 individuals. We also initiated nearly 9,800 criminal investigations. As a consequence, the Service probably has more information concerning the lives and affairs of individuals than any other agency of the Federal Government.

The needs of law enforcement and the needs of tax administration are in some respects difficult to reconcile. The balancing of these considerations is a delicate process. We acknowledge that it is difficult to strike a precise balance between the competing policy considerations, but believe that the balance struck by the Administration is appropriate and preferable to the other proposals before the Subcommittee.

The Administration believes that S. 2402 fails sufficiently to protect the legitimate privacy interests of individuals in that it would require evidence of criminal activities contained in individual taxpayers' books and records to be given to law enforcement agencies by the Internal Revenue Service. We believe that individuals

[1] Section 6001 of the Internal Revenue Code. (Unless otherwise specified, all references are to the Internal Revenue Code of 1954, as amended).
[2] Section 7602.

are entitled to a high degree of privacy protection in these records which they are required to maintain to meet their tax obligations, and therefore, should be available only under a court order proceeding initiated by the Justice Department. Corporations generally do not have privacy interests equal to those of individuals and therefore the Administration's proposal, as would S. 2402, requires such disclosure of criminal activities to be made in the case of certain corporations.

Furthermore, the Administration would propose amendments to Section 6103 which would have the effect of decentralizing from the Washington offices of the Department of Justice to responsible law enforcement officials in the field the authority to request information—thus significantly improving the timeliness and responsiveness of such requests.

Another significant improvement proposed by the Administration is to correct a problem in the existing statute which could be interpreted to require law enforcement officials to know in advance the contents of taxpayer return information before making a request for disclosure.

We also believe that the Administration's position to improve the summons legislation by requiring taxpayers who oppose process against third party recordkeepers to contest those summonses in courts will alleviate unwarranted delays in tax examinations and investigations. The Administration's proposal would alleviate a substantial burden on Government with no impact on legitimate taxpayer interests.

CURRENT LAW

Section 6103 permits disclosures of tax information for Federal non-tax criminal enforcement purposes, subject to certain safeguards, but generally does not permit such disclosures for Federal non-tax civil enforcement purposes, and permits no disclosures for State non-tax criminal or civil enforcement purposes.

Section 6103 creates a distinction between returns filed by taxpayers ("returns") and information furnished to the IRS by the taxpayer or his representative ("taxpayer return information") on the one hand, and information from sources other than the taxpayer ("return information") on the other. In case of returns and taxpayer return information, the Department of Justice and other Federal agencies must obtain a court order to obtain this information for non-tax criminal enforcement purposes. To obtain the order, the Department or other Federal agency must show that there is reason to believe that a specific criminal act has been committed, that there is reason to believe that the information sought is probative evidence of the matter in issue and that the information sought cannot be reasonably obtained elsewhere unless such information constitutes the most probative evidence.

In the case of return information other than tapayer return information, disclosure is permitted to the head of a Federal agency, or to the Attorney General, the Deputy Attorney General, or an Assistant Attorney General in response to a written request setting forth certain specific information, including the specific reasons why the disclosure is or may be material to the non-tax criminal proceeding or investigation. In addition, in the case of return information other than taxpayer return information, the Secretary is authorized to volunteer evidence of a possible violation of a Federal criminal law to the head of the agency charged with enforcing that law.

SUGGESTED REVISIONS TO EXISTING LAW

In their testimony, the Tax and Criminal Divisions of the Department of Justice have presented a general explanation of the Administration's position on the four Senate bills. In the remainder of my testimony, I would like to mention two differences between S. 2402 and the Administration's position that are of particular importance to tax administration, discuss further the change proposed to the third party summons provision, and summarize certain changes in our administrative procedures and program emphasis.

SECTION 6103

1. *Disclosure of Returns and Return Information To The States For Non-Tax Purposes.*—The Administration proposal continues the existing prohibitions on disclosures of returns or return information to the States for non-tax criminal and civil enforcement purposes. Under present law, returns and return information may be disclosed to the States only in connection with the administration of State tax laws.[3] Similar restrictions were contained in the law before 1976. To assure that tax information given to the States for tax administration purposes was not used for other purposes, Congress required each State receiving Federal tax information to

[3] Section 6103(d).

adopt a State statutory equivalent of Section 6103,[4] and required States to adopt safeguards to protect the tax information they received and to permit a review of the safeguards they established.[5]

The Administration opposes the provision of S. 2402 that would permit redisclosure of returns and return information to State law enforcement agencies for investigations and proceedings involving State felonies. There are more than 19,000 State and local police agencies in this country. Such a widespread dissemination of tax information for non-tax purposes would be extremely unwise, particularly since most police agencies are very small—more than 50 percent have 10 or fewer employees—and would be ill-equipped to provide even minimal protections for the information they secure. Accordingly, we believe the long-standing prohibition on disclosures to State agencies for non-tax purposes should be maintained.

2. *Disclosures For Federal Nontax Civil Purposes.*—With certain specific exceptions, Section 6103 now prohibits the disclosure of returns and return information for Federal non-tax civil enforcement purposes. the Administration's proposal would continue the general prohibition of disclosure of tax information for Federal civil purposes, but would make clear that such disclosures could be made to provide evidence in any administrative or judicial proceeding involving a civil forfeiture related to the enforcement of a Federal criminal statute. There has been no showing that any broader change is necessary.

SECTION 7609

Section 7609 requires the Internal Revenue Service to provide the taxpayer with notice in connection with service of summons on certain specified "third party recordkeepers." Following receipt of this notice, the taxpayer has 14 days to notify the summoned party not to comply with the summons and to furnish a copy of that notification to the Service. If the taxpayer does so, the Service must then obtain a court order to obtain the summons record.

At the time of its enactment, both the Service and the Department of Justice seriously questioned whether Section 7609 should be enacted because we believed that the provision extended no additional substantive rights to taxpayers and offered opportunities to those who wished to delay or defeat tax investigations and examinations. While acknowledging the validity of these arguments, Congress enacted Section 7609 in the belief that the taxpayer himself would be more likely to assert whatever defenses to summons enforcement were available under existing law than would the third party recordkeeper.

Whatever procedural or substantive protections may be accorded taxpayers by the third party summons procedures, it is clear that permitting taxpayers to stay compliance by simply sending a written notification to the summoned party imposes a substantial burden on the Federal Government that is not justified to protect the legitimate interest of taxpayers. As Mr. Ferguson has indicated in his testimony, there have been very few instances in our three and a half years of administration of this statute where taxpayers have raised valid defenses to summons enforcement. Legitimate taxpayer interest would be equally protected if the taxpayer were required to file a motion to quash with the Federal District Court.

RECENT ADMINISTRATIVE CHANGES

In its testimony on April 22, 1980, before the Treasury, Postal Service and General Government Subcommittee of the Senate Committee on Appropriations, GAO noted that IRS could reduce the required process requests for returns and return information pursuant to court orders issued under Section 6103(i)(1) by decentralizing our disclosure approval authority. GAO made a similar suggestion regarding decisions to disclose evidence of possible non-tax crimes obtained from third parties pursuant to Section 6103(i)(3).

Under the then-existing procedures, all such disclosures required review and approval by the Disclosure Operations Division in our National Office. Although GAO had found that the Service was generally as timely as possible in its response to court orders and requests for disclosures under Sections 6103 (i)(1) and (2),[6] it found this National Office review needlessly delayed the dissemination of requested information.

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[4] Section 6103(p)(8).

[5] Section 6103(p)(4).

[6] See "Disclosure and Summons Provisions of 1976 Tax Reform Act—Privacy Gains With Unknown Law Enforcement Effects" (G.G.D. 78-110) (March 12, 1979) and "Disclosure and Summons Provisions of 1976 Tax Reform Act—An Analysis of Proposed Legislative Changes" (G.G.D. 80-) (June 18, 1980).

On June 1, 1980, we revised Delegation Order 156 to permit District Directors and Assistant District Directors to make direct disclosures of returns and return information to the Department of Justice and other Federal law enforcement agencies without National Office approval.

In the same delegation order, we authorized Regional Commissioners to make disclosures of possible violations of Federal non-tax criminal statutes under Section 6103(i)(3).

These changes in procedure are also reflected in revisions to the Internal Revenue Manual published on June 16, 1980. Among other things, these revisions establish specific time frames for responding to both routine and emergency requests for returns and return information, and require District, Regional and National Office officials to become personally involved when those time frames are not met.

I have attached to my statement a chart[7] which compares the procedures now in place with those that were used before June 1, 1980. To facilitate the transition to the new procedures, we have trained our Regional and District disclosure personnel, coordinated our planning efforts with the Department of Justice, and established a "hotline" between the Department of Justice and our Disclosure Operations Division to handle any problems that may arise.

In addition, we have established an IRS/Department of Justice Coordinating Committee to assure active and ongoing cooperation between the agencies, and instructed our field officials to contact their United States Attorney(s) and offer to brief them on the new procedures.

Finally, we are establishing procedures to identify all requests for returns and return information under Sections 6103 (i)(1) and (2) as priority items in requests to Federal Records Centers where much of the information requested is stored.

To improve the efficiency of our cooperation with other law enforcement agencies in joint criminal investigations, we also revised our grand jury approval procedures. Time frames have been established for each level of managerial approval of the request—ten workdays for the Chief of the District's Criminal Investigation Division, five workdays for the District Director, five workdays for the Regional Commissioner, and ten workdays for the Regional Counsel. Approval authority for grand jury requests has been delegated to our Regional Commissioners, who may redelegate that authority to the Assistant Regional Commissioners (Criminal Investigation). These approvals must receive the concurrence of the Regional Counsel. Expansions of existing grand jury authorizations now may be approved by District Directors with the concurrence of the Deputy Regional Counsel (Criminal Tax).

In addition, we believe that recent and anticipated changes in our criminal enforcement program will result in increased Service participation in the prosecution of those whose criminal activity involves both tax- and non-tax laws.

Our limited criminal enforcement resources are allocated, like other Service enforcement resources, to all segments of our society in an attempt to assure compliance by all types of taxpayers. In the past, 70 to 75 percent of our total criminal enforcement effort has been devoted to our General Enforcement Program, and 25 to 30 percent of our Special Enforcement Program. The latter program includes investigations of organized crime figures, strike force targets, and narcotics traffickers. In the next fiscal year, we are considering increasing the Special Enforcement Program allocation to between 35 and 45 percent of the total program, with particular emphasis on the narcotic program and an increased utilization, in appropriate cases, of inter-agency grand jury investigations.

Moreover, we have recently revised our Memorandum of Understanding with the Drug Enforcement Administration to increase the volume and quality of DEA referrals to our Criminal Investigation Division. Under the revised agreement, DEA is to furnish the Service quarterly listings of all high-level drug traffickers and financiers that are identified as DEA "Class I" or "Class II" violators. On June 5, 1980, DEA furnished us a list of approximately 14,000 leads. We are now in the process of distributing these referrals to our field offices for association with available information and evaluation as to their tax potential. These leads will be tracked under established procedures to permit us to assess the value of these expanded referrals. We are also working with DEA to improve liaison between our respective field offices.

In the aggregate, we believe these changes will result in a substantial increase in the level and quality of assistance and cooperation between the Internal Revenue Service and other Federal law enforcement agencies. We also believe that the Administration's legislative proposals will enhance cooperative law enforcement efforts.

Mr. Chairman, that concludes my prepared testimony. We would be pleased to respond to your questions.

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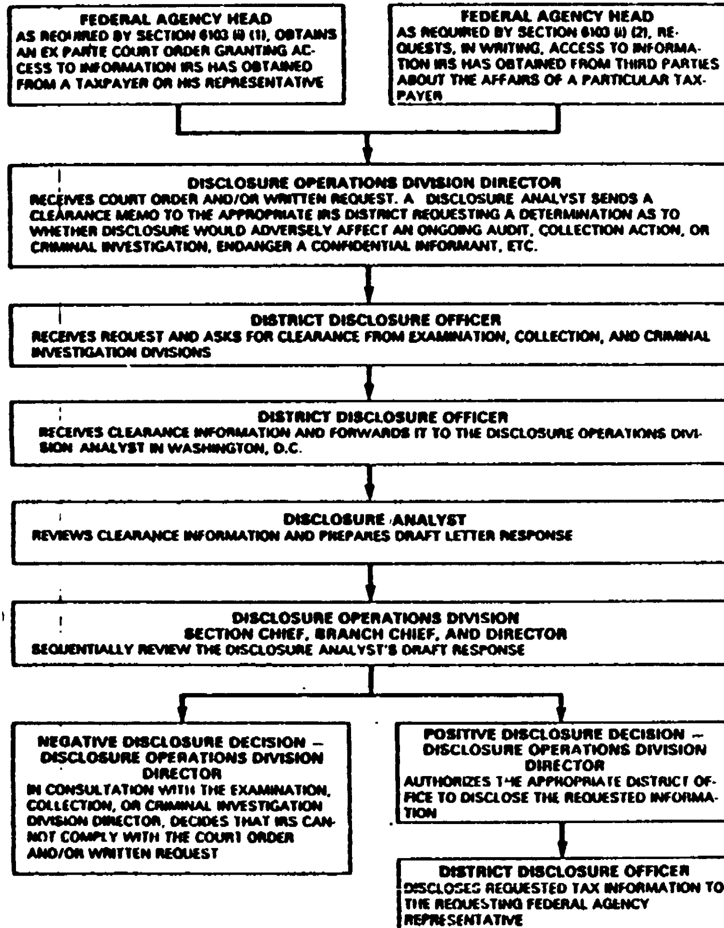
[7] Exhibit A.

PREVIOUS PROCEDURE - 1/1/77 to 5/31/80

PROCESS FOR DISCLOSING INFORMATION UNDER I.R.C. 6103 I (1) AND (I) 2



PRESENT PROCEDURE - EFFECTIVE 6/1/80

IRS ADMINISTRATIVE PROCESS FOR DISCLOSING INFORMATION UNDER I.R.C. 6103 I (1) AND (I) 2

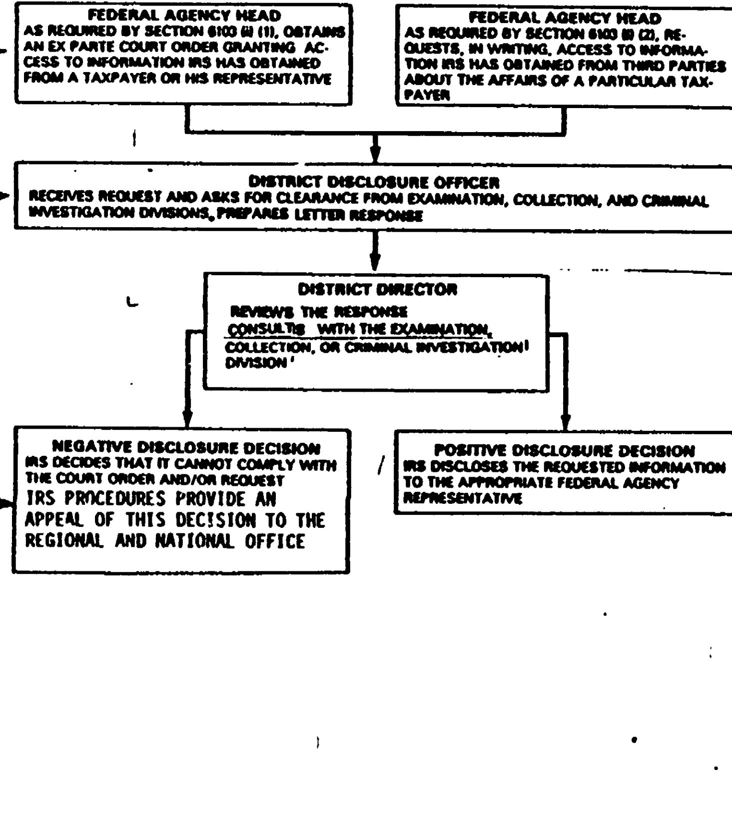


EXHIBIT A

Senator BAUCUS. Our next witnesses are representatives of the General Accounting Office. I might say at this time there is a vote on the floor of the Senate. We will temporarily recess. There are no back-to-back votes, as I understand it, so I can be back in the next 10 minutes.

So, the hearing will temporarily recess for about 10, 15 minutes.

[Whereupon, a brief recess was taken.]

Senator BAUCUS. The hearing will come to order.

The next witness is Mr. William G. Anderson, Director of the General Government Division of GAO. When he finishes, we will then have a panel consisting of Mr. Shattuck, of the ACLU, Mr. Walker, chairman of the Taxation Section of the ABA, and John Stephan, of the Taxation Committee of the American Bankers Association.

I would like at this point to begin a bit belatedly with a 5-minute limitation on testimony.

I am asking the witnesses to summarize their testimony, to get to the point, the heart of any matter they wish to present. Their full statements will be included in the record.

So, with that, let's begin.

STATEMENT OF WILLIAM J. ANDERSON, DIRECTOR, GENERAL GOVERNMENT DIVISION, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY KEN MEAD, ATTORNEY, OFFICE OF GENERAL COUNSEL, GAO, AND JOHN GUNNER, INTERNAL REVENUE SERVICE AUDIT MANAGER, GAO

Mr. ANDERSON. Very good, Mr. Chairman.

I would like to introduce the gentlemen at the table with me. On my left is Ken Mead, an attorney with our Office of General Counsel, and on my right is John Gunner, who is at our Internal Revenue Service Audit site, and has done a lot of the work that was referred to here this morning on various reports the GAO has produced.

I guess I would like to start off and say generally that as Senator Nunn brought out, we do agree with the thrust, with the intent underlying the four bills. I guess, though, that we also believe that if you are looking for any cause-effect relationship between passage of these bills and an impact on illegal activities, particularly organized crime and narcotics trafficking, it would probably be hard to discern, but again, there would be some effect.

I think that GAO in its testimony brings out the fact that other things need to be done, things that have been discussed in other reports GAO has issued on our attempts to cope with organized crime and with drug trafficking.

But on to the particular provisions of S. 2402, one of the things that we believe there is a need to do is to better define the two classes of information that would be provided for in the bill, namely, a return and nonreturn information.

We believe the line is rather fuzzy, and since there are separate disclosure provisions for the two, the spectrum would allow large parts of the data that is obtained on taxpayers to be released without obtaining a court order. We believe that distinction should be sharpened, and we believe that a large part of the data that would now be included in the definition of nonreturn information

should be folded in and classified as return information, and therefore require obtaining of a court order in order to have access to it.

We also speak to the provision in the bill concerning taxpayer identity information and have a recommendation that that be tightened up, in that right now IRS would be authorized to provide any information disclosing taxpayer identity. We believe that a much more restrictive definition is possible, and would serve the purpose of allowing IRS to identify taxpayers without incurring the risk of making other data perhaps improperly available.

We also agree with the thrust of the bill to limit the number of people that can request access to this tax information. I think we and the administration disagree somewhat in that they would automatically fold in all U.S. attorneys and heads of strike forces, whereas our proposed changes to the bills as submitted would even restrict it further in that we would eliminate, for example, deputy assistant attorneys and other officials, and require that only those specifically empowered by the Attorney General could make these requests.

We also question a provision in S. 2402 that would require IRS to specifically get court approval of its determination that disclosure of certain data would not be in the government's best interest; for example, where it might include the name of an informant.

Our experience has been that the Department of Justice and IRS have been able to work very effectively to negotiate these things, and we really don't see how that provision is going to add anything. There has only been one instance to date where it was necessary for IRS to go to court.

There is also a provision in the bill that would require IRS to automatically disclose to Justice any nonreturn information that contains evidence of nontax crimes. GAO had another proposal that you alluded to several times, Mr. Chairman, that would provide that IRS could not only provide that type of information, but also return information, if there was a clear indication in the information in its possession that a crime had been committed. IRS could unilaterally provide this information by obtaining a court order, subject to the same type of arguments that Justice must make to obtain an order.

I would rather at this point in time just respond to your questions.

Senator BAUCUS. If you have any final points you want to make, feel free to do so.

Mr. ANDERSON. All right, fine. Let me take one quick look.

With respect to the summons provisions, let me jump on to S. 2403, if I may. I think we agree with the fact that the procedures that are specified in section 1105 of the Right to Financial Privacy Act do seem to be working well. I think that we personally believe that there have been a number of abuses with respect to taxpayers' use of the present 7609 procedures.

I can refer to a study, an IRS study that we had access to, that showed that at one point last year there were 411 pending summonses, that is, where somebody was contesting IRS obtaining the information. Over half of those involved summonses that had been lodged in connection with special enforcement programs or with

organized crime investigations, and most of the balance with tax protestors.

In other words, it appears that the average taxpayer; that is, other than someone with a special interest, generally illegal, are not pursuing the present procedures. Therefore, we don't think that the average honest taxpayer would be impacted at all by the changes that the bill proposes, and that we concur in.

With respect to the other two bills, we believe that the severity of the penalties in the current legislation undoubtedly help explain why IRS employees are very reluctant and very cautious in transferring information to other law enforcement groups. When you think that $5,000 and 5 years could be the result of disclosing a piece of information, I can appreciate caution.

So, I believe that changing the law, in fact, would be beneficial and perhaps contribute to the freer movement of that information that should be moved between IRS and the law enforcement agencies.

I will stop there, sir.

Senator BAUCUS. All right. Thank you very much, Mr. Anderson.

Have your investigations uncovered any figures or information that might indicate how many nontax criminal investigations have been stalled due to the present law?

Mr. ANDERSON. Well, one thing we do know is, we did a study last year that developed information on the amount of time that it took IRS to respond to these requests. We hit two regions. Los Angeles, it averaged around 65 days from the time the request was made until IRS produced the data, either pursuant to a court order or pursuant to a request that they could honor without a court order.

Senator BAUCUS. So, on that point, it sounds like a lot of the problem is just in the delay with IRS, regardless of the procedure. Is that correct, or not?

Mr. ANDERSON. It takes a lot of time to search the files and locate the information, often. We do believe that that figure could be cut. We believe the arbitrary figure that is specified in S. 2402 is probably unobtainable, but IRS, I think, recognizes the problem. In fact, I think the Commissioner spoke of certain changes they made effective June 1, that should enable them to respond to the requests a little faster.

Senator BAUCUS. You were going to raise another point. I am sorry I cut you off.

Mr. ANDERSON. No, that is fine, sir.

Senator BAUCUS. All right.

Mr. ANDERSON. I was going to mention another city, Jacksonville, where the days were even longer, say, an 80-day average; but say, 60, 70, 80 days has been the experience.

Senator BAUCUS. Around the country, on an average basis, you are saying?

Mr. ANDERSON. Pardon me?

Senator BAUCUS. Sixty, seventy days around the country?

Mr. ANDERSON. That is correct.

Senator BAUCUS. What about illegal drug trafficking? Have you uncovered in your investigation any instances of illegal drug trafficking which are not currently under investigation because of the

difficlty of the Criminal Division or investigators in getting IRS information?

Mr. ANDERSON. Well, DEA, as you know, refers a large number of leads to IRS. I think the figure was cited of 14,000 that were referred there earlier this month. In past years, they have also made referrals, and I presume DEA makes a referral when it assesses its own opportunities to develop a case as perhaps being rather limited, or at least hopes that IRS, absent any success on its own part, will be able to develop a case.

In any event, the point I am leading up to is that since 1976, we are probably talking, before the 14,000 that were referred to, about 800 odd referrals. To date, IRS has succeeded in obtaining 11 convictions. So, even with a lead on a specific individual by name that DEA suspects to be a high level trafficker, even there, the difficulties in building these types of cases are such that the success rate is low.

Senator BAUCUS. What kinds of difficulties do you come across?

Mr. ANDERSON. I think it is basically the difficulty of trying to reconstruct the financial picture, and trying to understand how the cash that was accumulated on the street suddenly ends up in a bank account across the country and how the laundering of the moneys takes place.

This is an opportune time for me to make a point also that GAO has commented on, Mr. Chairman, and this relates to the need for more financial investigative expertise on the part of the law enforcement agencies. I think Mr. Nathan referred to a long-term effort to upgrade that type of capability in the FBI and DEA.

Obviously, the FBI has come a pretty long way already, but in DEA, financial expertise is almost nonexistent. Therefore, they have to look to IRS for what support they get in the area, except that IRS is a separate agency with a separate mission, and so the efforts, the financial expertise and the law enforcement expertise are really not ideally married when you have IRS and DEA coordinating.

Senator BAUCUS. What did you find to be the attitude of IRS agents in the field compared with the attitude, perhaps, of the Washington office with respect to this general question, this general problem?

Senator Nunn alluded to certain agents, certain IRS personnel who have spoken to him on and off the record indicating they are very frustrated at the inability to prosecute the cases that should be prosecuted.

Mr. ANDERSON. I will let Mr. Gunner supplement what I say here, but I think what comes across is that, No. 1, if you try and read the IRS regulations that distinguish between tax return information, return information, taxpayer return information, you come away confused.

I can imagine there are a lot of people out there who have a lot of uncertainty as to whether a piece of data they have that might be useful to somebody can even be released, and even then, getting back into the context of the severe penalties that are written into the law, I can appreciate their difficulties, and undoubtedly there is concern that, yes, we would like to do something, but I am

worried. I am worried about my personal vulnerability if I try and move with this information I have.

John, do you want to supplement that?

Mr. GUNNER. Yes, sir.

Mr. Chairman, the Tax Reform Act is only one of several things that came down upon IRS special agents all at about the same time, over a period of 2 or 3 years. There were, of course, the Watergate abuses, but even within the IRS there was Operation Leprechaun, and there was an awful lot of bad publicity brought on the IRS. There were an awful lot of new controls put on agents.

Then the Tax Reform Act was enacted, and for a period of time, there was a definite feeling on the part of the agents as well as the management that their capabilities, their ability to deal with the problems that they had to deal with had been really reduced. And it is taking time and effort on the part of management and the agents to work within these new controls, to start to develop a new attitude, and I think they are well on their way toward developing that attitude.

Senator BAUCUS. Do we need to change the statute, then? You are implying that a lot of these changes can be effected within the agency.

Mr. ANDERSON. I think that Senator Nunn stressed quite strongly this morning that he felt that a large part of the problem was basically interpretation of the statutes and attitude in implementing them.

I think that Mr. Kurtz made a very important statement here this morning when he indicated that IRS is going to increase the amount of resources that they devote to some of these unlawful activities.

Senator BAUCUS. I listened carefully to that, and he said, "they are considering a 40 percent increase." I think that is what he said.

Mr. ANDERSON. We will be following up on it. Well, he said, up to 35——

Senator BAUCUS. Up to 40 percent.

Mr. ANDERSON [continuing]. Or 40 percent.

Senator BAUCUS. He said, they are considering it.

Mr. ANDERSON. Yes.

Senator BAUCUS. In addition to listening to Commissioner Kurtz, do you have any view on that point? That is, the degree to which some of these problems can be corrected simply with internal changes and with changes in the rules and regulations apart from statutory change?

Mr. ANDERSON. I would say both of the above. I think that expression was used earlier today. I think that some changes need to be made. I thought that Mr. Nathan's comment on the Nicky Barnes situation—To me, one of the key defects in the present legislation is IRS's inability to unilaterally communicate out tax return information under any interpretation that might be placed today or even under S. 2402.

I think that the legislation does need fixing in any event. I also believe that there is a decision that has to be made—perhaps the Congress could make it for the Administration—as to what is an appropriate level of effort for IRS to devote to this.

Now, we know today that we heard the figure of less than 5 percent of their criminal investigative activities are being directed at drug enforcement, with some larger percentage under the special enforcement programs. We heard Mr. Kurtz's statement of increasing it further.

I will be honest. To me, it is a level of effort type decision, because even more probably is not going to make too much of a dent in the Government's fight on these activities, but more always helps a little.

Senator BAUCUS. Well, assuming that more always helps a little—— [General laughter.]

Mr. ANDERSON. Which unfortunately is correct in this area.

Senator BAUCUS. All right. And looking at the four statutes that Senator Nunn has introduced, do you have any view as to which portions of those statutes would be most helpful? That is, where is the greatest marginal return, assuming that some of those changes will significantly enhance our efforts to combat illegal drug traffic, and organized crime?

Mr. ANDERSON. Probably the principal change would be his S. 2402 plus the suggested GAO revision to allow IRS to unilaterally go to the courts and communicate this information that it has in its possession.

The second most important would be to make it easier for Federal prosecutors to get to the information that IRS has. The figure was cited earlier that we went from 1,000 such requests a year down to 100. I think we heard recently that something like one-third of the U.S. attorneys have never placed a request for tax return data because of the procedures that are contained in the existing legislation.

So, it appears that the means through which Federal law enforcement people could obtain access could be eased considerably.

Senator BAUCUS. Do you have a view on the effect of these bills on compliance? Senator Nunn suggests, in fact advocates, that passage of these bills will help IRS catch bigger fish in the drug trade and underworld as well, and that these bills will enhance voluntary compliance.

Some others suggest that just the opposite will occur. That is, by relaxing privacy protections and standards, the taxpayers will be less reluctant to comply.

Based upon your investigation, do you have a view on that issue?

Mr. ANDERSON. I have a personal view that I will give you. I think a large part of the taxpaying public is motivated by fear as much as anything else in the propriety with which they file. Again, that is a personal view. I think the bottom line is that, as Mr. Kurtz said, we don't have empirical data that can really track compliance over time.

Conceptually, I really can't see how this could affect it in either way, except that those criminals such as Nicky Barnes who included these items in their returns in the past because they knew that the law would not allow IRS to pass that information on to a law enforcement agency, would undoubtedly stop doing so once they knew that that was fair game for all law enforcement agencies if they included it.

That would be about the most measurable effect on compliance that I can anticipate.

Senator BAUCUS. All right. I have no further questions, unless you have some further observations to make.

Mr. ANDERSON. Fine.

Senator BAUCUS. Thank you very much. We appreciate it, Mr. Anderson.

Mr. ANDERSON. Thank you, Mr. Chairman.

[The prepared statement of Mr. Anderson and reports of GAO follow:]

STATEMENT OF WILLIAM J. ANDERSON, DIRECTOR, GENERAL GOVERNMENT DIVISION

Mr. Chairman and members of the subcommittee, our testimony today deals with four legislative proposals—Senate bills 2402, 2403, 2404, and 2405—currently under consideration by the Subcommittee. The bills, if enacted, would substantially revise the disclosure and administrative summons provisions of the Internal Revenue Code.

At the request of the Chairman of the Subcommittee on Treasury, Postal Service, and General Government, Senate Committee on Appropriations, we analyzed the Senate bills in detail and issued a report (GGD-80-76) on June 17, 1980. With your permission, we would like to submit our report for the record and highlight our major points.

Our analysis of the proposed legislative changes to the disclosure and summons provisions of the 1976 Tax Reform Act is based on past audit work aimed at assessing their effects on Federal law enforcement efforts. In March 1979, we issued a report to the Joint Committee on Taxation entitled "Disclosure and Summons Provisions of 1976 Tax Reform Act—Privacy Gains With Unknown Law Enforcement Effects" (GGD-78-110). In that report, we pointed out that the disclosure provisions had afforded taxpayers increased privacy over information they provide the Internal Revenue Service (IRS), but had adversely impacted on IRS' ability to coordinate with other members of the law enforcement community. We also pointed out that although the summons provisions had afforded taxpayers additional rights, they possibly tended to benefit those engaged in illegal activities. Again, with your permission, we would like to submit our earlier report for the record.

In December 1979, we testified before the Permanent Subcommittee on Investigations, Senate Committee on Governmental Affairs, on IRS' efforts to combat narcotics traffickers. We identified the disclosure/summons provisions as factors limiting IRS' involvement. We stated that changes were needed to the disclosure provisions, particularly with respect to IRS' authority to initiate disclosure of information about non-tax crimes. We also recommended that the summons provisions be revised by adopting procedures similar to those contained in the Right to Financial Privacy Act of 1978.

This past April, we testified before the Senate Appropriations Subcommittee on Treasury, Postal Service, and General Government on changes needed to strengthen Federal efforts to combat narcotics traffickers. We proposed various administrative actions that IRS could take to expedite authorized disclosures of tax information to other agencies. However, we reemphasized the need for legislative changes to the disclosure and summons provisions of the 1976 Tax Reform Act.

Although we support the need for revisions to the disclosure and summons provisions, we have maintained that such revisions alone would not resolve the problems Federal law enforcement agencies encounter in investigating illegal activities, such as narcotics trafficking, white collar crime, and other organized criminal activities. Rather, such legislative revisions would simply enhance the Federal Government's ability to deal with these problems.

We have also maintained that, in revising the disclosure and summons provisions, it is essential to maintain a proper balance between legitimate privacy concerns and equally legitimate law enforcement information needs. In this regard, our past work in the disclosure/summons areas, as well as our analysis of the proposed Senate bills, has been guided by two basic principles. First, IRS is not primarily a criminal law enforcement agency. Rather, its primary mission is to collect taxes and to encourage and achieve the highest possible degree of voluntary compliance with the tax laws. Second, taxpayers who supply information to IRS have a basic right to privacy with respect to that information. Such information should be subject to disclosure for non-tax purposes only when society has a compelling interest which outweighs individual privacy concerns.

I would now like to discuss the four Senate bills which seek to strike a better balance than presently exists between privacy concerns and law enforcement information needs. We support the overall thrust of the bills. However, S. 2402 could be modified to authorize a more effective disclosure mechanism and provide more balance. Appendix II of our report contains a detailed discussion of all our proposed modifications together with suggested statutory language where appropriate. I will now summarize our major suggested modifications.

SUGGESTED MODIFICATIONS TO SENATE BILL 2402

Our first modification centers on changes S. 2402 would make to categories of tax information. Present law defines three categories of tax information—a "return," "return information," and "taxpayer return information." These categories have proven confusing and need to be simplified. S. 2402 would accomplish that objective by dividing tax information into two mutually exclusive categories—a "return" and "non-return information."

Although we support the concept of simplified tax information categories, S. 2402's definition of a "return" seems too narrow in that certain kinds of tax information could receive less protection than under present law. In our view, any information taxpayers supply IRS about their returns ought to be included within S. 2402's "return" category and should be afforded the protection that category warrants. (Subsequent references to the term "return" in my statement pertain to our proposed definition.)

Second, S. 2402 would expand the definition of "taxpayer identity information" to include any information which reveals whether a taxpayer filed a tax return for any given year. We support the intent of this provision—to enable Justice attorneys to determine that a return exists before seeking court-ordered access. However, we do not believe that IRS ought to be able to disclose "any information" to achieve that goal. In our view, S. 2402 could achieve its intent by dropping the reference to "any information" and defining taxpayer identity to include the taxpayer's name, address, and identifying number, and a statement as to whether protected information relating to the taxpayer exists for any particular tax year.

Third, S. 2402 would vest the authority to seek access to tax information within a defined category of "Attorney[s] for the Government," all within the Justice Department. Under S. 2402, unlike present law, other Federal investigative agency heads could no longer independently request tax information.

We agree with the thrust of this proposal. Restricting this authority to Justice attorneys would enhance the coordination between IRS and Justice that is essential to efficient Federal law enforcement. Also, giving Justice attorneys sole authority to request tax information could better insure that such requests meet applicable statutory requirements.

To achieve a better balance between privacy and law enforcement concerns, however, we would limit the authority to request tax information to fewer Justice attorneys. These are the Attorney General, the Deputy Attorney General, the Assistant Attorneys General, and, when designated on an individual basis by the Attorney General, U.S. attorneys and attorneys in charge of Organized Crime Strike Forces.

Fourth, S. 2402 would require IRS to justify to a court its decision to deny Justice access to tax information when such access would, in IRS' view, identify a confidential informant or impair a tax investigation. Justice then would be able to contest IRS' decision in court. Present law authorizes IRS to make such determinations without court review. This procedure has provoked little controversy since it went into effect on January 1, 1977, because the two agencies have clearly demonstrated the ability to negotiate mutually agreeable solutions to access request problems. Thus, while we do not object to court review of IRS determinations, in this instance it seems unnecessary.

Fifth, present law authorizes IRS to disclose information concerning non-tax crimes it obtains from third parties. S. 2402 would legally obligate, rather than authorize, IRS to disclose third-party information, as well as certain information provided by the taxpayer, to other Federal law enforcement agencies. If interpreted as requiring IRS to regularly search its files for evidence of non-tax crimes, this provision could cause IRS to become deeply involved in intelligence gathering to the detriment of its basic responsibilities. The scope of IRS' responsibilities under this provision thus needs clarification.

On a related matter, present law does not authorize IRS to unilaterially disclose information concerning non-tax crimes obtained from a taxpayer. S. 2402 would not fully resolve this problem. Therefore, we suggest that Congress authorize IRS to apply for an ex parte court order to disclose such protected information.

Sixth, present law provides no specific authorization for disclosures under "exigent circumstances." S. 2402 seeks to resolve this problem by requiring IRS to disclose to other Federal agencies, without a court order, necessary information concerning a threat to persons, property, or national security. We support the intent of this provision. As presently drafted, however, it seems to us to be unnecessarily broad in scope.

The exigent circumstances provision of S. 2402 could be more narrowly drawn by keying it to IRS' inability to obtain a court order, as we suggested earlier, in sufficient time to prevent harm to persons, property, or national security.

SENATE BILLS 2403, 2404, AND 2405

I would now like to briefly discuss Senate bills 2403, 2404, and 2405.

Under existing law, a taxpayer can prevent third-party recordkeepers from complying with an IRS summons simply by serving notice on them not to comply. The Government then must bring a court action to enforce the summons. The taxpayer can, but is not rquired to, participate in the court action. S. 2403 would require that a taxpayer file a motion to quash the summons in the local district court. Thus, a taxpayer no longer would be able to delay an IRS investigation simply by serving a notice on the third-party recordkeeper.

The procedure contemplated under S. 2403, which already is contained in the Right to Financial Privacy Act, is reasonable. It also coincides with a recommendation we made in our March 1979 report and in recent testimony.

Senate bills 2404 and 2405 would amend existing provisions of the Internal Revenue Code which provide criminal and civil penalties for unauthorized disclosures. S. 2404 provides Federal employees an affirmative defense against criminal prosecution for disclosures made erroneously, but in good faith. S. 2405 would hold the Government, rather than the affected employee, liable for civil damages for similar erroneous disclosures.

In summary, we support the overall thrust of the four Senate bills. Enactment of S. 2402, with the modifications discussed, would provide law enforcement officials with needed access to tax information while protecting individual's privacy rights. Senate bills 2403, 2404, and 2405, as presently drafted, would effect desirable changes to the summons and disclosure penalty provisions of the Internal Revenue Code.

However, I would like to point out that although the Senate bills and our report address the disclosure and summons provisions' effects on criminal law enforcement efforts, neither addresses a second important issue—restrictions on the use of tax data for exclusively civil and administrative purposes. The Congress may want to address this issue in considering amendments to the Tax Reform Act.

This concludes my prepared statement. We would be pleased to respond to any questions.

REPORT BY THE

Comptroller General

OF THE UNITED STATES

Disclosure And Summons Provisions Of 1976 Tax Reform Act--Privacy Gains With Unknown Law Enforcement Effects

To better protect taxpayers and increase their privacy, the Congress, through the Tax Reform Act of 1976, tightened the rules governing the Internal Revenue Service's disclosure of tax data and its issuance of summonses to third-party recordkeepers, such as banks, brokers, and accountants.

GAO found that:

- --The new legal provisions have had their desired effects. Taxpayers have been afforded increased privacy over information they provide IRS and additional civil rights in summons matters.
- --The adverse impact on coordination between IRS and other members of the law enforcement community as a result of the disclosure provisions has not been sufficiently demonstrated to justify revising the law.
- --The results of IRS' initial experience with the summons provisions indicate that IRS needs to do more to protect taxpayers' rights.

GGD-78-110
MARCH 12, 1979

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-137762

To the Chairman and Vice Chairman
Joint Committee on Taxation
Congress of the United States

This report, one of a series in response to your Committee's request, discusses the effects of the disclosure and summons provisions of the Tax Reform Act of 1976.

The report describes specific issues concerning the disclosure and summons provisions which may warrant Congressional consideration. It also contains several recommendations aimed at improving IRS' controls over and information on third-party recordkeeper summonses. IRS agreed with our recommendations.

As arranged with your Committee, we are sending copies of this report to other Congressional committees, individual members of the Congress, and other interested parties.

Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT TO THE JOINT COMMITTEE ON TAXATION

DISCLOSURE AND SUMMONS PROVISIONS OF 1976 TAX REFORM ACT--PRIVACY GAINS WITH UNKNOWN LAW ENFORCEMENT EFFECTS

DIGEST

The Congress, through the Tax Reform Act of 1976, tightened the rules governing the Internal Revenue Service's (IRS') disclosure of tax data and its issuance of summonses to third-party recordkeepers. The new legal provisions have had their desired effects--taxpayers have been afforded increased privacy over information they provide IRS and additional civil rights in summons matters.

DISCLOSURE PROVISIONS: EFFECTS ON LAW ENFORCEMENT NOT SUFFICIENTLY DOCUMENTED

The disclosure provisions of the Tax Reform Act, effective January 1, 1977, placed substantial restrictions on other government agencies' rights of access to tax information and authorized criminal and civil penalties for unlawful disclosures.

In February 1977, IRS and Department of Justice officials expressed concern that those provisions would make the boundaries of lawful disclosure unclear and would cause a decrease in coordination between IRS and other members of the law enforcement community. (See pp. 2 and 3.)

Taxpayers have benefited from the increased confidentiality provided by the disclosure provisions of the Tax Reform Act. The concerns of law enforcement officials were not totally unfounded, however.

The new legal provisions have confused IRS employees. Despite the confusion, the number of court actions alleging

unlawful disclosures has been small. The few court actions could mean that IRS employees, when faced with disclosure questions, have properly interpreted the law or have erred on the side of caution by not disclosing data that could have been disclosed. Another possibility is that unlawful disclosures have gone unnoticed. Whichever the case, recent IRS efforts to provide additional disclosure training should help alleviate employee confusion. (See pp. 17 and 18.)

The disclosure provisions also have adversely affected coordination between IRS and other law enforcement agencies. Based on available evidence, however, some of the coordination problems produce little cause for concern. IRS, for example, almost assuredly takes more time now to respond to Department of Justice requests for access to tax information. The time IRS takes to respond to those requests, however, does not seem unreasonable considering the increased concern for privacy and the fact that Justice was unable to cite any examples of specific problems caused by IRS' response time. (See pp. 14, 15, and 19.)

Other coordination problems are more troublesome. For example, coordination with the Department of Justice has been affected because IRS is restricted, in some situations, from alerting attorneys that it has tax information that may be of value to them in their role as Federal law enforcement coordinators. (See pp. 10 to 12 and 19.)

Although the disclosure provisions have had some adverse effects, the record of those effects is insufficient to warrant recommending revisions to the law. In this regard, GAO is uncertain as to whether any revisions could be made without disturbing the balance between criminal law enforcement and individuals' rights. That balance is particularly important in tax administration because taxpayers should

be able to satisfy their income tax obligations with the knowledge that information they provide IRS will be used only as authorized by law. (See p. 20.)

Matter for consideration by the Congress

GAO is not advocating changes to the disclosure provisions of the Internal Revenue Code. The types of coordination problems being experienced, however, point up the need for Congress to consider whether the adverse impacts on Federal law enforcement activities warrant revision of the legislation and whether any revision can be made without disrupting the balance between criminal law enforcement and individuals' rights.

Agency comments

IRS agreed that taxpayers have been accorded increased privacy over information they provide the Service. Also, IRS acknowledged that the disclosure provisions have had no direct effect on IRS' enforcement of the tax laws.

The Department of Justice expressed the belief that GAO had understated the impact of the disclosure provisions and that the Tax Reform Act may not have struck a proper balance between privacy and law enforcement. In seeking to demonstrate that point, Justice referred to various matters, such as investigative delays, cumbersome procedures, diminished coordination, and duplicative investigations. Although GAO does not fully agree with each of Justice's comments, it does understand Justice's concerns. GAO also understands congressional and public concerns for privacy.

Aware of the need to strike an appropriate balance between varying concerns and mindful of the problems in trying to assess whether the Tax Reform Act has struck that balance, GAO's conclusion remains the same: it has seen insufficient evidence to warrant

recommending that the disclosure provisions be revised. (See pp. 20 to 23.)

SUMMONS PROVISIONS: ADMINISTRATIVE CHANGES ARE NEEDED

The summons provisions of the Tax Reform Act, effective March 1, 1977, require IRS to notify the affected taxpayer after issuing a summons to a third-party recordkeeper. The taxpayer then has 14 days to stay compliance, that is, to order the recordkeeper not to comply with the summons. If IRS initiates court action to enforce the summons, the taxpayer can intervene in the court proceeding.

In February 1977, IRS and the Department of Justice warned that the summons provisions would unduly delay criminal tax investigations and would tend to benefit those whose illegal activities extend beyond the tax laws. Unless IRS and Justice can substantiate the existence and extent of those problems, however, the Congress cannot be expected to look favorably on requests for changes to the law. The reporting system IRS initiated to monitor the effects of the summons provisions is not providing the type of data that can be reliably used to meet that need. (See pp. 4 to 6 and 29 to 35.)

Statistics GAO developed indicate that the investigative delays anticipated by IRS and Justice have occurred. Although delays are unavoidable when taxpayers are given the right to contest the legality of third-party summonses, procedures followed by IRS and the Department of Justice in processing requests for summons enforcement contributed to those delays. IRS and Justice have taken appropriate steps to streamline those procedures. (See pp. 35 to 37.)

Even if its reporting system were providing more reliable data on the effects of the summons provisions, IRS would find it difficult to demonstrate a need to amend those provisions since they have resulted in the withdrawal of many third-party summonses. Some of those summonses were withdrawn because they were determined to be defective or unnecessary. Most were withdrawn, however, because IRS employees were not fully conversant with the procedures to follow in preparing and issuing summonses. (See pp. 24 to 29.)

GAO's review was limited to those summonses on which taxpayers stayed compliance. But summonses not stayed by taxpayers are also likely to contain technical and procedural errors and may, in a few instances, be defective or unnecessary. Recognizing that, additional controls are needed to protect against such summonses being issued in the first place.

If IRS takes action to improve its summons issuance process and collects accurate and useful data to demonstrate the adverse impact of the summons provisions, it may be in a better position to seek changes to those provisions in the future. (See p. 39.)

Recommendations

GAO recommends that the Commissioner of Internal Revenue

--provide additional training to all employees responsible for issuing summonses to better insure that they fully understand all legal and technical aspects of the summons process and

--require the Director of IRS' Internal Audit Division to monitor the effectiveness of IRS' summons training program.

GAO also recommends that the Commissioner revise the summons reporting system to

--provide field office personnel with more specific guidance on accounting for summonses, stays, and interventions;

--collect information designed to determine whether those whose illegal activities extend beyond the tax laws tend to exercise their rights to stay summonses and intervene in enforcement actions more than the average investigative subject; and

--accumulate statistics on investigative delays caused by the summons provisions of the Tax Reform Act. (See pp. 39 and 40.)

Agency comments

IRS agreed with GAO's recommendations. It pointed out, however, that GAO's findings do not support a conclusion that the summons provisions of the Tax Reform Act have protected the legitimate rights of taxpayers in any substantial number of cases. While not disagreeing with IRS, GAO emphasizes that it (1) did not attempt to identify every instance nationwide in which the summons provisions have protected the legitimate rights of taxpayers and (2) has no assurance that it even identified every instance in the field offices it visited.

Both IRS and the Department of Justice expressed the belief that GAO had not adequately considered issues such as delays resulting from judicial consideration of summons enforcement action and the extent to which tax protesters and persons involved in illegal activities are benefiting from the summons provisions.

The absence of hard evidence hindered GAO's discussion of these concerns. The basic message of GAO's report is not that IRS' and Justice's concerns about the summons provisions are unfounded but rather that they have not been demonstrated. IRS has

not been accumulating the type of data that would facilitate such a demonstration.

Both IRS and Justice expressed concern that many taxpayers who stay compliance with third-party summonses fail to intervene in the summons enforcement procedure. In considering solutions, both referred to the Right to Financial Privacy Act of 1978 (title XI of P.L. 95-630, Nov. 10, 1978).

Like the summons provisions of the Tax Reform Act, the Right to Financial Privacy Act calls for an individual to be notified when a government agency seeks access to financial records through an administrative summons. The Right to Financial Privacy Act makes it more difficult, however, for the affected individual to stay compliance with the summons. Justice concluded that the rules pertaining to IRS summonses should be no different than the rules pertaining to summonses issued by other agencies and that Congress should consider amending the Internal Revenue Code accordingly.

Because GAO's review was limited to summonses issued under the Tax Reform Act of 1976 and the Right to Financial Privacy Act was just recently enacted, it did not compare the effectiveness of the different procedures for staying compliance. GAO believes, however, the idea of using the stay of compliance procedure mandated by the Right to Financial Privacy Act for IRS summonses has merit and should be considered by the Congress. (See pp. 40 to 43.)

MATTER FOR CONSIDERATION BY THE CONGRESS

The Congress may want to monitor the use of the stay of compliance procedure under the Right to Financial Privacy Act and consider whether the adoption of similar provisions for IRS summonses would be appropriate. (See p. 43.)

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ABBREVIATIONS

GAO General Accounting Office

IRS Internal Revenue Service

CHAPTER 1

INTRODUCTION

The Internal Revenue Service's (IRS') overall mission is to encourage and achieve the highest possible degree of voluntary compliance with the tax laws and regulations and to conduct itself so as to warrant the highest degree of public confidence in its integrity and efficiency. As part of carrying out this mission, IRS must seek out and recommend prosecution of those persons who willfully violate the tax laws. Responsibility for enforcing the criminal provisions of the tax laws rests with IRS' Criminal Investigation Division.

The Joint Committee on Taxation requested us to review IRS' criminal enforcement activities. This is the first in a series of reports in response to that request. This report addresses the effects on IRS' Criminal Investigation Division of the disclosure and summons provisions of the Tax Reform Act of 1976 (P.L. 94-455, Oct. 4, 1976). Subsequent reports will address the development, selection, management, and legal processing of criminal tax cases.

Special agents are the Criminal Investigation Division employees who actually gather information on and investigate charges of criminal violations of the tax laws. In carrying out their responsibilities, special agents gather sensitive taxpayer information and often find it necessary to issue summonses to banks, brokers, and other third-party recordkeepers to obtain information about taxpayers' financial transactions.

In enacting the Tax Reform Act of 1976, the Congress afforded taxpayers increased privacy over information they provide IRS and additional civil rights in summons matters. The disclosure provisions, effective January 1, 1977, placed substantial restrictions on other government agencies' rights of access to sensitive tax information. The summons provisions, effective March 1, 1977, generally require IRS to notify affected persons whenever it issues a third-party recordkeeper summons and give those persons the right to contest such summonses in court.

DISCLOSURE PROVISIONS OF THE TAX REFORM ACT

IRS probably has more information about more people than any other government agency in this country. Consequently, agencies needing information about people have

sought to obtain it from IRS. Before enactment of the Tax Reform Act of 1976, procedures for disclosing tax information had developed in a piecemeal manner. For a period of more than 40 years, various statutes, regulations, and executive orders were promulgated without sufficient consideration of a comprehensive approach to the disclosure of such information. As a result, law before 1977 contained few meaningful restrictions on a government official's access to tax data.

As the tax laws became more complex, the amount of personal and financial data on tax returns increased. And predictably, returns became an attractive source of information for scores of government agencies. Under procedures before 1977, tax returns were routinely made available to such diverse organizations as the Department of Defense, the Federal Trade Commission, the Department of Interior, the Tennessee Valley Authority, and the Veterans Administration.

The Tax Reform Act sets out new disclosure standards for a variety of potential recipients of tax information including congressional committees, State tax officials, Federal agencies, and the President. The act generally denies access to tax information in non-tax civil cases and requires either a written request to the Secretary of the Treasury or a court order before disclosure is granted in non-tax criminal cases. The law governing IRS disclosures to the Department of Justice with regard to criminal tax cases, on the other hand, remains basically unchanged.

<u>Agency concerns</u>

In letters to Members of Congress and in testimony before the Subcommittee on Oversight of the House Ways and Means Committee, in February 1977, the Attorney General expressed concern over the disclosure provisons of the Tax Reform Act. According to the Attorney General:

> "The basic problem with section 1202, the tax return disclosure provision, is that it attempts to spell out, exclusively, all the ways in which tax returns and tax return information may be disclosed in the whole investigative and judicial process, with stringent criminal and civil penalties for unlawful disclosure. Some portions of the statute are unclear and others are too narrowly drawn. Although regulations have been issued interpreting the statute broadly, they

> cannot add to the statutory uses, nor would they prevent or dictate the outcome of civil suits brought for harassment. Because of the vague and ambiguous language, the Government attorney or investigator is uncertain whether he can proceed with normal discharge of his duties without being exposed to criminal or civil liability."

The Attorney General said also that the particular subsections which authorize disclosure by IRS to the Department of Justice

> "are so phrased as to introduce considerable confusion concerning the boundaries of disclosure and the use which can be made of tax information in the course of complex tax fraud investigations and prosecutions."

IRS officials have expressed many of the same concerns cited by the Attorney General. Criminal Investigation Division officials advised us that the disclosure statutes would reduce their ability to cooperate with other members of the Federal law enforcement community such as the Drug Enforcement Administration, Strike Force attorneys, and U.S. attorneys. IRS officials also said that the disclosure provisions would in some cases preclude the release of information pertaining to non-tax criminal and civil matters to appropriate Federal, State, and local officials.

In a January 1978 letter (see app. III) to the Department of Justice, however, the Director of IRS' Disclosure Operations Division stated that IRS' first year of experience with the new law had shown that the

> "methods of converse between us [IRS] and other agencies prohibited by the new law are minimal and that such methods as are prohibited should be so restricted."

The Director also pointed out that IRS' position is subject to change as it gains more experience working with the law.

SUMMONS PROVISIONS OF THE TAX REFORM ACT

Most IRS officials responsible for examining tax returns, collecting taxes, or investigating a taxpayer's failure to comply with the tax laws are authorized to summon a taxpayer or a third-party recordkeeper--such as

the taxpayer's accountant or banker--to produce books, papers, records, or other data. Before March 1, 1977, IRS was not required to notify a taxpayer when it issued a summons to a third-party recordkeeper. Thus, taxpayers sometimes were unaware of IRS investigations into their financial affairs.

In explaining the reasons for changing the summons provisions through enactment of the Tax Reform Act of 1976, the Senate Finance and House Ways and Means Committees reported that:

> "The administration of the tax laws requires that the Service 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, the use of this important investigative tool should not unreasonably 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, IRS 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. * * * The Committee believes, however, that these administrative changes, while commendable, do not fully provide all of the safeguards which might be desirable in terms of protecting the right of privacy."

The Tax Reform Act of 1976 requires IRS to notify the affected taxpayer after issuing a summons to a third-party recordkeeper. The taxpayer then has 14 days within which to stay compliance, that is, order the third party not to comply with the summons, and, if IRS initiates court action to enforce the summons, the taxpayer can intervene in the court proceedings.

Agency concerns

In testimony before the Subcommittee on Oversight, House Committee on Ways and Means, in February 1977, Department of Justice and IRS officials expressed concern with the summons provisions of the Tax Reform Act.

The Attorney General, in urging that the effective date of the summons provisons be postponed until a workable substitute could be enacted, pointed out that:

--Under prior law, a taxpayer or third party generally could not intervene in a summons enforcement proceeding and the Supreme Court has held that to permit otherwise would "stultify" IRS' every investigative move.

--District Court dockets are so full that it takes several months to get a hearing in summons enforcement matters and from 18 to 24 months to get a final decision.

--Delays caused by stays of compliance and taxpayer interventions in court proceedings could make some tax investigations, such as those involving organized or white collar crime, impractical.

IRS' Assistant Commissioner for Compliance, in urging repeal of the summons provisions or at least a postponement of their effective date, expressed the belief that those provisions would "be exploited by taxpayers determined to delay investigations of their tax affairs and be a boon to the illegal element, in particular." He also expressed the belief that tax investigations would be jeopardized, tax revenue would be lost, and courts would be flooded with unnecessary litigation. The Assistant Commissioner stated that although

> "the new law gives the taxpayer the absolute right first to stay compliance by the summoned third party and then to intervene in the court suit against the third party necessitated by the taxpayer's action, the new law does not create any new grounds for objection to the enforcement of the summons, properly leaving that to existing case law. Thus, the primary result of this new law will not be less summonses enforced--the Service feels confident they will ultimately be enforced after the intervening taxpayer has exhausted his judicial appeals--but, instead, the clogging of the courts with unnecessary suits and the abuse of the process as a delaying tactic to thwart the investigation of serious tax evasion schemes."

Rather than postpone the effective date of the summons provisions, the Subcommittee suggested that Justice and IRS first study their actual experience with the new provisions and request changes in the law, if warranted, on the basis of that experience.

SCOPE OF REVIEW

We reviewed the legislative history of the disclosure and summons provisions of the Tax Reform Act of 1976 and the regulations, policies, and procedures IRS developed to implement those provisions. We interviewed IRS officials and Department of Justice representatives, reviewed IRS records related to disclosure, and analyzed statistical and other data on summonses issued by the Criminal Investigation Division.

We did our work at IRS' headquarters in Washington, D.C.; its regional offices in Chicago, Dallas, New York, and San Francisco; its district offices in Boston, Chicago, Dallas, Hartford, Los Angeles, Milwaukee, New Orleans, and Phoenix; and its service centers in Andover, Massachusetts; Austin, Texas; Fresno, California; and Kansas City, Missouri. We talked to Department of Justice officials including U.S. attorneys, Strike Force attorneys, and Drug Enforcement Administration personnel in Washington, D.C., and in several other cities throughout the country.

CHAPTER 2

EFFECTS OF DISCLOSURE PROVISIONS ON LAW ENFORCEMENT NOT SUFFICIENTLY DOCUMENTED

The disclosure provisions of the Tax Reform Act have afforded taxpayers increased privacy over information they provide IRS. At the same time, the provisions have adversely affected coordination between IRS and other law enforcement agencies and have confused IRS employees. The record of these adverse effects is insufficient, however, to warrant recommending revisions to the law, especially in light of the need to strike an appropriate balance between criminal law enforcement and an individual's right to privacy. The latter is particularly important with respect to tax administration in that taxpayers should be able to satisfy their income tax obligations with the knowledge that information they provide IRS will be used only as authorized by law.

COORDINATION BETWEEN IRS AND JUSTICE HAS BEEN AFFECTED BUT THE EXTENT IS UNKNOWN

Coordination between IRS and the Department of Justice is essential to efficient Federal law enforcement. U.S. attorneys, for example, are responsible for prosecuting criminal tax cases and other criminal cases referred to them by other agencies. Because they often are aware of the investigative efforts of numerous agencies, U.S. attorneys can coordinate Federal law enforcement efforts, prevent duplicate investigations, provide investigative guidance, and otherwise assist Federal law enforcement officials in developing successful cases. Likewise, Strike Force attorneys are responsible for coordinating the efforts of various Federal law enforcement agencies against organized crime.

The Tax Reform Act of 1976 gave the heads of certain Federal agencies, including the Department of Justice, the means to obtain tax information needed in non-tax criminal cases. They can gain access to tax information that IRS had obtained from third parties by submitting a written request to the Secretary of the Treasury specifying the taxpayer's name and address, the tax periods involved, the statutory authority under which the agency head is proceeding, and the specific reason why the tax information is needed. They can gain access to information IRS had obtained from taxpayers, including tax returns and associated information, by obtaining a Federal district court order.

Despite the means provided by the Act to obtain information, coordination between IRS and the Department of Justice has suffered since the disclosure provisions became effective, as evidenced by the following:

--IRS cannot always disclose information about non-tax crimes.

--IRS cannot alert Justice attorneys to seek disclosure of criminal tax information.

--IRS' involvement in Strike Force activities has declined.

--IRS apparently takes more time to respond to Justice requests for tax information.

--Coordination between IRS and the Drug Enforcement Administration has been slowed.

--IRS generally cannot disclose information about non-tax civil matters.

IRS cannot always disclose information about non-tax crimes

In conducting their daily activities, IRS employees sometimes obtain information indicating that a particular taxpayer has committed a crime outside IRS' jurisdiction. If such information is obtained by IRS from a third party, IRS can take the initiative in disclosing the information to the head of the appropriate Federal agency including the Attorney General. However, if that information is obtained from a taxpayer, his records, or his representative, IRS cannot alert the Attorney General or other Federal agency head regardless of the crime's seriousness. Furthermore, the disclosure provisions generally prohibit IRS from revealing any evidence of non-tax violations to State and local authorities regardless of whether the information is obtained from the taxpayer or a third party.

IRS has no comprehensive file or overall statistics on disclosure situations that have arisen since the Tax Reform Act. We reviewed information IRS did have and identified several situations involving non-tax crimes, examples of which are cited below.

In the following situations, IRS was able to disclose information because it was obtained from a third party:

--A special agent received a telephone call from an unidentified informant who alleged that a particular employee of another Federal law enforcement agency was providing advance information on bookmaking enforcement operations to a criminal who might have been affected by such operations.

--While reviewing and discussing a third party's records as part of a criminal tax investigation, a special agent was informed by the third party that the taxpayer's ongoing trial for fraudulent loan practices would result in an acquittal because a "deal" had been made with the judge.

--During a criminal tax investigation, a third party told a special agent that the subject taxpayer had stated that a particular United States Customs agent would assist in smuggling drugs into the country.

In the following situations, IRS was not able to disclose information on its own initiative because the information was obtained from the taxpayer, his records, or his representative or because the information related to a non-tax violation of a State law:

--IRS' audit of corporate records indicated that a Federal employee had accepted a bribe from the corporation and canceled a planned regulatory investigation. IRS could not disclose this information.

--A taxpayer imported antiques and declared a value of $5,000 for Customs purposes. During the tax investigation, IRS obtained documents which indicated that the antiques were valued at $300,000. IRS could not disclose this evidence of a potential Customs violation.

--During an audit, IRS' analysis of corporate records revealed that the corporation had made political contributions which constituted a potential violation of the Corrupt Practices Act. IRS could not disclose this evidence to the Attorney General.

--IRS' analysis of records submitted by a taxpayer during a criminal tax investigation showed that a union official had accepted gratuities from company officials. IRS could not disclose this evidence of an apparent violation of the Taft-Hartley Act.

--A local law enforcement agency held an arrest warrant on an individual accused of welfare fraud but had not executed the warrant because the individual could not be located. IRS learned of the taxpayer's whereabouts during an investigation of her tax affairs. Because a taxpayer's address comes under the protection afforded by the disclosure provisions of the Tax Reform Act and because the information related to a non-tax violation of a State law, IRS could not disclose it.

--A taxpayer was convicted of violating a State corporate law and was ordered to pay $75,000 to investors. The individual paid only $60 and filed a November 1975 financial statement with his probation officer claiming that he had received no income since October 1973. This information was brought to IRS' attention by a third party during an investigation of the taxpayer. The involved special agent compared the third-party information to the results of his tax investigation which showed that the taxpayer had earned $121,000 and $33,000 in 1974 and 1975 respectively. Again, IRS was prevented from disclosing this information because a non-tax violation of a State law was involved.

IRS cannot alert Justice to seek disclosure of criminal tax information

Another coordination problem arises when IRS has criminal tax information on an individual which can be useful to a U.S. attorney or a Strike Force attorney, and the affected attorney does not know IRS has the information. In this regard, the Tax Reform Act prohibits IRS from initiating discussions with Justice attorneys about a person's criminal tax affairs until IRS officially refers its case to Justice for prosecution. As a result, Justice attorneys believe that the Tax Reform Act has adversely affected their ability to properly carry out their duties as Federal prosecutors and law enforcement coordinators.

Neither IRS nor Justice had any overall statistics to indicate how often such coordination problems arise, but Justice attorneys did provide the following examples:

--On December 8, 1976, IRS told Justice that it had information indicating possible violations of Federal statutes outside IRS' jurisdiction by a specific individual and that the information would be provided once Justice requested disclosure through the then proper channels. Justice did so on December 23, 1976, but IRS, in its reply dated February 4, 1977, said that the recently enacted disclosure provisions of the Tax Reform Act prohibited IRS from releasing the requested information.

--A taxpayer under investigation by IRS was arrested by Customs agents for smuggling. The U.S. attorney could have considered indicting the individual on two counts--smuggling and tax fraud--if he knew in advance about IRS' investigation. Pursuant to the Tax Reform Act, however, IRS cannot disclose the identity of an investigative target until it officially refers its case to the Department of Justice for prosecution. In this example, it is unlikely that the individual would be charged with tax fraud if he had already been tried for smuggling due to the Department of Justice's "dual prosecution" policy. That policy provides that all offenses arising out of a single transaction, such as smuggling and evading taxes on the ensuing profits, should be tried together. Before the Tax Reform Act, IRS could have alerted the Department of Justice to the availability, through proper disclosure channels, of information valuable to a U.S. attorney concerning the named individual.

--A corporation that had allegedly made illegal payments overseas was under investigation by the Securities and Exchange Commission. The involved U.S. attorney learned of an ongoing IRS fraud investigation of the same corporation when he was requested to enforce a summons issued by IRS. The attorney concluded that the two agencies had conducted parallel investigations thereby wasting resources through lack of

coordination. Before the Tax Reform Act, IRS could have alerted the U.S. attorney to request disclosure on the corporation. The attorney then could have coordinated the investigative efforts of the two agencies.

--In one major city, the Strike Force attorney meets with IRS officials each month to discuss ongoing and planned efforts against organized crime. When IRS officials begin discussing individual cases, however, the attorney has to leave the room. Before the Tax Reform Act, IRS was able to discuss individual cases with Strike Force attorneys and the attorneys could then provide guidance consistent with their role as Federal law enforcement coordinators. Under present law, a Strike Force attorney can suggest that IRS initiate a criminal tax investigation on a specific individual. If IRS decides to conduct the investigation, however, it cannot so inform the Strike Force attorney.

IRS' participation in Strike Force activities has declined

The Government's chief weapon in the war against organized crime is the Federal Strike Force. Although IRS special agents have proven to be valuable Strike Force participants due to their expertise in investigating financial matters, their participation has declined since the disclosure provisions of the Tax Reform Act became effective on January 1, 1977. To demonstrate that decline, IRS officials provided the following nationwide statistics.

Fiscal year	Number of Strike Force cases initiated by IRS
1974	620
1975	547
1976 (note a)	592
1977 (note a)	333
1978 (10/1/77 to 6/30/78)	221

a/Transition quarter (7/1/76 to 9/30/76) statistics are not included.

A quarterly breakdown of Strike Force cases initiated during fiscal years 1976, 1977, and the first 9 months of 1978 shows this decline more clearly. Between July 1, 1975, and December 31, 1976, IRS initiated an average of 135 Strike Force cases each quarter. Between January 1, 1977, and June 30, 1978, the average dropped to 74.

Statistics provided by IRS' Disclosure Operations Division further indicate the extent to which cooperation between IRS and Strike Force attorneys has declined. During calendar year 1976, Strike Force attorneys submitted 144 requests for access to tax information. Only 71 requests were submitted during 1977. This decline may be due, at least in part, to the fact that the disclosure provisions now limit the extent to which IRS can take the initiative in getting attorneys to request disclosure on potential Strike Force targets identified by IRS.

Insufficient evidence exists to enable us to determine the extent to which the decline in Strike Force participation indicated by the statistics is due to the disclosure provisions of the Tax Reform Act. Other factors might be involved. In January 1976, for example, the Deputy Attorney General and the Commissioner of Internal Revenue signed a document setting out specific guidelines regarding Justice/IRS cooperation in joint investigations. According to IRS officials, the agreement increased IRS' control over the use of its personnel by Strike Forces and its participation in selecting Strike Force targets. We have no way of knowing how much of IRS' declining participation in Strike Force activities was due to those guidelines.

While not attributing the entire decline in Strike Force participation to the Tax Reform Act, IRS officials have cited the Act as a definite contributor. In testifying before the Subcommittee on Criminal Laws and Procedures of the Senate Committee on the Judiciary, IRS' Deputy Commissioner said in response to a question on IRS' participation in Strike Forces that "the disclosure statute and other requirements do tend to restrict our participation in terms of information that we can provide * * *." Similarly, IRS' Assistant Commissioner for Compliance said that "the fact that we [IRS] cannot as freely disclose today as we did in the past does adversely affect our participation in the strike forces."

IRS' Criminal Investigation Division Director also cited the Tax Reform Act as a reason for this decline. As he noted, however, the decline does not mean that IRS

is working fewer cases involving members of organized crime; it simply means that fewer of those cases are being done under the Strike Force umbrella which, in turn, would mean that Strike Force attorneys are less able to coordinate Federal efforts against organized crime. In commenting on a draft of this report, IRS provided additional statistics showing that it had initiated about the same number of criminal cases involving organized crime figures and persons involved in racketeering and narcotics trafficking in each fiscal year since 1975. After fiscal year 1976, however, a greater number of those cases was initiated outside the Strike Force.

We did not attempt to assess the impact of the disclosure provisions on other aspects of the Strike Force program, such as prosecution and conviction rates, because the provisions had not been in effect long enough to facilitate that type of assessment.

IRS' response time in handling requests for tax information is not unreasonable

Justice attorneys believe that IRS has been slow in responding to requests for tax information since January 1, 1977. IRS almost certainly does take more time to respond to access requests than it did in past years--and for good reason.

Before enactment of the Tax Reform Act, IRS had little cause to question the validity of requests for tax data made by U.S. attorneys, Strike Force attorneys, and other Department of Justice officials. The time needed to respond to such requests, therefore, would have been minimal. Since the disclosure provisions became effective, however, IRS has had to evaluate the propriety of each request and ensure that all applicable legal requirements have been satisfied. In light of these new concerns, an increase in IRS' response time would not be unexpected.

Our review of a random sample of 19 of 153 access requests made by the Department of Justice during the 9 months ended September 30, 1977, showed that IRS took an average of 37 calendar days to respond. Five of the 19 requests involved court-ordered disclosures to which IRS responded in an average of 32 calendar days. For the 14 head-of-agency requests, IRS took an average of 39 calendar days to respond.

In an effort to quicken the process in fiscal year 1978, IRS established an informal goal of 10 working days to respond.

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From January 1, 1978, through March 31, 1978, IRS received 56 requests for tax information from the Department of Justice. According to information obtained from IRS, an average of 23 calendar days were needed to respond to the 56 requests. Twenty-two of the 56 requests involved court orders to which IRS responded in an average of 17 days. The remaining 34 were head-of-agency requests to which IRS responded in an average of 27 days.

One reason cited by the Chief of IRS' Tax Disclosure Branch for not meeting the 10-day goal was an increase in the number of requests for access to tax information. In this regard, IRS received 153 access requests from the Department of Justice during the 9 months ended September 30, 1977, compared to 167 requests received during the first 7 months of fiscal 1978.

The time IRS takes to respond to Justice's access requests seems a small price to pay for increased taxpayer privacy--especially when Justice was unable to cite examples of specific problems caused by IRS' "slow" response time.

Slowed coordination between IRS and the Drug Enforcement Administration

In July 1976, IRS and the Department of Justice's Drug Enforcement Administration signed an agreement governing operation of the Narcotics Traffickers Tax Program designed to enable the two agencies to work together in dealing with high-level drug dealers. Once the disclosure provisions became effective, program implementation was slowed due to disclosure-related questions about the legality of and the methodology to be used under the agreement.

Although program implementation was slowed, the Tax Reform Act did not render the IRS-Drug Enforcement Administration agreement obsolete. In September 1977, the Drug Enforcement Administration, through an Assistant Attorney General, requested access to third party tax information on 798 alleged high-level drug dealers. IRS authorized that access in letters dated October, November, and December 1977.

In an August 2, 1977, message on Federal efforts against drug traffickers, the President indicated that consideration would be given to initiating changes in the disclosure provisions to promote IRS' participation in those efforts. As indicated in a December 28, 1977, letter to the White House from the Treasury Department, however, the timing was premature

because the record of experience and problems was incomplete. The letter stated:

"Since the disclosure laws became effective only on January 1, 1977, our experience with their effect in the narcotics enforcement area is limited. They have not totally prevented IRS cooperation with other agencies. IRS has continued to work with DEA [the Drug Enforcement Administration] and to actively investigate suspected narcotics dealers for possible violations of the tax laws. In addition, pursuant to this statute, IRS is in the process of supplying information to DEA concerning some 800 possible narcotics violators. This request was made on September 13, 1977. Also, a regulation relating to joint IRS-Justice Department investigations is under consideration which would make future coordination with the Justice Department smoother where tax and non-tax investigations involving the same facts are being pursued.

"Mindful of the political problems inherent in attempting to amend the Act and our still limited experience with these statutes, it seems inappropriate to advance proposals now for legislative changes. These issues involve the sensitive balance between enforcement and individual rights about which we should be cautious. While we will continue to monitor carefully the enforcement impact of these provisions, we believe that a more complete record of experience and problems should be developed prior to seeking any new legislation in this area."

IRS generally cannot disclose information about non-tax civil matters

The disclosure provisions generally do not authorize IRS to release information about non-tax civil matters to Federal, State, or local officials.

We were unable to assess the overall impact of the disclosure provisions on non-tax civil matters because IRS has no way of developing the type of data necessary to support such an assessment. Our review of information in IRS' files, however, provided the following illustrations of what can happen:

--During a criminal tax investigation, IRS obtained records which showed that a corporation had misappropriated a $650,000 contract advance from another Federal agency. Efforts by the Federal agency to obtain corporate records for use in a civil suit were thwarted because IRS had them. The agency requested IRS to provide the needed records but IRS felt it was precluded from doing so by the disclosure provisions. IRS records indicate that the agency lost the civil suit due to a lack of evidence.

--An Assistant Attorney General for the Department of Justice's Civil Division requested IRS to provide him a copy of a corporation's 1969 tax return for use in a civil lawsuit. A key aspect of the lawsuit involved a question about excessive profits the corporation may have realized that year. IRS could not honor the request.

--A Federal agency informed IRS in January 1977 that its involvement in an ongoing civil lawsuit required contact with former employees involved in reduction-in-force actions since 1967. The agency provided IRS with the names and social security numbers of the affected employees and indicated that the Government owed them money. IRS could not disclose the employees' addresses.

DESPITE EMPLOYEE CONFUSION, COURT ACTIONS ALLEGING IMPROPER IRS DISCLOSURES HAVE BEEN MINIMAL

In February 1977, the Attorney General said that the disclosure provisions would confuse Federal law enforcement officials faced with difficult disclosure related decisions. The Attorney General feared that such confusion would lead to numerous criminal and civil lawsuits against IRS and Justice employees. The anticipated confusion has materialized; the numerous lawsuits have not.

Although IRS has taken steps to alert its employees to the requirements of the disclosure provisions of the Tax Reform Act through guidelines and training, many employees do not fully understand those provisions. We asked 107 employees, several of whom were Criminal Investigation Division managers, to react to 8 hypothetical disclosure situations. Their reactions to several of the situations varied significantly (see app. IV). For example, 29 of the 107 employees were wrong when they said that the existence of an

ongoing criminal tax investigation could be disclosed to a U.S. attorney preparing to indict the subject for a relatively minor non-tax offense.

The Director of the Criminal Investigation Division told us that IRS had begun developing a disclosure training program for special agents before our reaction survey but that the results of our survey gave IRS reason to speed up the process.

The Tax Reform Act authorizes criminal and civil penalties for unlawful disclosures of tax information. Despite the apparent confusion caused by the disclosure provisions, the number of court actions alleging unlawful disclosures has been minimal particularly considering that IRS employs over 80,000 persons.

Until October 1977, IRS did not classify its investigations of alleged employee misconduct according to the type of violation involved. Nevertheless, IRS officials provided us with information indicating that only eight cases involving alleged violations of the disclosure laws were considered to have prosecution potential between January 1, 1977, and June 14, 1978. IRS referred all eight cases to the Department of Justice for its consideration, but IRS attorneys recommended prosecution in only one of the eight cases.

During the same period, eight civil lawsuits claiming damages for unauthorized disclosures were filed against IRS employees. Of those eight lawsuits, six involved allegations that IRS had made improper disclosures simply by issuing summonses to third party recordkeepers. Four of the eight lawsuits were dismissed; the other four were unresolved as of June 14, 1978.

CONCLUSIONS

Through the Tax Reform Act of 1976, the Congress intended to tighten the rules governing the disclosure of tax information, thereby affording taxpayers increased privacy. That intent is being achieved. On the other hand, officials from IRS and the Department of Justice had claimed that the disclosure provisions of the Act would serve to confuse Government investigators about the boundaries of lawful disclosure and would cause a decrease in coordination between IRS and other members of the law enforcement community.

The concerns of law enforcement officials were not totally unfounded; coordination has suffered and IRS employees are confused. IRS almost assuredly takes more time now to

respond to Department of Justice requests for access to tax information, its participation in Strike Force activities has declined, its coordination with the Drug Enforcement Administration was slowed, it cannot initiate discussions with Justice attorneys about a person's criminal tax affairs before officially referring its case to Justice, it is sometimes unable to disclose information about non-tax criminal matters, and it generally cannot disclose information about non-tax civil matters.

Based on the evidence available, some of these coordination problems produce little cause for concern. The time IRS takes to respond to access requests does not seem unreasonable considering the increased concern for privacy and the fact that Justice was unable to cite any examples of specific problems caused by IRS' response time. Although statistics indicate that IRS' participation in Strike Force activities has declined since the disclosure provisions took effect, the impact of that decline on the number of prosecutions and convictions involving members of organized crime is unknown. More importantly, insufficient evidence exists to indicate how much of the decline is actually attributable to the Tax Reform Act. Finally, coordination with the Drug Enforcement Administration has apparently improved after an initial slowdown due to questions raised by the new disclosure provisions.

The other coordination problems are more troublesome. Coordination with Justice attorneys has been affected by the fact that IRS is restricted in certain situations from alerting an attorney that it has tax information that may be of value to him in his role as a Federal law enforcement coordinator. Coordination with the law enforcement community in general has been hampered by limitations on IRS' ability to disclose information about non-tax criminal and civil matters. The evidence in support of these problems is limited to a few examples, however, and thus the extent to which the disclosure provisions have adversely affected law enforcement coordination--and particularly prosecution and conviction rates--is unknown.

IRS employees are confused by the disclosure provisions. Despite that confusion, the number of court actions alleging unlawful disclosures has been small. The few court actions could mean that IRS employees, when faced with disclosure questions, have properly interpreted the law or have erred on the side of caution by not disclosing data that could have been disclosed. Another possibility is that unlawful disclosures have gone unnoticed. Whichever the case, recent

IRS efforts to provide additional disclosure training should help alleviate employee confusion.

Although the disclosure provisions have had some adverse effects, the record of those effects is insufficient, in our opinion, to warrant recommending revisions to the law. In this regard, we are uncertain as to whether any revisions could be made without disburing the balance between criminal law enforcement and individuals' rights. That balance is particularly important in tax administration because taxpayers should be able to satisfy their income tax obligations without fear that information they provide IRS will be used for other purposes.

MATTER FOR CONSIDERATION BY THE CONGRESS

We are not advocating changes to the disclosure provisions of the Internal Revenue Code. The types of coordination problems being experienced, however, point up the need for Congress to consider whether the adverse impacts on Federal law enforcement activities warrant revision of the legislation and whether any revision can be made without disrupting the balance between criminal law enforcement and individuals' rights.

AGENCY COMMENTS AND OUR EVALUATION

By letter dated November 29, 1978, the Commissioner of Internal Revenue acknowledged that taxpayers have been accorded increased privacy over information they provide to the Service and that the disclosure provisions have had no direct effect on IRS' enforcement of the tax laws. (See app. I.) He noted, however, that IRS was in no position to assess the effect of those provisions on other law enforcement agencies.

By letter dated November 13, 1978, the Department of Justice endorsed our conclusion that the Congress may want to consider whether the identified coordination problems are tolerable or whether modifications to the disclosure provisions are warranted. (See app. II.) The Department said, however, that we have understated the impact of the disclosure provisions, and that the Tax Reform Act may not have struck a proper balance between privacy and law enforcement.

In seeking to show that the effects on law enforcement have been "more severe" than portrayed in our report, the Justice Department made the following points:

--Disclosure restrictions deny prosecutors access to tax information which has long been used in complex criminal cases.

--The Tax Reform Act, with its "new, unfamiliar and cumbersome procedures" is primarily responsible for a significant decrease in Justice's use of tax information.

--Because Government prosecutors are aware of the time required to obtain disclosure, they are reluctant to seek access to tax information if time is of the essence. Of particular concern, from a timeliness standpoint, is the need for tax information which arises after a trial has begun.

--Justice attorneys encounter difficulties in seeking court-ordered disclosures, particularly in the early stages of an investigation, because they must demonstrate (1) a reason to believe that a specific criminal act has been committed, (2) a reason to believe that tax information has a bearing on the crime, and (3) an inability to obtain the tax information from any other source.

--The Tax Reform Act's disclosure provisions, rather than other factors such as the 1976 Justice/IRS agreement, contributed to the sharp decline in IRS' Strike Force participation.

--The initial effect of the disclosure provisions was to cause a "virtual collapse" in coordination between IRS and Justice. Although that situation has since improved, coordination is and will continue to be greatly diminished.

--Numerous cases of duplication resulting from uncoordinated, parallel IRS/Justice investigations have arisen as a result of the Tax Reform Act.

We do not agree that disclosure restrictions deny prosecutors access to tax information. The Congress, in fact, recognized that prosecutors sometimes need tax information to properly carry out their responsibilities. Thus, it provided specific methods through which that information could be obtained--court-ordered disclosures and written requests from heads of Federal agencies. True, it cannot be obtained as freely; but that was the intent of the Tax Reform Act.

We do not disagree that Justice's use of tax information has decreased or that the procedures set forth in the Tax

Reform Act have contributed to that decrease. We believe, however, that the extent of that decrease will become less serious as Justice attorneys become more familiar with the procedures. Even then, the procedures will remain "cumbersome"; but, again, to protect the rights of taxpayers, it was Congress' intent to make it more difficult to obtain tax information. In this regard, it seems appropriate that Justice attorneys should be required to determine that tax information is vital to a particular case before they seek that information. If scarce resources must be expended to seek tax information, then tax information generally will be sought only when it is vital.

We understand Justice's concern about the delays its attorneys encounter when seeking tax information, but U.S. attorneys and Strike Force attorneys were unable to provide us examples of adverse effects arising from those delays. If Justice can document such examples, it should provide them to the Congress for consideration.

We agree that Justice attorneys encounter difficulties in seeking court-ordered disclosures. However, the requirements set forth in the Tax Reform Act for court-ordered disclosures, in our opinion, are not unreasonable when considered in light of the act's intent.

While we agree with the Justice Department's contention that the Tax Reform Act contributed to the decline in IRS' Strike Force participation, we are unable to determine the extent of that contribution from the available evidence. For example, Justice had no information to indicate that the disclosure provisions have affected Strike Force prosecution or conviction rates. Data on those rates would be more meaningful than statistics on cases initiated which involved IRS.

We do not disagree with Justice's contention that the Tax Reform Act has caused coordination and duplication problems. Available evidence is insufficient, however, to enable us to determine the full extent of those problems or the real impact of the Tax Reform Act. It would be unrealistic to assume that such problems were nonexistent before the Tax Reform Act.

In summary, although we do not fully agree with each of the Justice Department's comments, we can appreciate its concern that its ability to enforce the law has been hampered. However, we also appreciate congressional and public concerns for the privacy of those who file Federal income tax returns. The problem is trying to assess whether the Tax Reform Act has struck a proper balance between law enforcement and

privacy. The Justice Department contends it may never be able to prove satisfactorily with statistical data that the quality of criminal prosecutions has actually declined because of the disclosure provisions of the Tax Reform Act. We agree that the impact of the act on the quality of law enforcement is difficult to assess. We would add, however, that the positive benefits, accruing as a result of the increased privacy afforded taxpayers, also are difficult to assess.

Aware of the need to strike an appropriate balance between privacy and law enforcement and mindful of the difficulties in assessing whether that balance has been achieved, our conclusion remains the same: we have seen insufficient evidence to cause us to recommend that the disclosure provisions be revised.

CHAPTER 3

IRS NEEDS TO IMPROVE ITS CONTROLS OVER AND INFORMATION ON SUMMONSES

Before the summons provisions of the Tax Reform Act became effective, IRS and Department of Justice officials warned that the provisions would delay criminal tax investigations and would tend to benefit those whose illegal activities extend beyond the tax laws. These contentions have neither been supported nor refuted by existing statistical data. Moreover, a portion of the delays experienced to date are attributable to the manner in which IRS and the Department of Justice structured their summons enforcement process rather than to problems with the law. In any case, IRS' initial experience with the summons provisions indicates that the Service needs to improve its controls to ensure that only technically, procedurally, and substantively accurate summonses are issued in the first place.

FURTHER CONTROLS NEEDED TO PROTECT TAXPAYERS' RIGHTS IN SUMMONS MATTERS

IRS and the Department of Justice have withdrawn several third-party summonses issued by the Criminal Investigation Division after the taxpayers stayed compliance. We could not determine the number of withdrawn summonses because IRS had no overall statistics in that regard. We were able, however, to identify and review records pertaining to several withdrawn summonses at various locations.

Summonses withdrawn at the district level

IRS' summons reporting system is not designed to collect information on stayed summonses for which enforcement is deemed inappropriate. In commenting on a draft of our report, however, IRS provided the following statistics for four district offices:

District office	Time frame	Summonses issued	Summonses stayed	Summonses not enforced
Boston	3/1/77 to 10/31/77	355	14	12
Chicago	8/1/77 to 4/30/78	965	70	8
Dallas	3/1/77 to 6/2/78	325	83	27
Los Angeles	3/1/77 to 6/5/78	1,417	a/203	33
Total		3,062	370	80

a/Although 274 summonses were stayed during this period, IRS could not readily determine the status of 71 of them.

The statistics show that IRS did not seek to enforce 80, or 22 percent, of the 370 stayed summonses in the four district offices.

In an attempt to determine why IRS does not always pursue summons enforcement, we reviewed files in five district offices relating to 49 stayed summonses for which enforcement was considered inappropriate. District Criminal Investigation Division personnel in Boston, Chicago, Dallas, Los Angeles, and Phoenix declined to seek enforcement of 24 summonses for the following reasons:

Reason for not seeking summons enforcement	Number of summonses
Taxpayer filed proper return after summons issuance	8
Further investigation showed that summoned records were no longer needed	4
Taxpayer was granted immunity from prosecution by the Department of Justice	3
Third-party recordkeeper asserted fifth amendment defense	2
Taxpayer was not notified of summons issuance	1
Taxpayer was sentenced to 20 year jail term for non-tax offense	1
Information was obtained from another source	1
Taxpayer's attorney provided some but not all of the summoned records	1
IRS discontinued its investigation of the taxpayer	1
Third-party recordkeeper told IRS that summoned records were not in its possession	1
Recordkeeper had already provided the summoned records to a special agent in another district office	1
Total	24

IRS attorneys in the five district offices declined to seek enforcement of 25 other summonses for the following reasons:

Reason for not seeking summons enforcement	Number of summonses
Insufficient or improper notice to taxpayer of summons issuance	14
Lack of specificity in terms of records summoned and years involved and insufficient notice to taxpayer	3
Technical noncompliance with the law	3
Lack of specificity in terms of records summoned	1
Lack of specificity in terms of years involved	1
IRS closed its independent investigation of the taxpayer and recommended that the Department of Justice initiate a grand jury investigation	1
Special agent did not allow the taxpayer 14 days to stay compliance	1
Records irrelevant to IRS' investigation were summoned	1
Total	25

The above information indicates that most of the summonses withdrawn at the district level were withdrawn either for reasons unrelated to the Tax Reform Act, such as the taxpayer filing a proper tax return after issuance of the summons, or because IRS failed to satisfy the procedural requirements of the act, such as providing proper notice. A few of the withdrawals, however, involved defective or unnecessary summonses, such as those inadequately specifying the years involved or seeking irrelevant records.

Summons enforcement declinations by IRS' national office

IRS' Office of Chief Counsel, according to its own statistics, received 340 requests for summons enforcement from 7 district offices between March 1, 1977, and May 26, 1978. Of these, 88 were returned to the district offices for the following reasons:

Reason for returning summons to district office	Number of summonses returned
Summons enforcement declined	58
Insufficient factual information provided	25
District office withdrew summons enforcement request	5
Total	88

Twenty-five summonses were returned to districts because IRS attorneys in Washington, D.C., felt that Department of Justice attorneys would need additional information before seeking court enforcement. According to IRS' records, 24 of the 25 summonses were resubmitted with the additional information and subsequently forwarded to Justice for enforcement. The remaining summons was not resubmitted because IRS obtained the needed information from another source. Another five summonses were withdrawn by district office personnel when IRS either discontinued its investigation of the taxpayer or obtained the needed information from another source.

According to IRS records, the 58 summons enforcement declinations occurred for the following reasons:

Reason for declination	Number of summonses
Improper or insufficient notice to taxpayers	31
Third-party witness asserted valid fifth amendment defense	22
Defective or unnecessary summons issued	5
Total	58

Of the 58 declinations, 36 were attributable to provisions of the Tax Reform Act. The other 22 involved fifth amendment assertions against self-incrimination--assertions that third-party recordkeepers were able to raise before the Tax Reform Act became law.

Of the 36 declinations attributable to the Tax Reform Act, 5 involved defective or unnecessary summonses while 31 involved procedural errors related to the notification process. Twenty of the latter 31 involved a single issue--the need to notify both spouses when a summons is issued for jointly-owned records.

Summons enforcement declinations by the Department of Justice

Attorneys assigned to the Civil Trial Section of the Department of Justice's Tax Division informed us in June 1978 that they have refused to enforce some third-party recordkeeper summonses but that they did not maintain declination statistics and could not readily retrieve declination files. They were able, however, to identify four declination files which we reviewed. Those files showed that Justice declined enforcement in three instances because the taxpayers had not been properly notified and in a fourth instance because the face of the summons contained an obvious inconsistency that "would be difficult to explain to a Court in an enforcement proceeding."

IMPACT OF SUMMONS PROVISIONS ON CRIMINAL TAX INVESTIGATIONS NOT ADEQUATELY DOCUMENTED

IRS' efforts to monitor the summons provisions have not been successful. Available statistics are erroneous and some important statistics are not being accumulated. Moreover, the statistics that are being accumulated do not clearly indicate the extent to which taxpayers can be expected to exercise their new civil rights in summons matters.

In March 1977, in an effort to monitor the summons provisions of the Tax Reform Act and demonstrate their effect on criminal investigations, the Criminal Investigation Division began gathering monthly statistics on the number of

--summonses served,

--summonses served in which compliance was stayed,

--stays resolved,

--stays outstanding and cases affected by those stays,

--summonses served in which intervention action was taken,

--interventions resolved,

--interventions outstanding and cases affected by those interventions, and

--special agent staff days expended on stays and interventions.

According to IRS guidelines, a summons is stayed when the taxpayer, in writing, advises the third-party recordkeeper not to comply with the summons and notifies IRS that he has done so. An intervention occurs when a taxpayer files a petition with the court to be made a party to enforcement proceedings that the Government brings against a third-party recordkeeper. Summons statistics accumulated by the Criminal Investigation Division for the period March 1, 1977, through March 31, 1978, are included in appendix V.

IRS' statistics are inaccurate

To test the accuracy of IRS' statistics on summonses, stays, and interventions, we attempted to verify the statistics reported by eight district offices for October 1977.

Criminal Investigation Division officials in Los Angeles and Phoenix told us that their statistics contained numerous errors and would have to be reconstructed before we began our test. We verified the reconstructed statistics and found them accurate. A comparison of the reported and reconstructed statistics for both district offices showed substantial differences.

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	Los Angeles			Phoenix		
	Reported	Recon-structed	Differ-ence	Reported	Recon-structed	Differ-ence
Summonses served	191	120	71	49	38	11
Stays of compliance	17	23	6	11	-	11
Stays resolved	-	8	8	4	-	4
Stays outstanding (note a)	78	84	6	21	17	4
Cases affected (note a)	28	30	2	6	4	2
Interventions	-	-	-	-	-	-
Interventions resolved	-	-	-	-	-	-
Interventions outstanding (note a)	-	-	-	-	-	-
Cases affected (note a)	-	-	-	-	-	-

a/These statistics are cumulative for the period March 1 to October 31, 1977.

The October statistical report for Dallas understated the number of stays of compliance by 1 and indicated that a minus 53 summonses were served that month. According to a Dallas official, the minus 53 figure offset reporting errors in previous months--errors due, in part, to summonses served at the request of other IRS district offices and recorded by both the requesting district and Dallas. New Orleans reported issuing 26 summonses in October whereas we counted 40. According to a New Orleans official, the discrepancy resulted from the district's need to balance earlier reports which had overstated by 14 the number of summonses served. The New Orleans report also overstated by 1 the number of stays outstanding. Boston's statistical report for October was accurate only because two groups made balancing errors in their counts of summonses served. Hartford reported issuing 23 summonses in October, instead of the 21 we counted, to compensate for an error in its

September report. In its October report, Chicago understated the number of stays resolved by 4 and overstated the number of stays outstanding by 12.

The statistics also included summonses issued directly to taxpayers. During the 8 months ended October 31, 1977, for example, 24 of the 914 summonses issued by Chicago and 5 of the 67 stays of compliance pertained to other than third-party recordkeepers. During the same period, 16 of the 330 summonses issued by Milwaukee pertained to other than third-party recordkeepers. This commingling of taxpayer and third-party summonses occurred because guidelines IRS issued to its field offices did not specify whether Criminal Investigation Division reports should include all summonses or be limited to third-party recordkeeper summonses. In June 1978, IRS revised the reporting system to separate third-party recordkeeper summonses from all other summonses.

No statistical trends have been identified

Despite inaccuracies, IRS' statistics do provide some insight into the first year's effects of the summons provisions. No trends have surfaced, however. It is not yet clear how often taxpayers can be expected to stay compliance with third-party summonses and to intervene in summons enforcement actions.

Stays as a percentage of summonses served ranged from a low of 1.9 percent in March 1977 to a high of 12.6 percent in November 1977. By March 1978, however, the rate had declined to 7.2 percent. Stays as a percentage of summonses served increased steadily during the period April through November 1977 but then began declining substantially from December 1977 through March 1978. While no clear trend can be identified, the statistics show that taxpayers have stayed compliance with 2,313, or less than 8 percent, of the 29,895 summonses IRS reportedly served during the 13 months ended March 31, 1978.

During those same 13 months, taxpayers intervened in 217 summons enforcement actions. This small number of interventions--less than 1 percent of the 29,895 summonses served--is not a reliable indicator of the extent to which taxpayers can be expected to intervene in summons enforcement actions because several months may elapse between the date a summons is stayed and the date a U.S. attorney petitions the court to enforce that summons.

The Director of IRS' Criminal Investigation Division disagrees with our interpretation of the statistics. He believes the overall rate of stays and interventions is unacceptably high in that too many criminal tax investigations are delayed while IRS seeks summons enforcement.

Some important statistics not being accumulated

IRS is not accumulating the statistics necessary to support its contentions that the summons provisions would tend to benefit those whose illegal activities extend beyond the tax laws and cause delays in criminal tax investigations.

Some IRS officials have expressed the opinion that tax protesters and persons involved in illegal activities are the most likely to stay compliance with a summons and thus benefit from the summons provisions of the Tax Reform Act. Because IRS did not accumulate the information necessary to support such an opinion, we selected a random sample of summonses that were stayed during October 1977 in five IRS district offices and categorized the taxpayers based on a review of the case files and interviews with IRS officials. Among the factors we used to categorize taxpayers regarding their involvement in illegal activities or tax protester movements were (1) their placement in IRS' special enforcement program which is directed at individuals who allegedly derive income from illegal activities, (2) their inclusion in IRS' Strike Force program, or (3) evidence of their association with a known tax protest methodology or movement.

Of the 42 cases included in our sample, 20--or 48 percent--involved tax protesters or persons involved in illegal activities.

District office	Sample size	Persons involved in illegal activities	Tax protesters
Boston	4	1	-
Chicago	17	6	1
Dallas	7	2	4
Los Angeles	10	2	3
Milwaukee	4	1	-
Total	42	12	8

The results of our test are not conclusive because we did not attempt to determine the extent to which persons involved in

illegal activities and tax protest movements were included in the overall population of taxpayers affected by third-party summonses.

Further evidence of a potential problem in this area was provided in a memorandum from the St. Louis District Director to the Regional Commissioner in IRS' midwest region. According to the Director, the 13 intervention actions taken by St. Louis district taxpayers between March 1, 1977, and February 9, 1978, involved 9 Strike Force targets, 2 tax protesters, 1 narcotics trafficker, and 1 taxpayer not associated with illegal activities or a tax protest movement.

IRS and Department of Justice officials have argued that the summons provisions would serve to significantly delay criminal tax investigations. Such delays are a concern because the passage of time reduces the probability that a criminal tax case will conclude with a successful prosecution. In this regard, witnesses may forget, move, or die or dated evidence may lose jury appeal.

Despite this concern, the information IRS is gathering to monitor the effects of the summons provisions does not include statistics on length of delays. Although the absence of statistics precluded us from obtaining detailed information on investigative delays, we were able to develop information which provided some indication of the extent to which IRS' criminal tax investigations have been delayed by stays of compliance.

The following table shows the average number of days needed by eight district offices to resolve stayed summonses from March 1, 1977, to October 31, 1977. These statistics pertain to stayed summonses that were resolved without court action. Court action becomes unnecessary if IRS negotiates a solution with the taxpayer, the taxpayer decides to comply voluntarily, IRS decides that the summoned records are not critical to its case, or the summons is determined to be legally unenforceable.

District office	Average number of days	Number of summonses stayed	Number of cases involved
Boston	93	10	3
Chicago	63	12	11
Dallas	78	3	2
Hartford	78	6	4
Los Angeles	76	36	12
Milwaukee	125	4	2
New Orleans	12	22	3
Phoenix	62	9	7

At the time we gathered these statistics, relatively few stays of compliance had been resolved at the district level primarily because the law had been in effect for only 8 months. Our statistics show large district variances in the average number of days required to resolve stays and, therefore, may not be representative of IRS' overall experience with delays. Moreover, the statistics reflect only the minimal delays IRS would encounter as a result of the summons provisions because they pertain to the earliest point at which stayed summonses may be resolved--the district level. Stayed summonses involving court enforcement and subsequent taxpayer intervention can cause longer investigative delays. In Chicago, for example, two stayed summonses resolved through court action took 199 and 167 days, respectively, to resolve.

Streamlined summons enforcement process should reduce investigative delays

Although investigative delays are, to some extent, unavoidable when taxpayers stay compliance with third-party summonses and intervene in summons enforcement actions, IRS and Department of Justice procedures for processing requests for enforcement have contributed to those delays.

IRS and Department of Justice officials have contended that the Service's right to obtain summoned records from third-party recordkeepers has been proven in Federal district courts and the Supreme Court.

In theory then, and considering IRS' concern about investigative delays, one would expect that IRS would immediately refer stayed summonses to U.S. attorneys for enforcement. Until recently, however, stayed summons were subjected to a sequential, multitiered legal review process. Requests for summons enforcement prepared by the Criminal Investigation Division were reviewed sequentially by IRS attorneys in the field, IRS attorneys in Washington, D.C., and attorneys from

the Department of Justice's Civil Trial Section before they were referred to U.S. attorneys.

Our review of 15 requests for summons enforcement processed by Justice's Civil Trial Section between July 14, 1977, and June 8, 1978, showed that the requests had taken an average of 82 days to get to that level after the taxpayer stayed compliance. IRS and the Department of Justice follow this sequential legal review process despite their contentions that the Service's ultimate right to obtain such records has been proven time and again in the courts and that all possible legal defenses against summons enforcement have been raised by taxpayers and rejected by the courts.

Our analysis of court cases involving summons enforcement matters and our review of the legislative history of the Tax Reform Act showed that IRS and Justice officials were basically correct in pointing out that taxpayers' potential legal defenses to summons enforcement actions are generally limited to those recognized under existing law.

In the case of Donaldson v. United States, 400 U.S. 517 (1971), decided under prior law, the Supreme Court ruled that a taxpayer's right of intervention extends only to those instances where the taxpayer has a "significantly protectable interest" such as where a claim of attorney-client privilege or abuse of process may be raised. In the Tax Reform Act, the Congress changed the Donaldson rule to make a taxpayer's right of intervention absolute.

The legislative history also makes clear that the act provided taxpayers with no additional substantive bases for contesting summons enforcement. For example, the Senate's report on the Tax Reform Act said that the summons provisions were intended

> "* * * to facilitate the opportunity of the noticee to raise defenses which are already under the law * * * and that these provisions are not intended to expand the substantive rights of those parties."

Accordingly, for a taxpayer to defeat enforcement of a third-party summons, he must bring his case within one of the generally recognized defenses to enforcement. Because circumstances vary from case to case, however, a taxpayer's ability to defeat summons enforcement depends not only on the type of defense raised but also on the particular circumstances involved in the case.

A Department of Justice official defended the need to review requests for summons enforcement by noting that third-party summonses are prepared and served by special agents who are not lawyers and cannot be expected to understand all the legal requirements.

In response to our inquiry (see app. VI) about why IRS and the Department of Justice maintain a multitiered legal review process for proposed summons enforcement actions, a Special Assistant to IRS' Chief Counsel pointed out that

--the careful review given these cases has contributed to establishing a body of case law favorable to the Government and

--although the Tax Reform Act did not afford taxpayers additional defenses against summons enforcement, the person entitled to notice and the summoned recordkeeper do in fact have certain defenses which they may raise to a summons, such as the attorney-client privilege.

IRS' statistics relating to the outcome of court actions involving stayed summonses indicate that the multitiered legal review process is effective in terms of Government success in court. In this regard, between March 1, 1977, and Febraury 23, 1978, all 190 cases decided by the courts were decided in favor of the Government.

Recognizing the delays inherent in the multitiered legal review process, however, IRS and the Department of Justice recently implemented a revised procedure whereby IRS attorneys in the field will be able to refer most stayed third-party recordkeeper summonses directly to U.S. attorneys for enforcement. The procedure, effective July 2, 1978, affects third-party summonses that were issued to financial institutions and that do not involve substantive defenses raised by the taxpayer or the financial institution.

The Special Assistant to IRS' Chief Counsel estimated that about 60 to 70 percent of third-party recordkeeper summonses would qualify for direct referral. The remaining 30 to 40 percent would still be subject to the multitiered legal review process.

Effective October 1, 1978, IRS and the Department of Justice implemented another procedure for enforcing summonses not qualifying for direct referral to U.S. attorneys. The new procedure authorizes IRS attorneys in the field to refer those summonses directly to the Department of Justice, thereby bypassing IRS' national office.

CONCLUSIONS

Before the summons provisions of the Tax Reform Act became effective, IRS and the Department of Justice warned that the provisions would unduly delay criminal tax investigations and would tend to benefit those whose illegal activities extend beyond the tax laws. Unless IRS and Justice are able to substantiate the existence and extent of those problems, however, the Congress cannot be expected to look favorably on requests for changes to the law. The reporting system IRS initiated to monitor the effects of the summons provisions is not providing the type of data that can be reliably used to meet that need.

Statistics we were able to develop indicate that the investigative delays anticipated by IRS and the Department of Justice have occurred. A significant portion of those delays might be attributable, however, to the multitiered legal review process that IRS and Justice established to review summonses referred for enforcement. IRS and Justice have taken appropriate steps to streamline that process.

Even if its reporting system were providing more reliable data on the effects of the summons provisions, IRS would find it difficult, in our opinion, to demonstrate a need to amend those provisions when faced with the fact that they have resulted in the withdrawal of many third-party summonses. Some of those summonses were withdrawn because they were determined to be defective or unnecessary. Most were withdrawn, however, because IRS employees were not fully conversant with the procedures to follow in preparing and issuing summonses.

The withdrawal of a summons that was prepared or issued incorrectly does not reflect an attempt by IRS to obtain records to which it is not entitled. In fact, most such summonses will probably be corrected, reisssued, and enforced with IRS ultimately getting the records it originally sought. A procedural deficiency could have serious consequences, however.

As our review indicated, most of the procedural errors that caused withdrawal involved the failure to properly notify affected taxpayers that a summons had been issued. Despite improper notification from IRS, a taxpayer could still learn about the summons from another source, such as the third-party recordkeeper, and proceed to stay compliance. If the taxpayer does not learn about the summons from another source, however, IRS' failure to properly notify him could deprive him of the chance to stay compliance and raise

substantive defenses to summons enforcement. In such a case, improper notification becomes more than just a "procedural deficiency."

Our review was limited to those summonses where taxpayers stayed compliance. But it seems likely that summonses not stayed by taxpayers also contain technical and procedural errors and may, in a few instances, be defective or unnecessary. Recognizing that, we believe additional controls are needed to protect against such summonses being issued. If IRS improves its summons issuance process and collects accurate and useful data to demonstrate the adverse impact of the summons provisions, it may be in a better position to seek changes to those provisions in the future.

Considering that a number of summonses are erroneous, defective, or unnecessary, additional controls are needed to protect taxpayers' rights. One obvious but expensive alternative would involve having IRS attorneys review all summonses before they are issued. A second alternative would involve training affected IRS employees with regard to the legal and technical aspects of preparing and issuing summonses and providing for independent evaluation of the effects of that training. In our opinion, the second alternative is the most feasible; the first alternative may become necessary, however, should training prove ineffective.

RECOMMENDATIONS

We recommend that the Commissioner of Internal Revenue

--provide additional training to all IRS employees responsible for issuing summonses to better insure that they fully understand all legal and technical aspects of the summons process and

--require the Director of IRS' Internal Audit Division to monitor the effectiveness of IRS' summons training program.

We also recommend that the Commissioner revise the summons reporting system to

--provide field office personnel with more specific guidance on accounting for summonses, stays, and interventions;

--collect information designed to determine whether those whose illegal activities extend beyond the tax laws tend to exercise their rights to stay summonses and intervene in enforcement actions more than the average investigative subject; and

--accumulate statistics on investigative delays caused by the summons provisions of the Tax Reform Act.

AGENCY COMMENTS AND OUR EVALUATION

By letter dated November 29, 1978, the Commissioner stated that IRS

--was revising its summons reporting system;

--planned to provide further training to affected personnel, including agents, managers, and attorneys, in the legal and technical aspects of summons enforcement;

--intended to develop publications to which field personnel could refer when issuing summonses; and

--had requested Internal Audit to monitor the effects of the training and publications within 6 months after their implementation.

While agreeing with our recommendations, IRS stated that our findings do not support a conclusion that the summons provisions of the Tax Reform Act of 1976 have protected the legitimate rights of taxpayers in any substantial number of cases. To the contrary, IRS contends that our findings support a conclusion that the summons procedure has not been abused, and that, in all but a few cases, the legitimate interests of taxpayers have not been adversely affected. Although IRS agreed that failures to observe procedural requirements, such as giving proper notice of summons issuance, are appropriate matters for concern, it considered such failures irrelevant to a determination of whether the legitimate taxpayer interests that the summons provisions were established to protect have been affected.

IRS is correct in indicating that we identified only a few instances in which the summons provisions have protected the legitimate rights of taxpayers. We should emphasize,

however, that we did not attempt to identify such instances nationwide and that we have no assurance that we even identified every instance in the field offices we visited. In this regard, we are not so willing to agree that procedural defects are not relevant to any determination of whether taxpayer interests have been protected by the summons provisions. Errors like improper notice could result in taxpayers not being given the chance to exercise their rights. One can only speculate, then, what would have happened if those taxpayers had been properly notified.

IRS also expressed concern that we failed to adequately point out that administrative delays will continue even after the summons enforcement process is streamlined and that more substantial delays may occur during the judicial process. We do not dispute either of these contentions. Our basic message remains, however, that IRS needs to start collecting the statistics necessary to document the extent of those delays if it intends to seek legislative changes to the summons provisions.

By letter dated November 13, 1978, the Justice Department stated that:

--Our report fails to make note of the small number of interventions in summons enforcement actions and also fails to contain any data concerning the extent to which such interventions could have occurred before the Tax Reform Act became law.

--The rate of stays and the number of enforcement actions which must be brought impede and discourage vigorous investigative efforts especially in view of the fact that our report shows that "approximately 40 percent of the stays are obtained by tax protesters and persons involved in illegal activities."

--Our report makes "scant mention of the delays resulting from court consideration of enforcement actions."

The above comments relate to concerns that have been discussed since the summons provisions were enacted. While we appreciate those concerns, we continue to return to the same problem--the absence of hard evidence to support them.

In some cases, for example, Justice uses statistics we developed to show that few taxpayers have benefited from the summons provisions and that the benefits are mostly accruing to tax protesters and persons involved in illegal activities. As we indicated in the report, however, our statistics are far from complete; they provide only an indication of what is happening. Justice believes we have not provided sufficient data on certain other matters such as court delays. However, such data was not available.

To reemphasize, the message of our report is not that the various concerns regarding the summons provisions are unfounded, but rather that they have not been demonstrated. IRS has not been accumulating the type of data needed to demonstrate those concerns.

The Justice Department also pointed out that we did not weigh the administrative costs and burdens of implementing the summons provisions against the "few instances" in which taxpayers have benefited from those provisions. We decided against such an analysis because we considered it infeasible to put a price tag on privacy and civil rights and because data on taxpayers who have benefited was unavailable. The "few instances" we referred to in the report relate only to instances we could identify from incomplete records in a few IRS locations.

In their comments, both IRS and Justice expressed concern that many persons who stay compliance with third-party summonses fail to intervene in the summons enforcement procedure and, instead, are using the provisions of the law only to delay investigations of their tax affairs. In considering solutions, both agencies referred to the procedures prescribed by the Right to Financial Privacy Act of 1978 (title XI of P.L. 95-630, Nov. 10, 1978).

Like the summons provisions of the Tax Reform Act, the Right to Financial Privacy Act calls for an individual to be notified when a Government agency seeks access to financial records by means of an administrative summons. The laws differ significantly, however, in the procedures they prescribe for staying compliance. Under the Tax Reform Act, a taxpayer need only notify the recordkeeper and IRS in writing of his desire to stay compliance. The Financial Privacy Act, however, requires the affected individual, at the outset, to specify to a court in writing why he objects to the summons. The Government must then file with the court its written justification for seeking the records. The law further authorizes the court to reach a decision based on the written affidavits.

The Department of Justice described the differences between the two laws as follows:

> "The stay of compliance by letter procedure [as required by the Tax Reform Act of 1976] simply permits many taxpayers to obtain a delay, who have no intention of participating in the subsequent enforcement proceeding. [The Right to Financial Privacy Act], on the other hand, would stay compliance only as to those customers who have demonstrated that they intend to participate in the court proceeding and can come forward with evidence that the summons was improperly issued. These procedures are designed to reduce the potential for delay in obtaining enforcement of summonses and for that reason are superior to those contained in [the Tax Reform Act of 1976]."

Justice concluded that the rules pertaining to IRS summonses should be no more onerous than the rules pertaining to summonses issued by other agencies and that Congress should consider amending the Internal Revenue Code to adopt procedures similar to those contained in the Right to Financial Privacy Act. IRS basically echoed Justice's position. It concluded that experience with the stay of compliance procedures required by the Right to Financial Privacy Act may indicate their appropriateness for tax records as well.

Because our review was limited to summonses issued under the Tax Reform Act of 1976 and because the Right to Financial Privacy Act was just recently enacted, we did not compare the effectiveness of the different procedures for staying compliance. However, the issue raised by IRS and Justice seems valid and logical. If investigative subjects are staying compliance with IRS summonses merely to delay investigations, it seems they would be less likely to do so if they had to justify their position in court. Thus, we believe the idea of using the stay of compliance procedure mandated by the Right to Financial Privacy Act for IRS summonses has merit and should be considered by the Congress.

MATTER FOR CONSIDERATION BY THE CONGRESS

The Congress may want to monitor the use of the stay of compliance procedure under the Right to Financial Privacy Act and consider whether the adoption of similar provisions for IRS summonses would be appropriate.

COMMISSIONER OF INTERNAL REVENUE
Washington, DC 20224

Mr. Allen R. Voss
Director, General Government Division
General Accounting Office
Washington, DC 20548

Dear Mr. Voss:

Thank you for the opportunity to comment on your draft report to the Joint Committee on Taxation entitled, "Disclosure and Summons Provisions of the 1976 Tax Reform Act - Privacy Gains With Unknown Law Enforcement Effects".

Disclosure Provisions

We are in substantial agreement with the conclusions set forth in chapter 2 of the draft report concerning the restrictions on disclosure of tax returns and return information. In the Tax Reform Act of 1976, Congress for the first time enacted a statute setting forth comprehensive rules and procedures governing the disclosure of tax returns and return information. These rules and procedures have further increased the confidentiality accorded tax returns and return information -- particularly return information obtained from the taxpayer or his representative. We agree with your finding that taxpayers have been accorded increased privacy over the information they provide the Internal Revenue Service. Although we believe that the disclosure provisions have had no direct effect on our enforcement of the tax laws, we are not in a position to assess the effect of these provisions on other law enforcement agencies.

In your report, you mentioned a concern that the restrictions on disclosure of tax returns and return information had adversely affected the level of Internal Revenue Service participation in Strike Force activities. As mentioned in your draft report, the decline of Service participation in Strike Force activities may relate to a number of factors other than the disclosure provisions.

Department of the Treasury Internal Revenue Service

Mr. Allen R. Voss

Moreover, it does not signal a lessening of our commitment to the fight against organized crime and public corruption. We have initiated roughly the same number of criminal cases involving organized crime figures and those involved in racketeering and narcotics trafficking in each fiscal year since 1975. However, beginning in the transition quarter ended September 30, 1976, we have initiated a greater number of these cases outside Strike Forces.

Fiscal Year	No. of Strike Force Cases Initiated	No. of SEP Cases Initiated (other than Strike Force & Wagering Tax) */	Total
	(1)	(2)	(1+2)
1974 (7/1/73-6/30/74)	620	741	1361
1975 (7/1/74-6/30/75)	547	488	1035
1976 (7/1/75-6/30/76)	592	413	1005
T.Q. (7/1/76-9/30/76) **/	111	140	251
1977 (10/1/76-9/30/77)	333	700	1033
1978 (10/1/77-8/31/78)	291	796	1087

*/During this period, the responsibility for enforcing the wagering tax was transferred between the Service and the Bureau of Alcohol, Tobacco and Firearms. Wagering tax cases have been eliminated from these figures to permit valid comparisons. For example, the statistics for the fiscal year 1978 do not include 233 wagering tax cases initiated by the Service since the enforcement jurisdiction for wagering tax was returned to the Service.

**/Transition Quarter resulting from a change in the Federal Government's fiscal year.

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Summons Provisions

When Congress was considering the third party summons provision, the Service requested that Congress either not enact the provision or postpone its effective date. In support of its position, the Service noted that the provision would create no new substantive rights for taxpayers -- no new substantive grounds for objection to enforcement -- but rather would promote unnecessary and vexatious lawsuits and cause delays -- in many cases lengthy delays -- in our investigation of serious tax evasion schemes. Testifying for the Service, Singleton B. Wolfe, Assistant Commissioner (Compliance) stated that the third party summons provision could be exploited by taxpayers seeking to delay investigation of their tax affairs. Assistant Commissioner Wolfe noted that the provision could prove a particular boon to those whose criminal activities extended beyond the tax laws.

Congress did not disagree with the Service's contention that the provision created no new substantive rights for taxpayers. To the contrary, Congress acknowledged this fact. But Congress was concerned that a third party recordkeeper would not always have the same interest in asserting rights already existing under the law as the owner of the records. Accordingly, Congress adopted the notice, stay and intervention procedures contained in section 7609 of the Internal Revenue Code.

We remain concerned that a substantial number of taxpayers may be staying summons compliance for the sole purpose of delaying our investigations. Under the present third party summons provision, a party need only write a letter to the recordkeeper to require the Government to seek court enforcement of the summons. The provision requires no further action on the part of the taxpayer. Our experience to date indicates that a substantial number of those who stay compliance by a third party recordkeeper fail to intervene in the summons enforcement procedure. Moreover, through June, 1978 in 765 of the 771 summons enforcement proceedings in which Federal district courts had reached final determinations, the courts have granted in full the enforcement requested by the Government. In 5 of the remaining cases, the court granted partial enforcement. Under these procedures, the Government is frequently required to incur substantial delays and expense where no legitimate interest of the taxpayer is served by doing so. Those interests may be equally well served by a procedure

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that would minimize the burdens placed on the Government. For example, in the Right to Financial Privacy Act of 1978, Congress required that the record owner file a motion to quash enforcement with a court, supported by a statement of why enforcement should not be granted, in order to stay compliance. Experience under that procedure may indicate its appropriateness for tax records as well.

Despite these concerns, we are not now urging Congress to repeal or amend section 7609. Following the enactment of that provision, the Service designed a reporting system intended to gather information that would demonstrate whether the third party summons provision had (1) protected any substantial legitimate rights of taxpayers not protected under existing law and (2) caused vexatious litigation and substantial delays in our investigations. That reporting system has proved inadequate, producing inaccurate data and failing to collect certain data needed to fairly assess either the benefits to taxpayers or the adverse effects to the Government. For example, we do not presently have data on the length of the delays occasioned by the third party summons provisions.

We are now in the process of revising our reporting system. In accordance with your recommendation, that system will (1) include better guidance to field office personnel as to how to account for summonses, stays and interventions, (2) collect data to determine whether those whose crimes extend beyond the tax laws are more likely to stay compliance, intervene in an enforcement proceeding, or appeal a trial court determination in such a proceeding more frequently than any other subject of investigation, and (3) collect data on the length of investigative delay occasioned by the third party summons procedure (again, developing data for both subjects of investigation generally and those whose crimes extend beyond the tax laws).

We have also reviewed with interest your staff's findings concerning third party summonses challenged by the taxpayer or the third party and not pursued to enforcement by our field personnel and attorneys. Those findings reflect that summonses are not pursued for a number of reasons.

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A number of the summonses examined by your staff were returned to the initiating office with a request that further information be provided to support the enforcement of the summons. In most instances, these same summonses were resubmitted together with the requested information and forwarded for enforcement. Moreover, a number of these summonses were not pursued because the information sought under the summons was no longer required. This occurred when an investigation was closed, when the information was obtained from another source, or when the noticee withdrew objection to compliance by the third party recordkeeper. Additional summonses were not pursued because a valid defense to summons enforcement -- typically the fifth amendment privilege against self-incrimination -- was asserted by the third party recordkeeper. In our judgment, these cases are not a reason for concluding that the summonses in issue were inappropriate; nor do they support a conclusion that the third party summons procedures have served to protect legitimate interests that would not have been protected absent the third party summons procedures.

Your staff also examined certain summonses which were not pursued because our personnel had failed to observe the procedural requirements of the third party summons procedure. In most of these cases, the failures involved a failure to give notice, or the giving of untimely or inadequate notice of the service of a third party summons. Many of these cases involved legal issues not resolved at the early stages of the law's implementation (for example, that in the case of a joint account in the name of a husband and wife, notice must be sent to both account owners and not only to the taxpayer). However, some of these cases did indicate a lack of familiarity with or understanding of the third party summons provisions. We hope that fewer such instances will occur as our experience under the statute increases.

Finally, a few summonses were found that were not pursued because the summonses themselves or the manner of their issuance were erroneous in a way that adversely affected the substantive rights of taxpayers. These cases included issuance of summonses seeking records for the wrong period, or otherwise determined to be irrelevant to the investigation in question.

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These findings concerning errors affecting either the procedural requirements of the third party summons provisions or adverse effects on the rights of taxpayers are a matter of concern. We agree that these findings support your conclusion that the Service should do more to train our personnel in summons enforcement -- particularly third party summons enforcement -- and to monitor the effects of that training. In specific response to your recommendations:

We agree that we should provide further training to our personnel in the legal and technical aspects of summons enforcement -- particularly third party summons enforcement. We plan to revise our training in these matters for all employees whose duties may require them to issue summonses, including our special agents, revenue agents and revenue officers. Moreover, since your draft report indicates that certain of these defects were not detected by our supervisors, managers and field attorneys, we intend to extend training to these individuals as well. In addition, we intend to develop publications on this subject which will provide handy reference to our field personnel when issuing summonses.

We agree that our Internal Audit Division should monitor the effects of the training and publications to determine their effectiveness. The Assistant Commissioner (Compliance) has requested such a review within 6 months following the implementation of these management actions.

We do not believe, however, that these findings support a conclusion that the third party summons provisions have protected the legitimate rights of taxpayers in any substantial number of cases. To the contrary, these findings support the conclusion that there has been no abuse of the summons procedure and that in all but a very few cases, the legitimate interests of taxpayers have not been adversely affected. In enacting the third party summons procedure, Congress indicated that it did not intend to expand the substantive rights of taxpayers. Accordingly, although failures to observe the procedural safeguards of section 7609 are an appropriate matter

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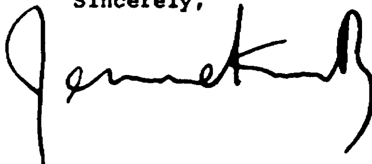
for concern, these failures are not relevant to the determination of whether the legitimate taxpayer interests they were established to protect have been affected. They also have no bearing on the determination of whether the costs and delays attendant to these procedures, when weighed against the instances in which the legitimate interests of taxpayers were protected, support a conclusion that the current provisions should be retained.

In closing, we would like to discuss what seems to us a troublesome inference that could be drawn from one aspect of your draft report. Your draft report correctly notes that the multi-tiered administrative reviews of stayed summons established by the Service and the Department of Justice may have contributed to the delays experienced under the statute.

We recognize this fact and have recently revised our system of review to minimize these delays. Hopefully, we will find that more than 18 months' experience with the statute and resolution of certain legal issues of first impression during that period will allow us to minimize review without sacrificing quality.

But two significant points are lost through this emphasis in the draft report. First, so long as the Government is asked to assume the substantial burdens placed upon it by the statute -- including the burdens of initiating suits in the courts and of responding to discovery requests by those asserting defenses to summons enforcement -- administrative delays will remain even under a more expeditious review procedure. Second, far more substantial delays may be occasioned in judicial review of the case -- particularly when appeals are involved. We believe these delays, over which we have no control, will contribute most significantly to the total delays occasioned by these procedures.

Sincerely,



UNITED STATES DEPARTMENT OF JUSTICE

WASHINGTON, D.C. 20530

Address Reply to the Division Indicated and Refer to Initials and Number

NOV 13 1978

Mr. Allen R. Voss
Director
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Voss:

This letter is in response to your request for comments on the draft report entitled "Disclosure and Summons Provisions of 1976 Tax Reform Act--Privacy Gains With Unknown Law Enforcement Effects."

The draft report generally reviews the law enforcement impact resulting from implementation of Sections 1202 and 1205 of the Tax Reform Act of 1976 which, respectively, amended Code Section 6103 (relating to confidentiality and disclosure of tax information) and enacted Code Section 7609 (relating to summonses issued to banks and certain third party recordkeepers). GAO does not recommend amendment of Section 6103 of the Code, but suggests that Congress may wish to consider whether the coordination problems are tolerable and whether to modify Code Section 6103 in light of the coordination problems. As for Code Section 7609, the GAO contends that the information available does not warrant amendment at this time.

DISCLOSURE PROVISIONS

The draft report discusses Code Section 6103, along with its legislative history, in some depth and concludes that implementation of that provision has caused coordination problems between the Internal Revenue Service (IRS) and other law enforcement agencies. GAO sees the loss of coordination as resulting from the fact that IRS cannot always disclose information about non-tax criminal offenses and cannot alert the Department of Justice (Department) to seek disclosure of criminal tax information in many instances. GAO notes that this has resulted in a number

of parallel, duplicate investigations. In addition, GAO concludes that participation by the IRS in strike force activities has declined, at least in part, because of the implementation of amended Code Section 6103.

The Department agrees that enactment and implementation of the revised Code Section 6103 have had an adverse impact on law enforcement and have damaged the coordination between the IRS and other law enforcement agencies. The Department takes issue with GAO, however, as to the extent of the adverse effects of the 1976 Act upon law enforcement. In this regard, there is one very important point: the adverse effect of disclosure limitations upon law enforcement is not susceptible of direct statistical measurement.

Disclosure restrictions deny prosecutors access to tax information which has long been used in complex criminal cases, more often for investigative than trial purposes. In the absence of the information, it is virtually impossible to demonstrate what that information, if available, would have shown. GAO, in seeking to document the effect of disclosure limitations, is attempting to prove the extent of a negative. Because there is little or no statistical information upon which to base a conclusion as to severity of the impact of disclosure restrictions upon law enforcement, the Department feels that the GAO report should take fuller account of the opinions of experienced prosecutors. Our own sounding of such opinion is that the effect has been much more severe than portrayed in the GAO report, particularly with respect to complex criminal prosecutions. Several facts support this view.

First, it is clear that the Department's utilization of tax information has dropped to a fraction of pre-1977 levels.1/ The 1976 Act, with its new, unfamiliar and cumbersome procedures, is primarily responsible for this reduced access. The civil sanctions are troublesome to prosecutors and investigators who are keenly aware that

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1/ During FY 1975, before the effective date of the Act, 6,535 tax returns were inspected by the Justice Department in connection with non-tax (Title 18) cases. By way of comparison, IRS figures show that disclosure of approximately 900 returns was authorized by Justice-initiated court orders under Code Section 6103(i)(1) during the post-Act period of August 1 to December 31, 1977. This translates to an annual rate of 2,160, or about one-third the pre-Act rate.

most criminal defendants are alert to and will seize upon any available means of delaying law enforcement investigations and proceedings or of harassing law enforcement officials. Indeed, this dilatory and harassment potential accounts for the longstanding and continued vitality of the doctrine that prosecutors are generally immune from tort liability. While it is true that few civil suits have been filed for unauthorized disclosure of tax information, the potential for such suits has an _in terrorem_ effect including, we suspect, an impact on the willingness of IRS to initiate permissible disclosures. Consequently, the Department continues to agree with the Privacy Commission (_Personal Privacy in an Information Society: The Report of the Privacy Protection Study Commission_, p. 560) that when an unauthorized disclosure is made, the governmental unit, rather than the prosecutor or investigator, should be liable for any resulting damages. _See also_ the Right to Financial Privacy Act, Title XI of H.R. 14279, which contains such a provision.

Even more disruptive than the chilling effect of the civil and criminal sanctions are the very substantial procedural obstacles placed in the path of disclosure. Before deciding to incur the rigors of paperwork and delay inherent in the Act, a prosecutor must determine that the answer to three questions is affirmative:

(a) Will the Departmental request be approved and complied with, or will the court order be granted?

(b) If so, will it result in securing information that will significantly assist the investigation or prosecution?

(c) If so, will the information be obtained within a timeframe that will permit its effective utilization?

Anything less than a clearly affirmative answer to all of the three questions will likely persuade a prosecutor that he should not gamble scarce attorney and clerical resources by seeking disclosure. With respect to the question whether a court order can be obtained, we believe GAO does not

fully appreciate the difficulty in making the required three-part showing, particularly in the early stages of an investigation.2/

The significant decline in access to evidence of criminal activity demonstrates the severe adverse impact of the Act upon law enforcement when considered in light of the major role which tax information has historically played in prosecutions of white-collar and organized crime, public corruption, and narcotics trafficking.3/ It is unavoidable that reduced access to tax information impedes law enforcement effectiveness in controlling these high priority areas of law enforcement.

Second, GAO has documented the delay involved in obtaining disclosure during the course of investigations and is also aware that there are severe time limitations upon prosecutors both in terms of statutory limits (the various statutes of limitations) and in terms of practical considerations (witnesses' memories are dimmed by time, stale cases have little jury appeal, and delay allows criminals to continue their unlawful enterprises). The Act is especially troublesome when the need for records arises after a trial has begun.

It is the cumulative effect of delay which can be particularly detrimental. In complex investigations, tax information once obtained may inculpate others with the result that an investigation of one complex scheme may suffer from multiple delays as prosecutors follow a paper trail that requires access to tax information pertinent to first one and then another of several conspirators.

2/ Regarding restrictions on information obtained by IRS from third parties, the Department is unable to appreciate the justification for such limitations, particularly as to information voluntarily disclosed to IRS by third parties.

3/ In this connection, complex crimes are difficult even to detect as there are seldom any innocent bystanders to witness the offenses and the victims, who may comprise a significant sector of the population, are usually unaware that they have been victimized. Tax information is crucial, therefore, to establish that a crime did occur. Yet the Government must demonstrate reasonable cause to believe a crime occurred to satisfy the first part of the three-part showing necessary to obtain a court order authorizing disclosure.

Because prosecutors are aware of the time required to obtain disclosure, they are reluctant to seek access to tax information if time is of the essence.

As to the average period of delay, this may indeed be subject to control to the extent that administrative procedures can reduce time required to process requests for non-return information. We are currently reviewing a number of proposals to minimize administrative delay, but we see little possibility of expediting court orders for return information or for reducing other court delays. In fact, at least one court concluded that it was bound to conduct an _in camera_ review of taxpayer information prior to release to prosecutors, _United States v. Praetorious, et al_, 78 CR 135. If other courts follow that decision, delays of several months (as experienced in the cited case) may become more common.

Third, GAO has documented numerous cases where disclosure restrictions have prevented IRS from informing the Department of clear criminal violations where information was based on taxpayer return information. These examples likely represent only a small portion of the total number of such instances as IRS understandably does not accumulate statistics on the number of crimes it discovers about which it can do nothing. In addition to such cases of clear criminal activity, there are also probably many cases where IRS information is, in itself, only mildly suspicious but which, taken together with information developed by the Department, would clearly evidence criminal conduct.

Fourth, GAO has documented the sharp decline in IRS strike force participation, a decline the Department believes has had an effect upon the national law enforcement effort against organized crime. We disagree, however, that the 1976 Treasury-Justice agreement was responsible for the decline in IRS strike force activity. If anything, the statistics cited by GAO show that it was the Tax Reform Act which contributed to the decline. GAO figures reveal that IRS strike force participation was higher in FY 1976 than in FY 1975 although the agreement was in effect during almost half of FY 1976. It was in FY 1977, when the Tax Reform Act went into effect, that the sharp drop occurred.

Fifth, GAO observed that the Act has had an adverse effect upon coordination between IRS and Justice. In our view, the initial effect of the Act--with its civil and criminal sanctions, its stringent restrictions, and its new procedures--was to cause a virtual collapse in coordination. While the situation has improved somewhat with experience, coordination between IRS and Justice is and will continue to be greatly diminished as compared to coordination before the Act.

GAO could have devoted more attention to two aspects of reduced coordination: (1) other law enforcement agencies have less access to IRS expertise in the analysis of financial records so crucial to complex prosecutions, and (2) IRS is deprived of leads that could assist it in enforcement of the tax laws. On this latter point, while IRS doubtlessly is notified of clear tax violations, it is not always informed in a timely manner about the white-collar and public corruption cases which so often involve elements of tax evasion.

Sixth, letters from United States attorneys state that there have been numerous cases of duplication resulting from uncoordinated, parallel IRS-Justice investigations. Because both IRS and Justice resources are finite, this duplication--largely attributable to the 1976 Act--clearly has an adverse impact upon law enforcement. In addition to wasting resources, parallel investigations result in duplicative questioning of witnesses and duplicative requests for information which tend to harass and alienate prospective government witnesses. The only existing vehicle for coordination of non-tax cases with tax investigations is the authorization in Section 6103(h)(2) of the Code, as interpreted by Treasury Regulations Section 404.6103(h)(2)-1(b) (43 Fed. Reg. 29115, July 6, 1978), for the conduct of joint tax/non-tax investigations in cases involving tax administration. This vehicle, while cumbersome and inefficient, is helpful. It does not permit the broad coordination of criminal justice efforts possible prior to the Act, however, since it applies only when adequate information of criminal tax violations is available, the matter has been referred to the Department of Justice by IRS, and the tax and non-tax offenses arise out of the same facts and circumstances. As a result, the IRS is not permitted to disclose tax information for purposes of selecting targets of a Strike Force investigation, and unless or until a tax case is referred to the Department, tax information is available to the Department only under Section 6103(i).

The Department believes that any one of the above effects would demonstrate a serious impact upon law enforcement. Taken together, the detrimental effect can be extreme. The primary effect that we perceive is in the quality of complex criminal prosecutions, rather than in quantity. In fact, it is unlikely that the effect of the Act will ever be clearly revealed by gross statistics on criminal prosecutions or prosecution success rates. In this regard, we have more investigative leads than we can properly pursue and more than enough cases to litigate. It is well known that a high percentage of criminal cases are disposed of by plea agreement. Because the Department has given priority attention to white-collar and organized crime, public corruption, and narcotics trafficking, even statistics on these complex cases may not decline. More likely, a decline will be experienced in really significant cases--those involving the largest number of victims, those directed against the most sophisticated criminal operators, and those having the greatest deterrent effect. As the quality of criminal prosecutions is so difficult to assess, we may never be able to prove satisfactorily, i.e., with direct statistical data, that quality has actually declined.

GAO concludes that the adverse effect of disclosure restrictions, as GAO assesses that effect, is balanced by privacy gains. The Department contends, however, that the full extent of the adverse effect upon law enforcement has not been placed in this balance. Giving sufficient weight to the public interest in effective prosecution of high-priority crimes might result in a different conclusion than the one reached by GAO.

In conclusion, while we agree with GAO's determination that the new disclosure restrictions have had an adverse impact on coordination of investigative activities between IRS and other law enforcement agencies, we believe that the impact is more severe than portrayed in the draft report. The Department is not convinced that a proper balance between privacy and law enforcement was struck in the Tax Reform Act. GAO suggests in its report that Congress may want to consider whether the coordination problems identified are tolerable. The Department endorses GAO's suggestion to reexamine the means by which the privacy of tax information can be protected without unnecessarily hampering law enforcement.

ADMINISTRATIVE SUMMONS PROVISIONS

The draft report concludes that the statute has achieved its desired effect of increased taxpayer protection in the summons area. The report indicates that taxpayers have stayed compliance of 8 to 10 percent of the some 29,895 summonses issued to third-party recordkeepers during the 13-month period ending March 31, 1978, and GAO acknowledges that taxpayers who have exercised their rights to stay compliance have benefited only "in a few instances." However, significantly, approximately 40 percent of the stays were obtained by tax protestors or persons involved in illegal activities other than tax offenses.4/ The report fails to take note of the small percentage of interventions in summons enforcement actions and also fails to contain any data concerning the extent to which the intervenors would have been allowed to intervene under existing law prior to the enactment of Section 7609 of the Internal Revenue Code.

Many of the criticisms leveled in the report relate to problems associated with the fact that the cases surveyed arose during the period immediately following the effective date of the new summons provision. A significant number of the defects noted by the GAO, which caused the withdrawal of summonses, concerned questions of interpretation of the new statute or implementation of new notice requirements and time limits created by the statute. These situations included such technical issues as whether notice must be given to both spouses, living in the same household, when only one is under investigation and access to joint bank accounts is sought. Indeed, the most prevalent defect identified by the GAO concerned inadequacies in the giving of notice, and a large proportion of those cases involved

4/ The 40 percent figure is derived from the sampling conducted by GAO. The draft report states that this figure is not conclusive because GAO did not determine taxpayers so categorized as a percentage of taxpayers affected by Code Section 7609 summonses. Approximately 12 to 18 percent of the tax cases referred to the Department for prosecution involve tax protestors or persons involved in illegal activities other than tax offenses.

failure to give notice to both spouses.5/ These types of problems have largely been corrected and are simply inherent in any situation where the Congress creates complex new procedural rules which govern an organization as large as the IRS and which apply to the average of some 2,300 summonses issued monthly by the Criminal Investigation Division during the survey period.

A second group of cases noted by the GAO, which involved the withdrawal of summonses, concerned situations in which, after the summons was issued, the need for the records changed; for example, the investigation was discontinued, the information was obtained from other sources, the Department granted immunity to the taxpayer, or the taxpayer received a substantial jail sentence on another matter. The investigating agent cannot predict matters of this nature and in many cases it seems likely that the delay in compliance which resulted from the stay allowed events to overtake the case before the summonses could be enforced.

A third group of cases involved third-party recordkeepers who exercised their Fifth Amendment privilege concerning the records. These situations are unpredictable, especially since the privilege may be waived.

The final group of cases is described by GAO as follows: "In a few instances, taxpayers who have exercised the right to stay compliance have benefited. In those few instances, IRS attorneys found that the summonses were defective or unnecessary." While we do not doubt this conclusion, the administrative costs and burdens of implementing this provision have been substantial, even aside from the delay factor, and are not mentioned in the report.

Another matter which is not discussed in the GAO report is the small percentage of cases in which taxpayers who stay compliance with a summons actually exercise their rights of intervention in the ensuing enforcement proceeding.

5/ The draft report contains an analysis of 107 summonses for which the IRS did not seek enforcement, and 42 percent of these cases involved defects concerning notice. The need to supply notice to a spouse was largely responsible for this high percentage, since 64 percent of the declinations by the Chief Counsel (20 out of 31 cases) on grounds of improper notice concerned this issue.

The rights of a taxpayer to stay compliance and intervene are set forth on the copy of the summons form with which the taxpayer is supplied along with notice that the summons has been issued to a bank or other third-party recordkeeper. In this regard, the Finance Committee stated in connection with the enactment of Code Section 7609 (S. Rep. 94-938, 94th Cong., 2d Sess., p. 369):

> The committee also expects that the Service will prepare a summary of the noticee's rights under these provisions, in layman's language, and that a copy of this summary will be enclosed with each copy of the certified notice, so that taxpayers and other noticees will not lose their right to intervention due to inadvertence or ignorance of their rights. (Emphasis added.)

Nevertheless, taxpayers, in most cases, simply choose not to intervene. The result is that although the stay of compliance was intended merely to provide an opportunity for intervention, taxpayers have not intervened in approximately two-thirds of the actions to enforce Code Section 7609 summonses. The unnecessary delay in these situations and the accompanying waste of resources by the IRS, the Department, and the courts are extremely troublesome.

Although in absolute terms the number of IRS investigations which can be shown to be aborted by stays of compliance is not large, the Department, like the Director of the IRS Criminal Investigation Division, believes that the rate of stays and the number of enforcement actions which must be brought impede and discourage vigorous investigative efforts, especially because, as shown by the GAO, approximately 40 percent of the stays are obtained by tax protestors and persons involved in illegal activities. It is impossible in most instances to detect and prosecute tax evasion or the filing of a false tax return without access to financial records. Financial records are significant not only for their evidentiary value, but also because the information obtained leads to other evidence, such as other financial accounts, other documentary evidence, and the names of potential witnesses. Tax prosecutions are somewhat unique in that the evidence required usually consists of a blizzard of paper and the leads to that paper commonly come from financial records. This form of evidence is

generally the only means for indirectly and circumstantially proving the tax evasion or the falseness of the return,6/ but delay in obtaining access to financial records at an early date increases the likelihood that the supporting documentation will have been destroyed or the witnesses will be unavailable.

Enforcement delays do occur during administrative and legal review at the IRS, at the Department's Tax Division, and/or the Office of the United States Attorney, and in the courts. The careful review which is given to summons matters has been reflected in the substantial body of case law favorably interpreting the statutes which permit issuance and enforcement of summonses. However, in an effort to reduce delay, the Department has already taken steps, in conjunction with the IRS and as noted by the GAO, to reduce substantially the number of summons cases which must be forwarded to the Tax Division prior to commencement of enforcement actions.

The draft report makes scant mention of the delays resulting from court consideration of enforcement actions. Reference is made on page 38 to two summons matters in Chicago which respectively took 199 and 167 days to resolve. Statistical information concerning court delay is not available. The best that can be said is that court delays vary from district to district with some cases taking more and some less than the 5 to 7 months involved in the two cases cited by GAO. However, substantial delays also occur in connection with appeals from decisions of the lower courts when a stay of compliance pending appeal is obtained from the court. For example, the Court of Appeals for the Ninth Circuit generally does not give such cases special treatment. The delay between the filing of the briefs and the oral argument is approximately 2 years in that Circuit and a decision is usually rendered 2 to 4 months later. On the other hand, the Court of Appeals for the Second Circuit disposes of such appeals in a rather expeditious manner.

6/ The usual methods of proving tax evasion or the filing of a false return are by the net worth method, the bank deposits method, or the specific items method. The net worth method requires proof of the taxpayer's assets and liabilities at the beginning and end of each prosecution year, together with nondeductible expenditures, but less gifts, inheritances, and other nonincome items. The bank deposits method requires proof of periodic bank deposits, less nonincome items, and frequently includes evidence of nondeductible expenditures. The specific items method contemplates proof of particular items of income received.

The essence of the recommendations made by GAO relative to summons matters is that additional training should be provided to IRS personnel concerning legal and technical aspects of summons matters; the effectiveness of the training program should be monitored; more specific guidance should be supplied in connection with collection of summons statistics; and statistics should be collected on the exercise of Code Section 7609 rights by persons whose illegal activities extend beyond the tax laws and on investigative delays resulting from implementation of the Tax Reform Act amendment. While we have no disagreement with regard to the recommendations concerning collection of statistics, we defer to the IRS concerning the remaining recommendations. Our impression, however, is that many of the initial technical problems which arose upon implementation of Code Section 7609 have been resolved, with a resulting reduction in the number of defective summonses issued.

Contrary to GAO's suggestion that Congressional action concerning the summons provision would be premature, we believe that the Congress should, at an early date, review implementation of the summons provision, in light of enactment of the Right to Financial Privacy Act of 1978 (H.R. 14279, Title XI). Like Code Section 7609, H.R. 14279 generally takes the approach that a customer must be notified when a Government unit seeks access to financial records by means of an administrative summons. The customer would have a right to stay compliance within 10 days after service of the notice or 14 days after mailing of the notice (See Code Sections 1104 and 1110). However, instead of being able to stay compliance by means of a letter to the bank, compliance could be stayed only by filing a motion to quash with the appropriate court. A form motion would accompany the notice to the customer and the customer must specify in the mo' on and affidavit his reasons for believing that the records are not relevant to a legitimate law enforcement inquiry or any other legal basis for objecting to release of the records.

65-628 O—80——16

If the court finds that the customer has complied with the statutory requirements, it will require the Government to file a sworn response and under certain circumstances, the response could be filed _in camera_. The court may conduct such additional proceedings as it deems appropriate in the event that it cannot make a determination based upon the affidavits. The additional proceedings are to be completed and the decision on the matter rendered within 7 calendar days after the filing of the Government's response. The motion to quash will be denied if the court finds a demonstrable reason to believe that the law enforcement inquiry is legitimate and a reasonable belief that the records are relevant to the inquiry.

The denial of a motion to quash will be treated as an interlocutory order and will not be immediately appealable by the customer. An appeal may be taken as part of a final order in any legal proceeding initiated against the customer on the basis of the records, or within 30 days after the customer is notified that no legal proceeding is contemplated by the Government.

The Department submits that the approach taken in H.R. 14279 concerning stays of compliance is preferable to that presently embodied in Code Section 7609. A summons is a form of legal process and more should be required to block compliance than the mere writing of a letter. The stay of compliance by letter procedure simply permits many taxpayers to obtain a delay, who have no intention of participating in the subsequent enforcement proceeding. H.R. 14279, on the other hand, would stay compliance only as to those customers who have demonstrated that they intend to participate in the court proceeding and can come forward with evidence that the summons was improperly issued. These procedures are designed to reduce the potential for delay in obtaining enforcement of summonses and for that reason are superior to those contained in Code Section 7609. The provision of H.R. 14279 relative to appeals from orders directing compliance with summonses would likewise reduce delay. See also _Personal Privacy in an Information Society: The Report of the Privacy Protection Study Commission, p. 372_, concerning appealability of summons enforcement orders.

While absent the passage of H.R. 14279 we would be reluctant to recommend Congressional consideration of this matter in light of the statistical defects noted by GAO, the Department believes that the rules pertaining to IRS summonses should be no more onerous than the rules which pertain to summonses issued by other agencies. Accordingly, we submit that the Congress should consider whether to amend the Internal Revenue Code for the purpose of adopting procedures similar to those contained in H.R. 14279.

We appreciate the opportunity to comment on the draft report. Should you desire any additional information, please feel free to contact us.

Sincerely,

Kevin D. Rooney
Assistant Attorney General
for Administration

Internal Revenue Service — Department of the Treasury

Washington, DC 20224

Person to Contact: Mr. A. Gordon
Telephone Number: 566-3908
Refer Reply to: CP:D
Date: JAN 13 1978

Mr. Robert L. Keuch
Deputy Assistant Attorney General
Criminal Division
Department of Justice
Washington, D.C. 20530

Dear Mr. Keuch:

In re: Anti-Disclosure Provisions of the Tax Reform Act of 1976 and Their Effect on the Ability of the Internal Revenue Service to Cooperate With Other Law Enforcement Angencies

Thank you for your letter of December 14, 1977, requesting our comments concerning ". . . the effect of the disclosure provisions of the Tax Reform Act of 1976 (26 U.S.C. 6103) on the Government's law enforcement program . . . 'and our ability' . . . to cooperate via the exchange of intelligence and to coordinate enforcement activities within the framework of the disclosure provisions."

As stated in the Deputy Commissioner's statement to the Select Committee on Narcotics Abuse and Control on October 12, 1977, we are continuing to study this area in an effort to assess the impact that the law has had on criminal investigations and our cooperation with other law enforcement agencies. Our study is far from complete and we are in need of a longer period of experience with the law to provide you with a complete report.

During our first full year of operation under the new provisions, we have encountered the normal difficulties experienced in reorienting thousands of employees as to the new requirements and the restrictions which these requirements have imposed on what was previously a relatively free exchange of information with your Department and other law enforcement agencies. Our employees have now been oriented and trained and are now becoming more familiar not only with the restrictions the law imposes, but the many permissible means of interchange that exist under the law.

These permissible avenues of exchange, though more restrictive than in the past, permit a greater degree of cooperation than is popularly understood. As our experience expands and our understanding and interpretation of the legalities involved grows, we feel more and more confident that the methods of converse between us and other agencies prohibited by the new law are minimal and that such methods as are prohibited should be so restricted. We believe that Congressional intent in this area as manifested in the law is, with the exception of very minor technical matters, the most prudent course for the Internal Revenue Service to pursue and thus would advocate little or no change at this time.

Mr. Robert L. Keuch

Basically the only information which we are not free to exchange with other law enforcement agencies is that which derives from the taxpayer or one acting on his behalf. Even this information is available to your agency and others pursuant to an ex parte court order. Information obtained by IRS from parties other than the taxpayer and through its own investigative efforts is available under 26 U.S.C. 6103(i)(2) and (3).

We believe that when our employees and our sister agencies become fully conversant with the new law and experienced in the methods employed thereunder, that there will be little that will be denied to them. Our experience thus far indicates that there are relatively few instances where the law has prevented us from reporting information as to criminal activity. As you are no doubt aware we have processed many requests under 6103(i)(1) and (2). We have also made, on our own initiative, numerous reports to you under 6103(i)(3). It is only those relatively few instances where information of a criminal nature coming from the taxpayer is not freely disseminable except where the requesting agency has enough knowledge of the taxpayer from its own resources to prompt them to obtain the ex parte order required by 6103(i)(1).

Accordingly the number of instances where the new disclosure laws have impeded the IRS from cooperation with Department of Justice Strike Forces and other law enforcement agencies is small, especially when viewed in the context of the total number of cases in which cooperation is ongoing.

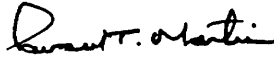
As stated previously our assessment is still incomplete and subject to change, especially when we consider that many present Strike Force cases arose previous to the new laws and sufficient information had previously been exchanged to apprise Strike Force attorneys of those taxpayers concerning whom a court order under 6103(i)(1) or request under 6103(i)(2) would be productive. We will continue to watch this area carefully and will coordinate with you if we believe legislative change is mandated.

In sum then we believe that the disclosure laws are working so as to protect to the maximum degree information given to us by taxpayers consistent with the intent of Congress, thus furthering our desire for taxpayers to have the highest degree of confidence in our tax system; the interchange of tax data and investigative information with sister agencies is ongoing and improving as our body of experience grows; and that except in a very few circumstances viable means of interchange exist and are working.

Mr. Robert L. Keuch

We thank you for the opportunity to furnish you with our views on this matter and pledge to advise you if there is any change in our position mandated by the field experience we gain in the future.

Sincerely yours,



Howard T. Martin
Director
Disclosure Operations Division

IRS EMPLOYEE RESPONSES TO DISCLOSURE QUESTIONS

Questions	Correct response	Number of correct responses	Number of erroneous responses	Percent of erroneous responses
1. May a tax return be presented to a return preparer for inspection for the purpose of ensuring that he did in fact prepare the return?	Yes	105	2	2
2. Can the existence of a numbered case be disclosed to a U.S. attorney preparing to indict the subject on a relatively minor non-tax related count?	No	78	29	27
3. At the half-way point of an investigation involving a lesser known section of the tax code, can the local U.S. attorney be consulted with regard to whether he will prosecute the case should further investigation substantiate the alleged violation?	No	86	21	20
4. During the course of an investigation, a special agent becomes aware of the commission of a non-tax felony by the subject; may this information be disclosed to the appropriate agency?	Yes	103	4	4

Questions	Correct response	Number of correct responses	Number of erroneous responses	Percent of erroneous responses
5. Can a document containing an alleged forged signature be shown to a non-IRS handwriting analysis expert for the purpose of obtaining evidence under a numbered case?	No	76	31	29
6. A suspect in a murder case advised local police officers that he was being interviewed by a special agent at the time the murder was committed. Seeking to verify the suspect's alibi, the local police officer requests verification from the special agent. Can the special agent verify the alibi?	Yes	104	3	3
7. May a tax return of a third party or information from it be disclosed for investigative purposes?	Yes	55	52	49
8. In a case in which the U.S. attorney plans to indict an individual simultaneously for both tax and non-tax crimes, can an agent from another Federal law enforcement group accompany the special agent on an investigative interview?	No	76	31	29

APPENDIX V

SUMMONS STATISTICS ACCUMULATED
BY IRS' CRIMINAL INVESTIGATION DIVISION
MARCH 1, 1977, TO MARCH 31, 1978
(note a)

	1977										1978			Total--March, 1977 to March, 1978
	March	April	May	June	July	August	September	October	November	December	January	February	March	(note c)
Summonses served	1,493	2,229	2,362	2,663	2,391	2,596	2,255	1,890	2,579	2,213	2,451	2,273	2,722	28,985
Cumulative summonses served (note b)	1,493	3,722	6,084	8,747	11,138	13,734	15,989	17,879	20,458	22,671	25,122	27,395	30,117	30,117
Stays of compliance actions	29	86	97	149	161	235	200	183	324	261	199	183	196	2,313
Stays as percentage of summonses served (note b)	1.9	3.8	4.1	5.6	6.7	9.0	8.9	9.7	12.6	11.8	8.1	8.0	7.2	7.7
Stays resolved at district level	15	12	20	39	47	48	68	88	82	150	132	117	176	993
Stays outstanding	12	84	130	278	373	506	681	798	1,031	1,171	1,228	1,291	13,20	-
Cases affected	8	70	88	136	177	240	327	332	383	369	368	390	400	-
Interventions	1	2	5	11	23	2	10	13	12	56	8	28	46	185
Cumulative interventions (note b)	1	3	8	19	42	44	54	67	79	135	143	171	217	217
Cumulative interventions as percentage of cumulative summonses served (note b)	0.1	0.1	0.1	0.2	0.4	0.3	0.3	0.4	0.4	0.6	0.6	0.6	0.7	0.7
Interventions resolved	-	2	-	6	2	1	-	3	5	11	21	22	31	96
Interventions outstanding	-	1	8	14	35	26	39	54	45	82	66	72	89	-
Cases affected	-	2	8	10	12	11	18	26	22	25	20	26	27	-
Special agent staff days expended on stays and interventions	6	25	40	58	91	104	87	102	169	220	218	164	206	1,461

a/Unless specifically noted, all numbers in this chart were provided by IRS.

b/GAO computations based on IRS monthly statistics.

c/Numbers in this column, provided by IRS, do not agree wtih cumulative totals derived by adding the individual monthly statistics. IRS personnel were unable to reconcile the cummulative totals to the monthly statistics.

OFFICE OF CHIEF COUNSEL
Internal Revenue Service
Washington, DC 20224

5 JUN 1978

Daniel C. Harris
Assistant Director
United States General Accounting Office

Dear Mr. Harris:

This is in reply to your letter of May 25, 1978 concerning the legal review process relating to summons enforcement. In your letter you refer to a statement which indicated that new I.R.C. § 7609 of Title 26 U.S.C. does not create any new grounds for objecting to the enforcement of Internal Revenue Service summonses and that the Internal Revenue Service's right to obtain records has been proven time and again in the courts. You question whether given this state of facts the multi-tiered legal review process for proposed summons enforcement actions maintained by the Internal Revenue Service and the Department of Justice is necessary.

First, it should be noted that the careful review given these cases has undoubtedly contributed to the establishment of a body of case law favorable to the government. Second, while not creating any new rights under section 7609 the person entitled to notice as well as the summoned witnesses certainly have certain defenses which they may raise to a summons, such as the attorney-client privilege. Another example of the type of legal issues that arise is indicated by the case of LaSalle National Bank, 554 F.2d 302 (7th Cir. 1977) cert. granted, 44 U.S.L.W. 3384 (Dec. 13, 1977), presently pending in the Supreme Court on the question of whether a summons may be issued for criminal tax investigative purposes. However, recognizing that a substantial body of case law favorable to the government has been created, the Chief Counsel's office of the Internal Revenue Service has been attempting in a continuous dialogue with the Department of Justice to identify those subject matter areas of summons enforcement in which the law is relatively clear, and in those areas to minimize the levels of review.

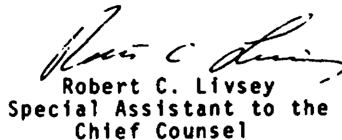
Department of the Treasury

These efforts have culminated in an exchange of letters with the Department of Justice, Tax Division, which indicate that the Department of Justice is agreeable to having the majority of summonses issued to financial institutions sent directly from the Regional Counsel's office receiving the summons enforcement request to the local United States Attorney for enforcement. It is anticipated that the agreement will be implemented in the very near future.

In addition, after a reasonable period of experience under the above procedure we will meet with the Department of Justice in hopes of decentralizing other types of summons enforcement cases. Further, we in Counsel are anticipating taking action which would eliminate the National Office of Chief Counsel from the review function in all but a few types of summons enforcement cases.

The proposed agreement with the Department of Justice will remove two levels of review in many of the summons cases now referred for enforcement. Our proposals would eliminate the National Office of Chief Counsel level of review in a significant number of the remaining cases. We hope this answers the questions raised by your May 25, 1978 letter and if you need any further assistance please call on us.

Sincerely yours,



Robert C. Livsey
Special Assistant to the
Chief Counsel

Enclosures:
As stated

(268046)

REPORT BY THE

Comptroller General

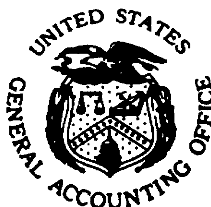
OF THE UNITED STATES

Disclosure And Summons Provisions Of 1976 Tax Reform Act--An Analysis Of Proposed Legislative Changes

Legislative changes are needed in the 1976 Tax Reform Act, which currently hampers the Government's ability to detect and prosecute criminals. The act's disclosure and summons provisions afford taxpayers increased privacy with respect to information they provide IRS and additional rights in summons matters. However, the disclosure provisions inhibit coordination between IRS and other Federal law enforcement agencies. Similarly, the summons provisions adversely affect IRS' ability to carry out criminal tax investigations.

Senate bills 2402, 2403, 2404, and 2405 would significantly revise these sections of the Tax Reform Act, and GAO supports their overall thrust. However, Senate bill 2402 can be further refined to authorize a more effective disclosure mechanism and improve the balance between privacy concerns and law enforcement information needs.

GAO prepared this report at the request of the Chairman, Subcommittee on Treasury, Postal Service, and General Government, Senate Committee on Appropriations.



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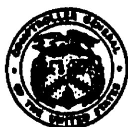
JUNE 17, 1980



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-199000

The Honorable Lawton Chiles
Chairman, Subcommittee on
Treasury, Postal Service,
and General Government
Committee on Appropriations
United States Senate

Dear Mr. Chairman:

As you requested during hearings on April 22, 1980, we are providing our views and suggestions on four bills--S. 2402, S. 2403, S. 2404, and S. 2405. The Senate bills, if enacted, would substantially revise the disclosure and summons provisions of the 1976 Tax Reform Act. Similar bills--H.R. 6764, H.R. 6765, H.R. 6766, and H.R. 6767--have been introduced in the House of Representatives. Since the Senate bills are currently being considered by the Senate Committee on Finance, we are sending a copy of this report to that Committee's Chairman and to the Chairman of its Subcommittee on Oversight of the Internal Revenue Service.

Basically, the Senate bills seek to strike a better balance than now exists between legitimate privacy concerns and equally legitimate law enforcement information needs. We support the overall thrust of the bills because the record (see app. I) indicates a need for legislative revisions aimed at strengthening the Government's ability to detect and prosecute criminals. On the other hand, S. 2402 can be further refined to authorize a more effective disclosure mechanism and improve the balance between privacy and law enforcement concerns.

In analyzing the proposed bills, we were guided by two basic principles:

--The Internal Revenue Service (IRS) is not primarily a criminal law enforcement agency. Rather, its primary mission is to collect taxes and to encourage and achieve the highest possible degree of voluntary compliance with the tax laws.

--Taxpayers who supply information to IRS have a basic right to privacy with respect to that information. Such information should be subject to disclosure for non-tax purposes only when society has a compelling interest which outweighs individual privacy concerns.

Although the Senate bills and our analysis address the disclosure and summons provisions' effects on criminal law enforcement efforts, neither addresses a second important issue--restrictions on the use of tax data for exclusively civil and administrative purposes. For example, Federal debt collectors could carry out their responsibilities more effectively given access to tax information. Federal agencies could make more accurate program eligibility decisions in certain instances given access to tax data. Also, Federal statistical analyses could be improved if certain tax data were made available to various agencies. The Congress may want to address this issue in considering amendments to the Tax Reform Act.

Following is a summary of our views and suggestions on the major provisions of the bills. A detailed comparative analysis of the Senate bills to present law is included as appendix II. References to specific pages in appendix II are provided.

SENATE BILL 2402

We are suggesting modifications to Senate bill 2402, which would substantially revise the disclosure provisions of the Internal Revenue Code. The bill, among other things, would

--simplify existing categories of tax information;

--broaden the definition of taxpayer identity information;

--extend the authority to seek access to tax information to additional Justice Department attorneys;

--limit the time IRS has to respond to access requests;

--require that IRS justify, to a court, decisions to deny Justice Department attorneys access to requested tax information;

--require IRS to disclose information regarding non-tax criminal violations;

--provide a mechanism for IRS to disclose tax information under exigent circumstances;

--authorize redisclosure, to State officials, of tax information concerning non-tax crimes; and

--authorize redisclosure, to Federal authorities, of certain tax information affecting Federal civil litigation.

Our suggested changes are discussed below.

Clear tax information categories are needed

The manner in which tax information is categorized and defined is extremely important because the law affords various levels of protection to different kinds of information. Present law defines and affords certain levels of protection to a "return," "return information," and "taxpayer return information." However, as experience with the Tax Reform Act demonstrates, these definitions have proven confusing to IRS employees, Justice Department officials, and other Federal agencies. Thus, existing categories and definitions of tax information need to be simplified while insuring that taxpayers' privacy rights are retained.

S. 2402 would divide tax information into two basic categories--return and non-return information. A "return" would be defined generally as "any document the taxpayer is required by law to furnish to the Secretary [of the Treasury]." All other information would be considered "non-return information." Substantial protection would be afforded to a return; less protection would be afforded to non-return information.

Although S. 2402 would simplify the categories and definitions of tax information, the bill seems to define the term "return" narrowly in that certain kinds of tax

information could receive less protection than under present law. Also, the definition of return contains two ambiguities. First, it offers little guidance about what would qualify as a document. Second, it does not explain the circumstances in which taxpayers are required by law to furnish documents to IRS. Thus, while a tax return and attached schedules certainly would be considered a return under S. 2402, other information a taxpayer supplies IRS might not. For example, books and records voluntarily made available to IRS by a taxpayer during an audit, including oral explanations of those materials, might not be considered part of the return. On the other hand, the same books and records arguably could constitute a return if supplied to IRS as a result of a summons.

In our view, any information taxpayers supply IRS about their returns ought to be included in the return category and should be afforded the protection that this category warrants. In this regard, virtually all information defined under present law as a "return" and "taxpayer return information" should be protected information. To that end, we have developed proposed statutory language to clarify the definition of a return. Henceforth, all references to the term "return" pertain to our proposed statutory definition. (See pp. II-1 to II-3, II-7, II-8, and II-13.)

The definition of "taxpayer identity information" needs to be expanded

To obtain a court-ordered disclosure and/or to request access to third-party tax information, Justice Department attorneys need to know the taxpayer's name, address, and identifying number. However, Justice does not always have all the information it needs to make such requests. Existing law authorizes IRS to disclose "taxpayer identity information" to Justice on request.

The existing definition of taxpayer identity information does not include information on whether an individual has filed a tax return for particular tax years. As a result, Justice obtained on several occasions a court order authorizing disclosure of information, such as a tax return, which did not exist. In such instances, Justice attorneys and the courts wasted resources simply because present law prevents IRS from telling Justice whether a return was filed.

S. 2402 would expand the definition of taxpayer identity information to alleviate this disclosure problem. The definition would enable a Justice attorney to determine that a return exists before seeking court-ordered access to the return. We support the intent of this provision.

As presently drafted, however, S. 2402 authorizes IRS to disclose any information which identifies the name, address, or social security number of any taxpayer or which reveals whether the taxpayer filed a tax return for any given year. Precisely what may qualify as any information is not defined and thus is open to various interpretations. S. 2402 could achieve its intent by dropping the reference to any information. Then, taxpayer identity information should be defined to include the taxpayer's name, address, and identifying number, and a statement as to whether protected information relating to the taxpayer exists for any particular tax year. (See p. II-4.)

<u>The authority to seek access to tax information needs to be extended to other officials</u>

Under existing law, the authority to request tax information, for criminal law enforcement purposes, either by court order or written request, lies with the head of any Federal agency that enforces Federal criminal laws not involving tax administration. In the case of the Justice Department, that authority extends to the Attorney General, the Deputy Attorneys General, and any Assistant Attorney General. S. 2402 would vest this authority in a defined category of "Attorney[s] for the Government," all within the Department of Justice. The heads of other Federal investigative agencies could no longer independently request tax information.

We agree with the thrust of this proposal. Restricting this authority to Justice Department attorneys would enhance coordination between IRS and Justice essential to efficient Federal law enforcement. Justice, as a result, could prevent duplicative investigations, provide investigative guidance, and otherwise assist Federal law enforcement officials in developing successful cases. Also, giving Justice attorneys sole authority to request information could better insure that such requests meet applicable statutory requirements.

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In our April 1980 testimony, we discussed the need for IRS to decentralize its disclosure processes in accordance with existing law. IRS did so on June 1, 1980, and now should respond more quickly to access requests. Under present law, however, Justice attorneys must send requests through headquarters officials for signature. IRS' action thus has created a need to decentralize within Justice the authority to seek access to tax information.

We do have one suggested modification to S. 2402's definition of the "Attorney for the Government." We would limit the authority to request tax information to fewer additional parties than contemplated under S. 2402. In our view, a better balance between privacy and law enforcement concerns could be achieved by limiting the number of persons authorized to seek access to tax information, consistent with the needs of law enforcement agencies.

We suggest that S. 2402 vest such authority in the Attorney General, the Deputy Attorney General, the Assistant Attorneys General, and, when designated on an individual basis by the Attorney General, U.S. attorneys and attorneys in charge of Organized Crime Strike Forces. (See pp. II-5 and II-6.)

Placing limits on IRS response time to access requests is impractical

We believe the 10-day limit proposed by S. 2402 on IRS' response time to court-ordered disclosures and written requests should be reconsidered. Although we concur with the intent of the provision to expedite the disclosure process, we consider the time limit impractical for two reasons.

First, IRS could not always meet the proposed 10-day limit because its efforts to locate, obtain, and review the requested information often take much longer than 10 days. For example, several weeks are often needed to locate information requested by a U.S. Attorney that has been stored in a Federal records center. Second, through extensive audit work at several IRS offices throughout the country, we determined that IRS invariably seeks to respond to disclosure requests as quickly as possible. Also, effective June 1, 1980, IRS decentralized its disclosure processes in an effort to further speed the process.

We do not object to the imposition of a limit on IRS' response time. However, no systematic study has been undertaken of reasonable time restrictions. Without data on which to base such a decision, any time limit would be arbitrary. We therefore suggest deleting this provision of S. 2402. (See p. II-9.)

Little apparent need for additional controls over IRS' authority to deny access requests

Under present law, IRS may decline to provide requested tax information if it determines and certifies that such a disclosure would identify an informant or impair a tax investigation. In such instances, S. 2402 would require that IRS apply to a Federal district court for permission to deny an access request. The Attorney for the Government then would have the right to contest IRS' application in court by seeking to show that the disclosure is of "such substantial importance to a Federal criminal investigation that said disclosure should take precedence over the considerations for any civil or criminal tax investigation." Although we do not object to court review of IRS determinations, in this instance it seems unnecessary and could have some undesirable effects.

Both IRS and Justice officials believe that court review is not needed because the agencies have clearly demonstrated the ability to negotiate mutually agreeable solutions to access request problems. As a result, since January 1, 1977, IRS has only once had to use the current court certification process to deny Justice access to requested tax information.

Also, in providing a forum for conflict resolution, S. 2402 could cause some potential problems. First, it could inadvertently affect IRS' ability to develop and use confidential informants. Some informants simply will not cooperate with IRS if anonymity cannot be guaranteed. Second, by having the judiciary make final disclosure decisions, S. 2402 could have a negative impact on the ability of IRS and Justice officials to successfully resolve their differences without court intervention. Finally, the application of this standard would place the Judicial branch of government in the awkward position of making prosecutorial value judgments that have historically been the responsibility of the Executive Branch.

If, however, the Congress decides that court review is appropriate, we would suggest that it be invoked only in those instances in which the agencies cannot reach an agreement through informal negotiations. This would preclude the need for court review when Justice does not contemplate challenging IRS' determination that it should deny an access request. (See pp. II-10 and II-11.)

B-199000

Proposed requirement that IRS disclose information concerning non-tax crimes needs clarification

S. 2402 would obligate IRS to provide law enforcement agencies information that "may constitute evidence of a violation of any Federal criminal law or which may be pertinent to any investigation of a violation of Federal statutes." If interpreted as legally requiring IRS to regularly search its files for evidence of possible non-tax crimes, this provision could create an undesirable situation. Such an interpretation could effectively cause IRS to become an intelligence gathering arm for every other Federal law enforcement agency. We therefore suggest that the scope of IRS' responsibilities under this provision be clarified. Subject to the protection provided by other sections of the bill, IRS should be required to disclose only non-tax criminal information it becomes aware of in the course of administering the tax laws.

On this point, one serious problem with present law should be addressed. When IRS uncovers criminal evidence based on taxpayer return information, it lacks authority to unilaterally report the evidence to the appropriate law enforcement agency. This also would be the case with respect to a return under S. 2402. Therefore, we suggest that Congress authorize IRS to apply for a court order to disclose protected information. This would ensure that a neutral third party--the judiciary--decides on the disclosure of such information. Accordingly, we have developed a proposed revision to the statutory language contained in S. 2402. (See pp. II-13 to II-15.)

IRS needs specific authority to disclose tax information under exigent circumstances

Present law provides no specific authorization for disclosures under "exigent circumstances." S. 2402 seeks to resolve this problem. Under exigent circumstances, including a possible threat to persons, property, or national security, IRS would be required to disclose without a court order any necessary information to the appropriate Federal investigative agencies.

We support the intent of this provision. However, as presently drafted, it could cover a wide variety of situations because it does not define the term "exigent circumstances." This provision should be more narrowly drawn, and the exigencies intended to be covered defined with greater

clarity. For reasons discussed previously, we suggested that IRS be given the authority to seek court-ordered disclosures when it uncovers criminal evidence based on a return. In light of this, we suggest that the exigent circumstances provision of S. 2402 be explicitly keyed to IRS' inability to obtain a court order in sufficient time to prevent harm to persons, property, or national security.

In addition, we would authorize rather than require the Secretary to make such disclosures. This would give the Secretary discretion in situations where the potential harm to a confidential informant or a particularly sensitive tax investigation outweighs the potential harm to persons, property, or national security. We would also expand this authorization to allow disclosure of such information to appropriate State authorities, since many exigent circumstances, such as murder, would involve State crimes.

We have developed statutory language to incorporate our proposals. (See pp. II-16 to II-18.)

Redisclosure of non-tax State felony information should be authorized

Present law forbids disclosure of tax information concerning non-tax State crimes. S. 2402 would authorize Attorneys for the Government to obtain a court order authorizing redisclosure to State authorities of information they possess concerning non-tax State felonies. Thus, the Attorneys could self-initiate such redisclosures and could, but would not be required to, respond to State requests for such information. We concur with the need for such redisclosure authority and the court controls over them. However, with privacy concerns in mind, we suggest that such redisclosures be limited to State attorneys general. The attorneys general would, of course, be authorized to further redisclose the information as necessary to carry out their specific criminal law enforcement responsibilities. (See p. II-19.)

Redisclosure of certain tax information for Federal civil litigation purposes should be authorized

Present law generally does not authorize disclosure of tax information for civil litigation purposes. S. 2402 would authorize the Attorney for the Government to apply for a court order authorizing redisclosure, for Federal civil litigation purposes, of tax information obtained initially for use in actual or contemplated criminal prosecutions.

We concur with the need for this redisclosure authority. However, again, with privacy concerns in mind, we suggest that such redisclosures be limited to the heads of the affected Federal agencies. They would then have the authority to further redisclose the information as necessary to carry out their official duties. (See p. II-20.)

SENATE BILL 2403

Under existing law, a taxpayer can prevent third-party recordkeepers from complying with an IRS summons simply by serving notice on them not to comply. The Government then must bring a court action to enforce the summons. The taxpayer can, but is not required to, participate in the court action. S. 2403 would require that a taxpayer file a motion to quash the summons in the local district court. Thus, a taxpayer no longer would be able to delay an IRS investigation simply by serving a notice on the third-party recordkeeper.

The procedure contemplated under S. 2403, which already is contained in the Right to Financial Privacy Act, is reasonable. It also coincides with the recommendation we made in our March 1979 report on the effects of the disclosure/summons provisions (GGD-78-110) and in recent testimony. (See p. II-22.)

SENATE BILLS 2404 AND 2405

Senate bills 2404 and 2405 would amend existing provisions of the Internal Revenue Code which provide criminal and civil penalties for unauthorized disclosures. S. 2404 authorizes Federal employees an affirmative defense against criminal prosecution for improper disclosure, i.e., that the disclosure resulted from a good faith, but erroneous, interpretation of the law. S. 2405 would hold the Government, rather than the affected employee, liable for civil damages under circumstances similar to those described above. (See pp. II-23 and II-24.)

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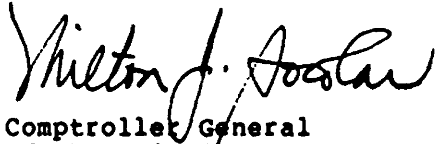
In summary, we support the overall thrust of the four Senate bills. Enactment of S. 2402, with the modifications discussed above, would provide law enforcement officials with needed access to tax information as well as provide adequate control to protect individuals' privacy rights.

B-199000

Enactment of S. 2403 would enable IRS to better carry out its mission. Taxpayers, however, would retain the right to contest administrative summonses in court. Enactment of S. 2404 and 2405 would enable Federal employees to make authorized disclosures without undue fear of criminal prosecution or responsibility for civil damages. In our view, the Congress should adopt these bills.

As arranged with your office, in addition to the earlier mentioned persons to whom we are sending copies of this report, we are also sending copies to the Chairman of the House Ways and Means Committee, the sponsors of the Senate and House bills, and other interested parties who request them.

Sincerely yours,



Acting Comptroller General
of the United States

SELECTED RECORD OF THE EFFECTS OF THE DISCLOSURE AND SUMMONS PROVISIONS OF THE 1976 TAX REFORM ACT

Hearings on the Erosion of Law Enforcement Intelligence Capabilities and its Impact on the Public Security before the Subcommittee on Criminal Laws and Procedures, Senate Judiciary Committee, April 1978.

General Accounting Office report entitled "Disclosure And Summons Provisions of 1976 Tax Reform Act--Privacy Gains With Unknown Law Enforcement Effects" (GGD-78-110, March 12, 1979).

General Accounting Office report entitled "Gains Made In Controlling Illegal Drugs, Yet the Drug Trade Flourishes" (GGD-80-4, October 25, 1979).

Hearings on Illegal Narcotics Profits before the Permanent Subcommittee on Investigations, Senate Committee on Governmental Affairs, December 1979.

General Accounting Office report entitled "The Drug Enforcement Administration's CENTAC PROGRAM-- An Effective Approach To Investigating Major Traffickers That Needs To Be Expanded" (GGD-80-52, March 27, 1980).

Hearings on Federal Efforts to Combat Narcotics Trafficking before the Subcommittee on Treasury, Postal Service, and General Government, Senate Committee on Appropriations, April 1980.

APPENDIX II

COMPARATIVE ANALYSIS OF 26 U.S.C. §§6103, 7609, 7213, AND 7217 WITH SENATE BILLS 2402, 2403, 2404, AND 2405

TAX DISCLOSURE PROVISIONS: COMPARISON OF 26 U.S.C. §6103 AND S.2402 1/

CATEGORIES OF TAX INFORMATION

26 U.S.C. §6103

Existing law divides information into three categories: return, return information, and taxpayer return information.

(b) Definitions

(1) Return--any document the taxpayer is required by law to file, including information returns, declarations of estimated tax, claims for refund, and any schedules and attachments.

(2) Return information--(a) all information on the return; (b) information IRS has concerning the return, e.g., whether the return is being audited; (c) all data received or collected by IRS relating to the return and determination of tax liability; and (d) any background or written document on the determination not open for public inspection.

By definition, return information does not include data in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer.

(3) Taxpayer return information--return information (as in (2)) which is filed with or furnished to IRS by or on behalf of the taxpayer.

S. 2402

Proposal, by definition, divides information into return and non-return information, eliminating the category of taxpayer return information.

(b) Definitions

(1) Return--defined similar to existing law, but also includes any document the taxpayer is required by law to provide IRS.

(2) Non-return information--all other information IRS has relating to the return and tax liability.

Which one for corporate tax return?

1/ This analysis is limited to the impact of the major provisions of S. 2402.

APPENDIX II

GAO Comments

The present statutory definitions of return, return information, and taxpayer return information are somewhat unclear. For example, it is difficult to determine what information falls within the meaning of "taxpayer return information." One reason for this difficulty is the problem of identifying when information is actually supplied on behalf of the taxpayer. Information supplied by the taxpayer's attorney, accountant, or witness brought to an audit seems to be information supplied on behalf of the taxpayer. It is not clear, however, whether information qualifies as taxpayer return information when, for example, the taxpayer's witness decides to testify against the taxpayer and supplies information harmful to the taxpayer's case.

These definitions should be easily understood because the definitional categories ultimately determine the degree of privacy afforded the taxpayer. For this reason, we agree with S. 2402's premise that the present statutory definitions need clarification.

Although the definitions need to be clarified, S. 2402 limits the category of protected information, and the bill's definitions are somewhat ambiguous. Any definitional ambiguities could seriously erode the careful balance the bill's sponsors intended to strike between privacy concerns and law enforcement information needs. Under the proposal, only a "return" would be protected from disclosure by IRS absent a court order. The term "return" clearly covers the actual tax return and such documents as a taxpayer's refund claim. It is not clear, however, whether a taxpayer's books and records provided during an audit would be included. Only documents required by law to be provided IRS are covered by the definition. The bill neither defines the term "documents" nor describes the circumstances in which a taxpayer is "required by law" to provide "documents" to IRS. A taxpayer's books and records provided during an audit should be included within the category of protected information, as well as any return-related information supplied to IRS by the taxpayer or anyone actually acting on the taxpayer's behalf.

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GAO Suggested Statutory Language

Paragraph (1) of subsection (b), section 6103 of title 26, United States Code, should be amended to read as follows:

(1) Return
The term "return" means:
(A) Any tax or information return, declaration of estimated tax, or claim for refund required by, or provided for or permitted under, the provisions of this title which is filed with the Secretary by, on behalf of, or with respect to any person, and any amendment or supplement thereto, including supporting schedules, attachments, or lists which are supplemental to, or part of, the return so filed, and
(B) Any information provided by or on behalf of the taxpayer to whom such information relates including
(i) the nature, source, or amount of the taxpayer's income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, over-assessments, or tax payments, and
(ii) any part of any written determination, or any background file document relating to such written determination (as such terms are defined in 6110 (b)) which is not open to public inspection under section 6110,
But such term does not include data in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer.

Paragraph (2) of subsection (b), section 6103 of title 26, United States Code, should be amended to read as follows:

(2) Non-return information: The term "non-return information" means any information which the Secretary collects, obtains, or receives, or any part of any written determination or any background file document relating to such written determination which is not a return as defined in paragraph (1).

Paragraph (3) of subsection (b), section 6103 of title 26, United States Code, the category "taxpayer return information," should be repealed.

DEFINING TAXPAYER IDENTITY

26 U.S.C. §6103	S. 2402
(b)(6) Taxpayer Identity-- Name, address, and identifying number of taxpayer	(b)(3) Expands definition to cover more than just the name, address, and identifying number by including any information which identifies name, address, or identifying number of taxpayer, or which reveals whether taxpayer filed a tax return.

GAO Comments

It is not clear what is meant by the phrase "any information" in this definition. Arguably, any information that even indirectly identifies a taxpayer is included. This conceivably could include a document, such as a letter from an informant, which refers to an organized crime figure. Such a reference could reveal the taxpayer's identity. Since taxpayer identity information would be disclosed merely on the request of a Government attorney, the category of "taxpayer identity" information should be clarified by deleting the reference to any information. In addition, Justice attorneys need to know whether IRS has information other than just a filed tax return. For example, IRS could have a criminal tax case file on a nonfiler which could be useful to Justice. IRS should be able to inform Justice that it has such "return" information. Actual disclosure of the information could be accomplished through the court order process.

GAO Suggested Statutory Language

Paragraph (6) of subsection (b), section 6103 of title 26, United States Code, should be amended to read as follows:

> (6) Taxpayer identity: The term "taxpayer identity" means the name of a person with respect to whom a return is filed, the person's mailing address, and identifying number (as described in section 6109) and an affirmative or negative statement as to whether 'return' information exists for any particular tax year, or a combination thereof.

APPENDIX II

AUTHORITY TO SEEK ACCESS TO TAX INFORMATION

26 U.S.C. §6103		S. 2402
(i)(1)(B), (i)(2)	Authority to request access to tax information vested with certain agency heads and, in the case of the Justice Department, the Attorney General, Deputy Attorney General, and any Assistant Attorney General.	Adds a new paragraph (9) to subsection (b): (9) Attorney for the Government--Defined as the Attorney General, the Deputy Attorney General, any Assistant Attorney General, Deputy Assistant Attorney General, and any U.S. Attorney, any head of a local or regional office of the Department of Justice, an attorney in charge of an Organized Crime Strike Force, or any supervisory attorney designated by Attorney General. These are the individuals authorized either to file court orders to obtain returns or to request non-return information from IRS.

GAO Comments

Under existing law, the authority to request tax information for law enforcement purposes, either by court order or written request, generally lies with the head of any Federal agency that enforces Federal criminal laws not involving tax administration. S. 2402 would vest this authority in a defined category of Attorneys for the Government, all within the Department of Justice. The heads of Federal investigative agencies could no longer independently request tax information.

We agree with the thrust of this proposal. Restricting this authority to Justice attorneys would insure coordination between IRS and Justice essential to efficient Federal law enforcement. In this manner, Justice could prevent duplicate investigations, provide investigative guidance, and otherwise assist Federal law enforcement officials in developing successful cases. And, by placing this authority in Justice attorneys, a mechanism is provided to insure that all tax information requests meet applicable requirements.

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We would, however, suggest a modification to the list of officials authorized to apply for tax information. We suggest vesting this authority in the (1) Attorney General, (2) Deputy Attorney General, (3) Assistant Attorneys General, and (4) U.S. attorneys and heads of Organized Crime Strike Forces, when specifically designated by the Attorney General. This would provide the Attorney General with flexibility to authorize a wide range of individuals to request tax information when necessity demands, and to withdraw such authorization when necessary. This revision would recognize the balance that must be struck between the need to decentralize this authority within Justice and the danger of having too many people requesting tax information.

GAO Suggested Statutory Language

Subsection (b) of section 6103 of Title 26, United States Code, should be amended to add a new paragraph numbered (9) as follows:

(9) Attorney for the Government: The term "Attorney for the Government" means the Attorney General, the Deputy Attorney General, the Assistant Attorneys General, and, when specifically designated on an individual basis by the Attorney General, any U.S. Attorney or Attorney in Charge of a Criminal Division Organized Crime Strike Force.

APPENDIX II

COURT ORDERED DISCLOSURES

26 U.S.C. §6103	S. 2402
(i) Disclosure For Administration of Federal Laws Not Relating to Tax Administration	(i) Disclosure For Administration of Federal Laws Not Relating to Tax Administration
(1) Non-tax criminal investigation:	(1) Non-tax criminal investigation:
(A) Requires ex parte court order for disclosure of return or taxpayer return information to law enforcement agencies.	(A) Requires ex parte order for disclosure of "return" only.
(B) Application for order by head of Federal agency involved in law enforcement or in case of Department of Justice, the Attorney General, Deputy Attorney General or Assistant Attorney General.	(B) Application for order by an "Attorney for the Government."
Ex parte order may be issued if	Ex parte order may be issued if
(i) on the basis of reliable information, there is reasonable cause to believe a crime has been committed;	(i) it relates to a lawful administrative, judicial, or grand jury proceeding pertaining to a possible violation of a Federal criminal statute; and there is
(ii) there is reason to believe that the return is probative; and	(ii) reasonable cause to believe that the information sought is both material and relevant.
(iii) information cannot reasonably be obtained from another source.	

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GAO Comments

Under existing law, "taxpayer return information" can be disclosed only by court order, applied for by certain agency heads. Taxpayer return information includes any information concerning the return supplied to IRS by either the taxpayer or anyone acting on the taxpayer's behalf. Under this provision, for example, an accountant's work papers provided on behalf of the taxpayer during an audit can be disclosed only by court order.

Under S. 2402, ex parte orders would be required for disclosure of a "return." As a general proposition, all other information would be disclosed on the request of the Attorney for the Government. In our view, information supplied to IRS by the taxpayer or anyone actually acting on his behalf should be disclosed pursuant to a court order. (See page II-2.)

S. 2402 does, however, provide a needed amendment to the criteria for obtaining a court order. Under existing law, law enforcement agencies are caught in a Catch 22 position. To obtain the order, they must show, based on reliable information, that there is reasonable cause to believe a crime has been committed and that the information sought from IRS is probative. The Department of Justice has testified to considerable difficulty in meeting this standard in that it often cannot make these determinations until it has the requested information. We believe the less burdensome "material and relevant" standard of S. 2402 is reasonable and could alleviate the Catch 22 scenario.

S. 2402 does away with the requirement that, to obtain a court order, the agency seeking disclosure from IRS first ascertain that the information is not available from another source. In recognition of IRS' primary responsibility to administer the tax laws and collect the revenue, the Committee could consider refining the bill to recognize that if the law enforcement agency can obtain the information from another source in a timely manner and without prejudicing enforcement, there is no persuasive reason why judicial process should be invoked to compel disclosure by IRS.

APPENDIX II

DISCLOSURE TIME LIMITS

26 U.S.C. §6103

No comparable provision

S. 2402

Adds a new paragraph (D) to section (i):

> IRS must disclose a "return" to the Attorney for the Government within 10 days of receipt of an ex parte court order.

GAO Comments

We understand the intent of this provision--to speed the disclosure process--but consider the time limit impractical. IRS could not meet the proposed 10-day limit because locating, obtaining, and reviewing the requested information often takes a great deal of time. For example:

--Information requested by a U.S. Attorney that has been stored in a Federal records center could take weeks or even months to locate and obtain.

--A criminal tax case file containing references to (but not the name of) a confidential informant must be studied in detail--a time consuming process--by IRS before that file can be disclosed. IRS has to ensure that the disclosed information will in no way indicate the informant's identity.

--Certain disclosure requests sometimes include hundreds of targets. IRS must locate, obtain, and review hundreds of files in response to such a request. This, again, is a time consuming process.

Moreover, through extensive audit work at various IRS offices throughout the country, we determined that the Service invariably seeks to respond to disclosure requests as quickly as possible. Furthermore, effective June 1, 1980, IRS decentralized its disclosure processes in an effort to further speed the process.

We do not object to the imposition of a limit on IRS' response time. However, no systematic study has been undertaken to develop reasonable time restrictions. Without data on which to base such a decision, any time limit would be arbitrary. We therefore do not believe this provision of S. 2402 is necessary.

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IRS' AUTHORITY TO DECLINE ACCESS REQUESTS

26 U.S.C. §6103		S. 2402
(i)(1), (i)(2)	To prevent an otherwise required disclosure, IRS certifies to the court that disclosure would identify an informant or impair a tax investigation. IRS certifications are not subject to challenge.	Revises sections (i)(1) and (i)(2) by adding a new paragraph: Reasons for nondisclosure are the same; however, IRS must apply for approval (not merely certify) to District Court. The Attorney for the Government may contest IRS' determination in court.

GAO Comments

The procedure contemplated by S. 2402, not contained in existing law, requires the judiciary to make the final determination as to whether disclosure would be harmful to an IRS investigation or compromise a confidential informant's identity. Present law vests the authority to make such determinations with IRS. Although we do not object to court review of IRS' determinations, in this instance it seems unnecessary and could have some undesirable effects.

Both IRS and Justice officials believe that court review is not needed because the two agencies have clearly demonstrated the ability to negotiate mutually agreeable solutions to access request problems. As a result, since January 1, 1977, IRS has only once had to use the current court certification process to deny Justice access to requested tax information.

Also, in providing a forum for conflict resolution, S. 2402 could cause some potential problems. First, it could inadvertently affect IRS' ability to develop and use confidential informants. Some informants simply will not cooperate with IRS if anonymity cannot be guaranteed. Second, by having the judiciary make final disclosure decisions, S. 2402 could have a negative impact on the ability of IRS and Justice officials to successfully resolve their differences without court intervention. Finally, this provision would place the Judicial Branch of government in the awkward position of making prosecutorial value judgments that have historically been the responsibility of the Executive Branch.

If, however, the Congress decides that court review is appropriate, we would suggest that it be invoked only in those instances in which the agencies cannot reach agreement

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through informal negotiations. This would preclude the need for court review when Justice does not contemplate challenging IRS' determination that it should deny an access request. Also, the bill, as presently drafted, makes no provision for either _in camera_ court review or the issuance of protective orders to insure the confidentiality of these proceedings. If this provision is enacted, this authority should be specifically given to the judiciary as there is a valid concern of protecting an informant's identity and not impairing a viable tax investigation.

APPENDIX II

DISCLOSING NON-RETURN INFORMATION

26 U.S.C §6103	S. 2402
(i)(2) Disclosure of return information other than taxpayer return information by written request of certain agency heads.	(i)(2) Disclosure of all information other than returns on written request of Government attorney. IRS must disclose within 10 days. Also, the Attorney for the Government can further disclose non-return information to agents and agencies assisting him in the investigation. Provision similar to grand jury secrecy rules, except Senate proposal, unlike Rule 6(e), requires no accounting to the court for redisclosures.

GAO Comments

Under existing law, information which can be disclosed on written request of an agency head is limited to information which is not considered taxpayer return information. S. 2402 would allow all information other than that defined as a "return" to be disclosed upon written request of the Attorney for the Government. As discussed on page II-2, the definition of a return under S. 2402 seems too narrow. It would allow Government attorneys to gain access by written request to some categories of information that, in our opinion, should be protected and disclosed only via court order.

One additional feature of the provision, not previously discussed, authorizes the Attorney for the Government to redisclose non-return information to anyone involved in the criminal investigation. To avoid abusive disclosures, safeguards should be provided to assure that redisclosures are made on a "need to know" basis, and that an accounting is made for those disclosures.

Also, IRS would be required to disclose requested tax information 10 days after receipt of the ex parte court order. For the reasons discussed on page II-9, we consider the time limit unnecessary.

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IRS-INITIATED DISCLOSURE
OF NON-TAX CRIMINAL INFORMATION

26 U.S.C. §6103	S. 2402
(i)(3) IRS may disclose information other than taxpayer return information to agency heads when there is evidence that a Federal crime has been committed.	(i)(3) Places legal duty on IRS to disclose criminal information except for limited category of returns.

GAO Comments

S. 2402 places an affirmative legal duty on IRS to provide enforcement agencies information that "may constitute evidence of a violation of any Federal criminal law or which may be pertinent to any investigation of a violation of Federal statutes." This obligation is not explicitly limited to a duty to review IRS files upon request or to disclose evidence uncovered in the normal course of tax administration. The scope of this duty needs clarification. As presently drafted, the bill could contemplate a responsibility, even in the absence of a request, to regularly review IRS files for nontax criminal evidence. Recognizing that IRS' primary responsibility is in the area of tax administration, we believe IRS' disclosure obligation should extend to non-tax criminal information it becomes aware of when (1) administering the tax laws and (2) reviewing case files pursuant to a Department of Justice request.

At the same time, we recognize the need expressed in S. 2402 to enable IRS to provide assistance to law enforcement agencies. Under present law, when IRS uncovers criminal evidence based on taxpayer return information, it lacks authority to report it to the appropriate law enforcement agency. This is because the law authorizes only heads of Federal criminal investigative agencies other than IRS to apply for a court order to disclose taxpayer return information. This also would be the case with respect to a "return" under S. 2402. Therefore, we suggest that Congress authorize IRS to apply for a court order to disclose protected information. Such a provision would ensure that a neutral third party--the judiciary--decides on the disclosure of such information.

APPENDIX II

GAO Suggested Statutory Language

Paragraph (3) of subsection (i), section 6103 of title 26, United States code, should be amended to read as follows:

(3) Disclosure of information concerning possible criminal activities.

(A) Information from taxpayer: Upon application by the Secretary, a U.S. District Court may, by ex parte order, direct that a return (as defined in section 6103(b)(2)) be disclosed to the head of the appropriate Federal investigative agency if, in the opinion of the court, such information is material and relevant to a violation of Federal criminal law.

(B) Application for order: The application for an ex parte court order shall set forth the name of the taxpayer involved; the time period to which the request relates; and the reasons why, in the opinion of the Secretary, the information is material and relevant to a violation of Federal criminal law.

(C) Procedures: A U.S. District Court shall act upon any application for an ex parte order within 5 days of the receipt thereof. In the event that the district court denies the application

(i) a motion for reconsideration shall be acted upon not later than 5 days after the receipt of such motion and

(ii) an appeal shall be disposed of as soon as practicable but not later than 30 days after receipt of appeal.

(D) Duty of the Secretary: The Secretary or a designee shall disclose, to the head of the appropriate Federal investigative agency, information ordered disclosed pursuant to this subsection.

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(E) Further Disclosure: The head of the Federal investigative agency may further disclose any information, which has been disclosed to him pursuant to an ex parte order, to such other Government personnel as he deems necessary to assist him during or in preparation for any administrative, judicial, or grand jury proceeding or in a criminal investigation which may result in such a proceeding.

(F) Non-Return Information: The Secretary may disclose in writing non-return information which may constitute evidence of a violation of Federal criminal laws to the extent necessary to apprise the head of the appropriate Federal agency charged with the responsibility for enforcing such laws. For purposes of this subsection, the name and address of the taxpayer shall not be treated as a return if there is non-return information which may constitute evidence of a violation of Federal criminal laws.

APPENDIX II

DISCLOSURES UNDER EXIGENT CIRCUMSTANCES

26 U.S.C. §6103	S. 2402
No comparable provision.	Adds a new paragraph (4)(b) to subsection (i) Exigent circumstances: Under exigent circumstances, including a possible threat to persons, property, or national security, IRS must disclose without a court order any necessary information to the appropriate Federal agency. District Court must be notified of disclosure, but not until after IRS releases the information.

GAO Comments

We support the intent of this provision, which provides the Secretary the authority to disclose information in exigent circumstances. As presently drafted, however, this provision could cover a variety of situations. The bill sets forth no clear standards about what constitutes an "exigent circumstance" or "possible threat to persons, property, or national security." Thus, the provision could be interpreted in many different ways and could become the subject of abuse.

This provision could be more narrowly drawn, and still achieve its intent. As discussed on page II-13, the Secretary should, in our view, be given the authority to seek court-ordered disclosures when IRS uncovers criminal evidence based on a "return." In light of this, we suggest that the exigent circumstance disclosure authority of S. 2402 be explicitly keyed to the Secretary's inability to obtain a court order in sufficient time to prevent harm to persons, property, or national

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security. We would also suggest expanding this authority to allow disclosure of criminal evidence based on a "return" to appropriate State authorities, since many exigent circumstances, such as murder, would involve State crimes.

With regard to the act of disclosing information related to exigent circumstances, we would authorize rather than require the Secretary to make such disclosures. This would enable the Secretary to use discretion in situations where the potential harm to a confidential informant or a particularly sensitive tax investigation outweighs the potential harm to persons, property, or national security.

APPENDIX II

GAO Suggested Statutory Language

Subsection (i), section 6103 of title 26, United States Code should be amended to add a new paragraph:

Exigent Circumstances

(A) Under exigent circumstances, the Secretary or a designee may disclose such information, including returns, as is necessary to apprise the appropriate Federal or State authorities having jurisdiction over the offense to which such information relates.

(i) "Exigent circumstances" means circumstances involving an imminent threat of harm to persons, property, or national security, and in which, in the judgment of the Secretary, time is insufficient to obtain an ex parte order authorizing disclosure of the information involved.

(B) The Secretary shall maintain standardized records or accountings of all disclosures made under this paragraph.

APPENDIX II

DISCLOSURE TO STATE OFFICIALS

26 U.S.C. §6103	S. 2402
No comparable provision.	Adds a new paragraph (7) to subsection (i) Provides Attorneys for the Government with authority to obtain an ex parte court order authorizing the redisclosure of tax information which evidences a violation of a State felony statute. Under this provision, a court can authorize that redisclosure of such information be made to an appropriate State official whose duty it is to investigate or prosecute the crime involved.

GAO Comments

Present law does not authorize the redisclosure of tax information concerning non-tax State crimes. S. 2402 would authorize the Attorney for the Government to obtain an ex parte court order authorizing such redisclosure when the information relates to State felony violations. We believe there is a need for this redisclosure authorization.

However, we suggest a modification to this section to accomodate privacy concerns. Redisclosure should be made only to State Attorneys General. The Attorneys General would, of course, be authorized to further redisclose the information as necessary to carry out their specific criminal enforcement responsibilities. Also, IRS should be notified of redisclosures to State Attorneys General by the Attorney for the Government.

APPENDIX II

DISCLOSURE CONCERNING FEDERAL CIVIL LITIGATION

26 U.S.C. §6103	S. 2402
No comparable provision.	Adds a new paragraph (8) to subsection (i) Provides a mechanism through which the Attorney for the Government may redisclose, for Federal civil litigation purposes, information obtained initially for use in a non-tax criminal investigation. The redisclosure would be authorized only upon issuance of an ex parte court order.

GAO Comments

This provision provides a needed authorization for redisclosure of tax information in connection with civil actions initiated under the civil rights, antitrust, fraud, and organized crime statutes. It also could be invoked for other civil statutes that have a criminal counterpart. However, we would suggest a modification to this section to accommodate privacy concerns. Redisclosure should be made only to the heads of Federal agencies. The agency heads would, of course, be authorized to redisclose the information as necessary to carry out their specific responsibilities.

Also, one feature of the authorization could complicate and detract from its workability. Namely, the authorization would not apply, for example, to organized crime and antitrust cases where the Government elected to proceed civilly but not criminally. This is because the provision provides no mechanism to transfer tax information where the judicial action is exclusively civil and there is no related criminal proceeding or criminal investigation.

APPENDIX II

DISCLOSURE FOR USE IN MUTUAL ASSISTANCE TREATIES

26. U.S.C.§6103	S. 2402
No comparable provision.	This section provides a mechanism to allow the Government to perform according to mutual assistance treaties it has entered into with foreign countries to exchange criminal evidence.

GAO Comments

As an adjunct to Mutual Assistance treaties, this provision should be useful to identify laundering operations involving the use of foreign depositories and foreign investments.

APPENDIX II

SUMMONS PROVISIONS: COMPARISON OF 26 U.S.C. §7609 and S. 2403

26 U.S.C §7609	S. 2403
Taxpayer receives notice of the issuance of an IRS summons. Taxpayer can prevent third-party recordkeeper from complying with the summons simply by serving notice on the recordkeeper, within 14 days, not to comply. IRS then must initiate court action to enforce compliance with the summons.	Taxpayer receives notice of the issuance of an IRS summons. To halt compliance by the third-party, taxpayer must file a motion with the district court to quash the summons. The Government then must respond to that motion within 10 days. Court ruling denying taxpayer's motion to quash is not appealable until the court issues final order in case for which records were sought.

GAO Comments

Under existing law, a taxpayer is able to stay compliance with a third-party summons merely by serving notice on the recordkeeper not to comply. IRS believes organized crime figures, drug traffickers, and some tax protesters tend to use the present law as a means for delaying and obstructing tax investigations. S. 2403 would still require that IRS notify a taxpayer when it has issued a third-party recordkeeper summons. Unlike present law, however, the taxpayer could intervene in the process only by filing a motion to quash with the court.

APPENDIX II

CRIMINAL PENALTY PROVISIONS: COMPARISON OF 26 U.S.C. §7213 and S. 2404

26 U.S.C. §7213	S. 2404
Provides criminal penalties for unauthorized disclosure of tax information.	Adds an affirmative defense to a prosecution under this section, i.e., that the disclosure resulted from a good faith but erroneous interpretation of the law.

GAO Comments

Enactment of S.2404 would make clear that criminal sanctions attach only in the case of intentional violations of the disclosure provisions.

APPENDIX II

CIVIL PENALTY PROVISIONS: COMPARISON OF 26 U.S.C. §7217 and S. 2405

26 U.S.C. §7217

Authorizes the payment of civil damages to a taxpayer by the Federal employee responsible for unauthorized disclosures of tax information.

S. 2405

Makes the Government, rather than the individual employee, responsible for payment of civil damages with respect to good faith disclosures.

GAO Comments

In the absence of a knowing or intentional violation of the disclosure restrictions, civil damages awarded to a taxpayer as a result of an unauthorized disclosure would be payable by the Government, rather than by the employee making the discloure.

APPENDIX II

Senator BAUCUS. Next we will hear from a panel consisting of Mr. Shattuck, of the ACLU, Mr. Walker, of the American Bar Association, and John Stephan, of the American Banking Association.

Gentlemen, there is no particular order. If some of you have to leave, you can determine the order for yourselves. Otherwise, at the top of my list, I have John Shattuck of the ACLU.

STATEMENT OF JOHN SHATTUCK, DIRECTOR, AMERICAN CIVIL LIBERTIES UNION

Mr. SHATTUCK. Thank you very much, Senator Baucus.

It is always pleasant to be in the position of a rebuttal witness after a long series of witnesses.

To make the major point in my testimony, I would simply respectfully submit that the case has not been made for many of the proposals that are before you. There is no evidence of nontax crimes in which information is not being made available to the Justice Department. There is no evidence of applications for court orders that are being denied by the Justice Department for access to some of the information that is at issue here.

In short, I think, and it is certainly the view of my organization, that there is very little reason for the Congress to tear down the minimal privacy protections for tax information that were erected 4 years ago, and I think that were erected because they were good for privacy and because they were good for the administration of the tax laws.

The act itself is a product of extensive evidence, real evidence rather than the kind of speculation, I think, that has been engaged in this morning, of abuse of tax records by agencies of Government that were putting pressure on the IRS. This is extensively documented in the Church committee report and other congressional reports, and it was referred to by Senator Weicker in his excellent statement this morning.

The Tax Reform Act was designed to remedy this, and although the act is by no means stringent, it provides a minimum degree of protection for IRS records. It requires the Government to meet a reasonable standard of proof to justify disclosure and disclosures may only be made following the independent judgment of a Federal judge.

IRS, as you have heard this morning, and of course as you are well aware, Mr. Chairman, has been given enormous unparalleled power by Congress to obtain information from taxpayers about virtually every aspect of their lives.

This is an important power. It is a central power for the enforcement of the tax laws, but because it is so broad, there has been an effort to conform that power to constitutional guarantees of the privilege against self-incrimination under the fifth amendment by the Supreme Court through the carving out of a required records exception to the privilege against self-incrimination. That required records exception was created principally for the purposes of IRS.

I think the fact that IRS has this special authority is certainly not a reason to consider transferring all of that authority, or even any part of it, to other agencies of the Government which are

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pursuing other governmental objectives, indeed, important objectives, but not enforcement of the tax laws.

The information that the IRS gathers does not in any sense belong to the government at large. It is being held in special trust by IRS for the purposes of tax enforcement.

I think in introducing his legislation and in testifying on it this morning, Senator Nunn has made it a central premise of the legislation that IRS should become much more actively involved in the war against illegal drugs and organized crime. I would respectfully submit, Mr. Chairman, that that is not the central or even perhaps any purpose of IRS, because IRS is not set up for the general purpose of enforcing the nontax laws. That is the business of other agencies of Government.

You have just heard from Mr. Nathan of the Department of Justice that it is not even clear that the proposals in the Nunn legislation would in fact have any real impact in terms of the war against illegal drugs or organized crime, but I think we are quite clear that they would have a substantial impact on the privacy of all taxpayers and on the enforcement of the tax laws.

These are the broad considerations, and I think they have to be borne in mind during the course of these hearings, because so often it is possible to have a hearing of this kind become essentially a discussion of a lot of very narrow and fine provisions of law, but I think we have got to step back and see whether the case has been made for changing something which Congress considered and considered very carefully and extensively 4 years ago.

We would respectfully submit that that case has not been made. In my testimony, I have identified some seven or eight major areas of concern with respect to S. 2402. I will not go through those now, because I can see the 5-minute rule has already taken its toll on my testimony, but I did want to stress in this summary that I do not believe the case has been made for the proposed changes.

There are some provisions of 2402 and 2403 which the ACLU would certainly not object to to the extent that they go to the expediting of the procedures that the Tax Reform Act sets up, but we do object to any substantive change of the standards or the other protections for privacy of taxpayer information.

Of course, I would be happy to answer questions after the panel is completed.

Senator BAUCUS. All right. I will have some questions later I will want to ask. Thank you very much.

Mr. SHATTUCK. Thank you.

Senator BAUCUS. Mr. Walker.

STATEMENT OF CHARLES M. WALKER, CHAIRMAN, SECTION OF TAXATION, AMERICAN BAR ASSOCIATION

Mr. WALKER. Thank you, Mr. Chairman.

I am Charles M. Walker, of Los Angeles. I appear today as chairman of the section of taxation of the American Bar Association. The views I express are those of the tax section, and on S. 2402, 2404, and 2405, are the views also of the section of individual rights and responsibilities.

The association as a whole has not considered these subjects, and has not established a position on them.

We have prepared a written statement, Mr. Chairman, which I would ask be included in the record.

Senator BAUCUS. Without objection, the written statements of each of the three of you will be included in the record.

Mr. WALKER. So, I will summarize now only a few of the main points.

On the three bills dealing with disclosure of tax returns and tax return information for use in nontax criminal investigations, we support a streamlining procedure and the removal of unnecessary roadblocks. In our opinion, however, S. 2402 goes too far in some respects. The present law on this subject represents a careful balancing of interests between enforcement of nontax criminal laws on the one hand and the rights of taxpayers to privacy of their tax returns and tax return information on the other.

Those interests still need to be balanced, and from the standpoint of Federal law enforcement, a balance also is needed between enforcement of nontax criminal laws and enforcement of tax laws, both criminal and civil. I was concerned a little this morning by what appears to be a possibility of a confusion between the objective of disclosure of tax information for nontax crimes and the desire that there be more vigorous prosecution of organized crime and narcotics figures for tax crimes.

I think those are differences that need to be borne in mind. I feel that there should be no change made in the disclosure laws to aid enforcement of nontax crimes if it will seriously impede compliance with the tax laws. Tax compliance is under constant and increasing strain. The efficiency of our tax system demands that we bolster compliance in every way we reasonably can.

The objections we have to S. 2402 are based on two principles: First, preservation of a taxpayer's right to privacy, and second, bolstering tax compliance. Both of these principles are as applicable to tax information relating to corporations as they are to individuals.

We therefore strongly object to the recommendation that we heard this morning that different rules be provided for individuals and for corporations. So, in this respect we take exception to the administration's proposal.

The principal point I would like to make now is this. We agree with the bill which requires a court order before a tax return may be disclosed. We do not agree, however, that present law should be changed so that a court order is no longer required to disclose tax information obtained from the taxpayer or his representatives.

The tax laws require taxpayers to maintain books and records adequate to prove their tax liabilities. The Internal Revenue Service's access to that material for tax audit purposes obviously is in order, but the Internal Revenue Service disclosure of that material obtained from the taxpayer or his representative without a court order violates the taxpayer's reasonable expectation of privacy.

Moreover, if the bill is enacted, a taxpayer, realizing that disclosure without a court order could be made, will be placed under still greater strain than he already is willingly to comply with tax reporting and tax recordkeeping requirements. In other words, compliance could well suffer.

We recommend, therefore, that the bill be amended to restore the requirement of a court order before a disclosure can be made.

On S. 2403, dealing with the use of summons by the Internal Revenue Service, we agree with the shift from the Government to the taxpayer of the burdens of instituting procedures for judicial review of the summons. We recommend, however, that the bill be amended to remove the suspension of the statute of limitations during judicial proceedings, because it is no longer needed in the greatly expedited process.

Alternatively, the bill should be amended to alter the suspension provision so as not to prejudice the rights of taxpayers to the undue advantage of the Government. Our statement suggests several possible alternatives in this respect.

The bill eliminates the taxpayer's present right to appeal from a court order enforcing the summons. We think this is wrong. An appeal should be possible. The bill also raises the distinct possibility of duplicative judicial proceedings. This should be avoided, and our statement indicates ways we think this can be done.

Further, the bill limits its application to summonses issued for records of individuals and partnerships of five or fewer individuals. For reasons set forth in our statement, we strongly object to this limitation, and we think it should be eliminated from the bill.

As previous testifiers have indicated, Mr. Chairman, there are numerous other elements in particular to the disclosure bill that I would like to go into. I can't. They are in our statement.

I will be glad to answer any questions.

Senator BAUCUS. Thank you very much, Mr. Walker. We will get back to you later.

Mr. Stephan.

STATEMENT OF JOHN STEPHAN, CHAIRMAN, TAXATION COMMITTEE, AMERICAN BANKERS ASSOCIATION

Mr. STEPHAN. Thank you, Senator.

My name is John Stephan. I am chairman of the Taxation Committee of the American Bankers Association, and senior vice president of Bank of America in San Francisco.

The American Bankers Association, comprised of over 90 percent of the Nation's 14,000 full service banks, is pleased to have this opportunity to comment, and we are commenting primarily on Senate bill 2403.

At the outset, I would like to indicate that we believe that the current provisions of I.R.C. section 7609 have been successful, and have provided much needed clarity and precision in this area. While there may be some abuse in the use of the automatic stay provisions for delaying purposes, I.R.C. section 7609 has been largely successful in eliminating the casual attitude with which pocket summonses were issued prior to I.R.C. section 7609.

As Congressman Stark indicated, the American Bankers Association became involved in this area after a significant amount of complaints from our constitutents, and a survey indicating that over 100,000 IRS summonses were being received annually by the commercial banks.

The provisions of I.R.C. section 7609 have been successful in reducing the number of unnecessary or defective summonses which

have been issued. It has also provided a very important procedural forum through which taxpayers can test the validity and the propriety of the summonses issued by the Internal Revenue Service.

These significant benefits, we believe, should not be taken away merely because a limited amount of abuse may exist.

Therefore, the major concern that we have is with the shifting of the burden to initiate legal proceedings from the Government to the taxpayer. We are also concerned about the repeal of the appeal provisions in 2403, and with the limitation of the coverage of the section to individuals and small partnerships.

The Government indicates that the section needs to be changed because the automatic stay provided taxpayers has caused delays and has hindered legitimate investigations of tax protestors and criminals.

We would submit that the very limited GAO statistics, and they are the only statistics available, do not support this conclusion, and I would agree with Mr. Shattuck that the Government has simply not made its case.

We heard this morning that 90 percent of the taxpayers who invoke the stay proceedings have not shown up in the court subsequently. I think that is a misleading statistic, because as I read the GAO report, I see that in only 8 percent, only some 2,000 out of the 30,000 summonses that were issued in the test period, did the taxpayers invoke the automatic stay, and of those 8 percent, a significant amount, perhaps as much as 50 percent, were dropped by the Government.

So, the 90 percent of taxpayers failing to show up in court is 90 percent of about 4 percent. That is a very limited amount of abuse, and I submit that it is not sufficient justification for changing the law.

Moreover, most of the discussion this morning has concerned criminals, and these people are thoroughly familiar with their legal rights, and are just as likely to utilize other court processes available to them to cause similar delays. Moreover a significant amount of the delays we are talking about are caused by the Government's internal review process, according to the GAO report.

So, our position is, to summarize very quickly, that we simply don't feel that the case has been made to change 7609; however, if Congress should decide to amend 7609, then we think that several very important amendments should be made to Senate bill 2403.

First of all, we believe, and other witnesses have said the same thing here, that the summonses should be reviewed by IRS attorneys before being issued. We believe that consistent with the Right to Financial Privacy Act, a taxpayer should be provided with a motion paper and instructions as to how to quash the summons.

Mr. Anderson testified a moment ago as to the difficulty of interpreting IRS regulations, and I would submit that taking away this right of the taxpayer puts him in the very difficult position of either analyzing a very complex law or hiring an attorney in every single case in order to interpret what his rights are. He should at least be provided with instructions as to how to proceed to quash the summons.

If I may just continue about three more very quick points. If the Congress amend section 7609 or enacts S. 2403, then we would urge that provisions consistent with the Financial Privacy Act be added providing that third party recordkeepers not be required to produce the requested information until the Secretary certifies that he has complied with the existing provisions of law, and that the recordkeeper who provides records in reliance on the certificate by the Government shall not be liable to taxpayers for production of the records.

Finally, in agreement with several other witnesses, we would urge that if there are changes in the existing law, that the right to appeal the determination of quashing the summons be put back into S. 2403, and that rather than limiting this appeal to an interlocutory or discretionary appeal, we agree with the Bar Association's submission that the ruling of the court should be a final and appealable ruling.

To just make one closing comment, we feel strongly that the case has not been made, and that 7609 is a satisfactory piece of legislation, and that it ought to be the subject of a more careful consideration, a more thorough statistical gathering before any changes are made.

If changes are made, I hope that you will give due consideration to our proposed suggestions.

Senator BAUCUS. Thank you very much, gentlemen.

On your last point, that the case has not been made, I wonder if you could amplify that a little more. Are you saying that based upon your experience, Mr. Stephan, there aren't an unusual number of strange deposits in banks, or that if there are, the Criminal Division or U.S. attorney can sufficiently obtain the information, given reasonable safeguards?

What do you mean when you say that the case has not been made?

Mr. STEPHAN. What I am saying, Senator, is that as I get the thrust of the Government's position, the automatic stay provisions cause significant delays and hinder investigations. I would say that first of all, the automatic stay provisions have not been invoked, from the statistics available to us, in a significant number of cases.

The GAO report indicates, as I mentioned, that during the test period of criminal summonses issued, in only 8 percent did the taxpayer request or, rather, submit to the stay proceedings, so that I think with 92 percent of the taxpayers going along and furnishing information, or third party recordkeepers furnishing information without the automatic stay provisions being invoked, it is not sufficient grounds to change the existing law.

Second, the Government says that where the automatic provisions have been invoked in this small percentage of the total number of summonses, that significant delays have occurred, and as I look at the operation of the Government, both from having served in the Justice Department and now in banking, I see that at least in my view the overwhelming amount of the delay is caused by the Government's own administrative review process.

Senator BAUCUS. Your comments are confined primarily to S. 2403.

Mr. STEPHAN. That is correct.

Senator BAUCUS. Not so much to S. 2402.

Mr. STEPHAN. That is correct.

Senator BAUCUS. Mr. Shattuck, you probably have an answer to that question.

Mr. SHATTUCK. Yes, my comment on the case not having been made was addressed primarily to section 6103, which is amended in S. 2402. That is the set of disclosure provisions.

There, I rest on principally two points, and that is, in having reviewed the hearings that underlie this legislation, and then, of course, the testimony this morning, I find no evidence that nontax crime evidence in IRS that the Justice Department thinks should be turned over is not being turned over, or that IRS believes is in its files and it is precluded from turning over to the Justice Department under the Tax Reform Act.

That is the first point, and the second point is that there is no evidence that applications for court orders that are made by the Justice Department for access to tax information under the disclosure provisions of section 6103 are being denied.

Senator BAUCUS. But their answer is, the standards are so high that they don't seek the order. That was Mr. Nathan's response to that point.

Mr. SHATTUCK. Well, I think they have an obligation to show us a little more than simply that there are applications that they are not making because the standard is so high. I mean, it would be useful to have the kind of information that one could get in a report that did not contain any investigative information that was going to be damaging to individuals, but nonetheless, demonstrated the kinds of applications that are not being made.

Senator BAUCUS. Is my understanding correct? I believe that the standards in the present law, 6103, are higher than they are for Government in trying to obtain a wiretap.

Mr. SHATTUCK. No, I don't believe that is so, Mr. Chairman. I think in fact they are lower. The Privacy Protection Study Commission recommended that a standard of probable cause be the disclosure standard for the Tax Reform Act. That was not adopted by Congress when section 6103 was enacted.

In fact, a reasonable cause standard applies. It is indeed true that there must be suspicion of a particular crime, whereas under S. 2402, the standard is merely that the information is relevant to a general, ongoing investigation, not necessarily of any particular crime.

Senator BAUCUS. My question goes, though, to the present 6103, the present stantutory standard.

Mr. SHATTUCK. That is right. It is not a probable cause standard, which is the wiretap standard, of course.

Senator BAUCUS. Right, but 6103 requires a showing that the information cannot be obtained from any other source.

Mr. SHATTUCK. Well, in fact, that is also generally the wiretap standard. You must demonstrate to a court under title III of the Omnibus Crime Control and Safe Streets Act that there is no other practical avenue for obtaining the evidence that the wiretap would obtain. That would be one of the elements that must be submitted to the court in the affidavit underlying the wiretap application.

So, I think that, if anything, the standard in 6103 is lower than it is with respect to wiretap applications, and I certainly agree with the testimony of several witnesses this morning and Senator Byrd's observation that we are clearly dealing with information here that is every bit as sensitive as wiretap information.

Senator BAUCUS. What is your reaction to the GAO approach with respect to expanding the definition of tax returns and return information, imposing a duty upon the Service to provide potentially incriminating evidence to the relevant agency?

Mr. SHATTUCK. Our position, which I have spelled out in my prepared statement, is that the information in IRS is really very unique and should not be made available even by a court order approach. Centainly, then IRS itself should not make the information available without an application coming in from another agency of Government.

We do not believe that it is the obligation of IRS to enforce the criminal laws. Under some narrow circumstances now defined by the Tax Reform Act, section 6103, it is possible for other law enforcement agencies to get access to IRS records that are relevant and important to a criminal investigation.

Senator BAUCUS. Do you think that if the IRS says, "my gosh, there is an obvious massive bribery going on here," that it should be under some obligation to turn over the information?

Mr. SHATTUCK. I think it is a close call, but I think that to be consistent with the position that we are talking about the nature of the IRS information gathering process, that it is awfully hard to know where one could draw the line. One could imagine some exigent circumstance properly defined in which either life is at stake or vast sums of property are at stake and a crime is in process, but that line certainly is not drawn either in the GAO report or in the legislation before us.

Mr. WALKER. Senator, could I comment on that subject for a minute?

Senator BAUCUS. Certainly.

Mr. WALKER. I think there is a difference between the information the IRS has that it obtains in its own investigation of the tax liability of the taxpayer or his return and supporting documents and the trash bag thing that we heard about, which was something that was information that was not obtained from the taxpayer. I think the standard would be different in those two cases.

Senator BAUCUS. So if it is not obtained from the taxpayer, it would be a lower standard, then?

Mr. WALKER. Yes.

Senator BAUCUS. Mr. Shattuck, you were, before the red light and the bell cut you off, going to list seven different objections to S. 2402. What are the one or two most egregious provisions that you see?

Mr. SHATTUCK. One that has been well discussed by other witnesses, which is probably the most serious problem, is the change in the definition of protected information, so that anything except taxpayer return information would not be protected against disclosure under the definition of S. 2402.

Beyond that, the change in the standards of proof which I have been discussing, in answer to your questions, lowering of the re-

quired showing of proof that an agency would have to make to obtain a court order for access to IRS information, concerns us considerably.

A third area is the possibility that information obtained under a court order could be further disseminated within the Government without any checks against further dissemination is an area of great concern.

Fourth, dissemination to State agencies. I think the Justice Department itself has taken the position that that is inappropriate.

Fifth, use for civil litigation is a matter of concern to us, and that also, I think, is opposed by the Department of Justice and IRS.

Disclosure to foreign governments is a matter of great concern. I think Senator Weicker went into that quite well. Many foreign nations have standards of proof in criminal laws that are different from the standards required under our Constitution or by definitions of criminal laws that have been enacted by Congress, and in fact, there are crimes in foreign countries that may not even be criminal conduct in this country.

So, I think that requests from foreign governments for information from the IRS are wholly inappropriate for the reasons that we would oppose disclosure to State agencies, but for the additional reasons that the standards of proof and criminal conduct may be different in foreign countries.

We would agree with the position of the American Bankers Association with respect to the summons procedures of section 7609, where we submit that, as Mr. Stephan has been pointing out, there has really been no demonstration of a need for changing the burden of proof from the IRS to the taxpayer himself.

Finally, as I said at the end of my testimony, we do support a number of provisions of the bills that would expedite procedures. We endorse the imposition of time limits, the extension to magistrates of the authority to rule on government applications, the provision allowing attorneys for the government rather than heads of agencies to apply for disclosure.

Senator BAUCUS. Do any of you have any view with respect to the bill that would lower the liability of IRS agents or any IRS personnel in disclosing information?

Mr. WALKER. Yes. Mr. Chairman, we think that there should be an easing on the penalty, at least to let the government backstop the agent if he has in good faith performed his duty on the disclosure. We think, however, some penalties should remain to just assure against, and I think Senator Nunn in his statement introducing these bills has indicated that some penalties should remain, but to spare the agent the burden of a very, very large potential liability, civil liability.

We agree with that. We agree with the easing of the criminal penalty where there has been an affirmative defense now provided in the bill. We do think, however, that some thought might be well given to extending the penalty to the receiver as well as the giver of the disclosure that is improper, because sometimes there is undue pressure brought to bear to get disclosure that really should not have been made.

So, we think that some kind of a monetary penalty would be appropriate in those situations.

Senator BAUCUS. You all seem to feel that the case has not been made. Let me take the other side of that coin. Do any of you have suggestions as to how the Federal Government can better combat organized crime and illegal drug trafficking?

[No response.]

Senator BAUCUS. Anyone?

Mr. WALKER. Well, I was interested. If I could just react to what Commissioner Kurtz said, while he is perhaps saying they are thinking about increasing their resources to the enforcement of the criminal tax laws, that certainly would be a way to take direct response to some of the concerns expressed by Senators Nunn and Percy and so forth to really pursue more vigorously the violators of the criminal tax laws.

That doesn't answer the question about this disclosure of information for nontax crimes. The protections, I think, that we have been emphasizing, are still important in that respect, but that would be for nontax crimes, whereas the significant motivation for some of this legislation has been to use the Internal Revenue Service information for nontax crimes.

So, I think it is important, obviously, to have coordination between the two agencies. And we heard testimony to the effect that that is taking place, and how better to do it, I don't have anything, obviously, specific to suggest, Senator.

Mr. STEPHAN. Senator, I would say, I am not convinced, as I have indicated, that there is a correlation between combating organized crime and the summons procedure itself, but to the extent that notice does hamper legitimate investigations of organized crime, I would submit that section 7609 already has existing provisions for the Government to proceed with an ex parte order and to go after the criminal without notice.

Mr. SHATTUCK. Mr. Chairman, I will just add a couple of words to what I have already said. I do believe that the expediting proposals in S. 2402 would solve a fair number of problems that have been identified in the earlier hearings. Apparently one of the principal problems for the Justice Department and IRS is simply the time factor and the difficulties of getting Federal judges to rule on applications.

I think going to magistrates and vastly stepping up the time and procedural requirements will both safeguard important privacy rights and assist in solving some of the problems.

Senator BAUCUS. I have one final question, Mr. Shattuck. Do you have any views on the Government's position on distinguishing between corporate and individual taxpayers with respect to these general questions?

Mr. SHATTUCK. Well, we would not make the kind of blanket distinction that the Government seems to be proposing here. We do recognize, as I point out in my prepared statement, that there may be different considerations in corporate tax returns than there are in individual tax returns.

On the other hand, there is a great deal of individual information in a corporate return. I think that a much more finely tuned approach toward the distinction the Government is suggesting needs to be considered. I have not drafted any language to that

effect, but I would not simply totally exempt corporate returns from the procedures of the Tax Reform Act.

Mr. WALKER. Could I comment in that respect, too, Senator?

Senator BAUCUS. Mr. Walker?

Mr. WALKER. The comments were made numerous times as the suggestion was made that there could be a distinction between corporate books and records and individuals on this disclosure business to the fifth amendment rights of individuals that don't apply to corporations.

That might very well be true, but there still is a fourth amendment that is out there against unreasonable searches and siezures and all the rest, and we don't see any basis, really, for distinguishing, when we come to the business of rights to privacy and protection of the enforcement of the tax laws, and compliance with the tax laws, that there should be a distinction made between individual tax return information and corporate tax return information.

Senator BAUCUS. All right, gentlemen. Thank you very much. We appreciate your time, and you have been very helpful.

[The prepared statements of the preceding panel follow:]

STATEMENT OF JOHN H. F. SHATTUCK, DIRECTOR, AMERICAN CIVIL LIBERTIES UNION WASHINGTON OFFICE

I am pleased to testify this morning on the privacy of taxpayer information, an issue of much importance to the American Civil Liberties Union. I am the Legislative and Washington Office Director of the ACLU, a nationwide, nonpartisan organization of more than 200,000 members devoted to the protection of individual rights and liberties. I am also the author of a textbook, "Rights of Privacy" (National Textbook Co. 1977).

For many years the ACLU has played an active role in the effort to safeguard individual privacy from broad intrusion by government and private recordkeeping practices. Through a project on privacy and data collection which we sponsored from 1973 through 1978, the ACLU provided advice—and in some instances legal representation—to individuals whose rights and interests were adversely affected by the recordkeeping and dissemination practices of governmental and private institutions. We also sought to publicize in a monthy "Privacy Report" the many ways in which privacy has been eroded in a society where personal information is increasingly recorded by third parties and used for a wide variety of purposes, without the consent or even the knowledge of the person involved.

The ACLU is particularly concerned about the issue of taxpayer privacy, and has testified frequently in congressional and other hearings on this subject, including hearings of this committee when it was considering the Tax Reform Act of 1976. We were strong opponents of the Justice Department's earlier effort to amend the Act in 1977, and we oppose many of the proposed amendments before the Committee today.

PRIVACY OF TAX RECORDS

The disclosure and summons provisions of the Tax Reform Act of 1976 are the product of a grave concern for the privacy of tax records held by the IRS. The provisions were generated by revelations, over a period of several years, of a widespread pattern of abuse of IRS records by government agencies for non-tax purposes. Among the many improprieties that were revealed by various investigations of governmental intelligence operations were a number of projects initiated within the IRS as a result of pressure brought to bear on that agency by governmental law enforcement agencies. These projects included the Ideological Organizations Audit Project and the Special Service Staff (1969-73) which targeted more than 8,000 individuals and 3,000 groups for extensive investigation specifically because of their political activities. The SSS operated in secrecy and was abolished in 1973 when IRS Commissioner Donald Alexander learned of its existence. These internal IRS projects seriously threatened the constitutional rights of all taxpayers. The projects were the product of external pressures exerted by Congress, the White House and government law enforcement agencies who claimed that the IRS was not participating sufficiently in the governmental battle against crime.

More central to the origins of the disclosure provisions of the 1976 Act were the extensive revelations of abuse of IRS information by other agencies of the government which had solicited the information from the IRS. See "Final Report," Book III, Senate Select Committee on Study of Governmental Operations with Respect to Intelligence Activities, 94th Cong., 2d Sess. [Church Committee] (1976). Between 1966 and 1974, the FBI, either directly or through the Justice Department made approximately 200 requests to the IRS for tax returns. 65 percent of these requests were for two counter-intelligence (COINTELPRO) programs conducted by the FBI—the Key Activist program aimed at leaders of the anti-Vietnam War movement, and the Key Black Activitis program, aimed at leaders of the so-called Black Nationalist movement. In addition, the FBI made numerous ongoing requests to the IRS for lists of contributors to ideological organizations under investigation by the Bureau. In this manner, the FBI obtained information offered voluntarily to the IRS by groups to assist in enforcement of the tax laws. Between 1957 and 1972, the Central Intelligence Agency made a number of unofficial requests to the IRS for tax return information on persons the CIA was investigating. Finally, the Senate Committee that investigated the Watergate burglary revealed extensive use of IRS records by the White House against political opponents of the Nixon Administration. Indeed, abuse of tax information was one of the central components of the Nixon Administration's broad pattern of intelligence operations aimed at harassing and intimidating political "enemies."

Before the Tax Reform Act of 1976, the IRS lacked any meaningful standards by which to judge the numerous requests for information it received from other government agencies. Though a procedure for determining the legitimacy of requests did exist, it was so vague, and so widely ignored as to be useless. Indeed, in 1968 when the Chief of Disclosure of IRS learned of the procedure, he termed it "illegal." The Church Committee found that in the absence of any meaningful guidelines, the IRS could not judge whether the request was legitimate. Consequently, the Committee noted, the "IRS had delegated the determination of the propriety of the request to the requesting agency." "Final Report," Senate Select Committee to Study Government Operations. With respect to Intelligence Activities, Book III, p. 840.

The Tax Reform Act was designed to remedy this legacy of abuse of IRS information. Although the Act is by no means stringent, it provides a degree of protection of IRS records. It requires the government to meet a reasonable standard of proof to justify disclosure. Furthermore, such disclosure may only be made following the independent judgment of a federal judge. These safeguards were all designed with specific reference to known abuses of IRS information by government agencies.

SENSITIVE NATURE OF TAXPAYER INFORMATION

A person's tax returns, and the records of his financial transactions with a bank or another private entity, are a reflection of that person's life. Those records mirror, often in great detail, the personal habits and associations of individuals. The beginning of a tax return gives name, address, social security number, identity and dependents and the taxpayer's gross income. Various schedules may indicate political and religious affiliations and activities, medical or psychiatric treatment, union membership, creditors, investments and holdings. Additional documents compiled by the taxpayer and pertaining to statements made on a tax return but not filed with the return contain a similar wealth of sensitive personal information. In 1975, the then IRS Commissioner Donald Alexander noted that the IRS has "a gold mine of information about more people than any other agency in this country." Committee Print, "Confidentiality of Tax Returns," House Committee on Ways and Means, September 25, 1975, at 3.

Apart from information related to tax returns, documentary materials routinely obtained by IRS for the enforcement of the tax laws also contain vast quantities of private information. Bank records, or similar records, reveal the political causes one supports, the books and magazines one buys, the organizations one joins, as well as one's style of life, tastes and habits. People assume that these matters are confidential, and that they do not sacrifice that confidentiality when they conduct financial transactions with the assistance of a bank. This assumption has been acknowledged and embraced by courts across the country. As one state court has noted: [I]t is impossible to participate in the economic life of contemporary society without maintaining a bank account. In the course of such dealings, a depositor reveals many aspects of his personal affairs, opinions, habits and associations. Indeed, the totality of bank records provides a virtual current biography. . . . *Burrows* v. *Superior Court,* 13 Cal. 3d 238, 529 P.2d 590 (1974).

I make these opening observations so that it is clear that the privacy interest an individual has in his or her tax return and bank records is formidable, and must be taken fully into account. In introducing the proposed amendments to the Internal

Revenue Code under discussion, Senator Nunn noted that "a balance must be struck between the privacy of tax returns and the legitimate needs of law enforcement agencies." "Congressional Record," March 11, 1980, p. S2375. The hearings that generated these bills contained testimony principally from law enforcement officials concerning the asserted needs of law enforcement agencies. If the balance to which Senator Nunn referred is to be stuck fairly and accurately, it is essential that the privacy interests of individuals be given equal weight.

THE EXTRAORDINARY POWERS OF IRS

The IRS is accorded enormous, unparalleled coercive power to obtain information from individuals concerning every aspect of their private lives. The IRS may, without a subpoena or a warrant or any showing of probable cause, require an individual to divulge information. Because of the clear threat such broad powers hold to an individual's constitutional rights to be free from government coercion, the Supreme Court has carved a narrow "required records" exception to the Fifth Amendment, principally for the benefit of IRS. See *United States* v. *Sullivan,* 274 U.S. 259 (1927). This exception and the extraordinary authority which Congress has bestowed on IRS create a powerful presumption against any attempt to transfer that authority to other agencies of government.

The statutory authority of IRS to obtain information must not be viewed as creating some form of governmental asset which may then be transferred to other arms of the government pursuing legitimate governmental objectives. The information gained by the IRS does not in any sense "belong" to the Government. Rather, it is held in special trust by the IRS for its unique, important purpose of collecting taxes. Indeed, it is only the unique nature of the IRS function that justifies the extraordinary degree of intrusion that the agency is allowed to make into the lives of individuals. Dissemination of IRS information to other governmental agencies for non-tax purposes, however meritorious, is a violation of the IRS' special trust.

In introducing S. 2402-2405, Senator Nunn identified as his central concern the insufficient level of participation of IRS in the government battle against organized crime and large drug trafficking. In our view, casting the question in that light fundamentally distorts the realities of the situation. The IRS is not designed to participate in that battle. Its extraordinary powers were granted for quite another purpose—the collection of revenue and enforcement of tax laws—and are limited to that purpose. to the extent that the IRS has, in the past, strayed from that purpose, it has operated outside its charter. Measures taken to remedy that impropriety are to be lauded; to portray the Tax Privacy Act of 1976 as withdrawing the IRS from the battle against crime is misleading and harmful.

Governmental agencies such as the Department of Justice, the Drug Enforcement Administration and the Federal Bureau of Investigation are not—and should not be—empowered to exercise the same authority as the IRS to compel and use personal records and other information about virtually the entire public. As the Privacy Protection Study Commission noted in its 1977 report: It is understandable that other agencies with important responsibilities want to use information the IRS has authority to collect, but they have not, in fact, been vested with the IRS' authority to compel such information. [Report at p. 540.]

We believe that dissemination of taxpayer information and records by IRS to other government agencies, and the summoning of financial records by IRS, threaten the constitutional policy underlying the Fifth Amendment right to be free from compulsion of self-incriminating statements.

The Fifth Amendment protects an individual from government coercion in a criminal prosecution. In most instances, the government may not compel an individual to divulge information that might tend to incriminate him. The "required records" exception of the Fifth Amendment was created in part to allow the IRS to require individuals to divulge information that might otherwise be protected by the privilege against self-incrimination. Failure to provide information sought by the IRS is a felony punishable by statute (26 U.S.C. § 7602). Alternatively, the government may issue a summons to the taxpayer or to third parties that will yield information to the IRS. In either case, the information is effectively obtained by IRS through compulsion. The use of that information in a non-tax criminal proceeding, therefore, is sharply at odds with the constitutional policy underlying the Fifth Amendment.

In order to promote fair and efficient administration of the revenue laws and collection of taxes, it is essential not to burden the filing of taxpayer returns with Fifth Amendment problems. If a taxpayer believed that the information he or she was providing to IRS might be routinely made available to other law enforcement agencies, he or she might be disposed to be less cooperative with IRS. The taxpayer would be put in the position of having to scrutinize all of the revelations on the

return and determine their relevance to any possible criminal investigation. If as a result of this guesswork, the taxpayer determined the possibility of self-incrimination, he would, at that time, claim a Fifth Amendment privilege, for fear of losing it otherwise at a later stage. See *Garner* v. *United States,* 424 U.S. 628 (1976). This process would make the tax collecting process so complex and so cumbersome as to render it fundamentally ineffective. The Privacy Commission expressed concern for this result in noting that "widespread use of the information a taxpayer provides to the IRS for purposes wholly unrelated to tax administration cannot help but diminish the taxpayer's disposition to cooperate with the IRS voluntarily. . . . Such a tendency in itself creates a potentially serious threat to the effectiveness of the federal tax system." "Report of the Privacy Protection Study Commission," p. 540.

These impediments are unjustified. Moreover, they are unnecessary. The number of potentially valid Fifth Amendment claims would be small in comparison with the total number of people filing returns. The more practical solution is to allow the tax return process to go unimpeded by Fifth Amendment considerations—and that is precisely why the "required records" exception to the Fifth Amendment was created, and why it was limited to circumstances such as revenue collection.

These broad questions of constitutional policy concerning the disclosure and dissemination of tax information provide the background against which the specific amendments under discussion today must be viewed. Because the IRS has been accorded special and extraordinary powers, we are fundamentally opposed to any dissemination of tax information within the government. If, in some extraordinary case, such dissemination is authorized by statute, we believe it is essential that in order to justify it, the government must meet a high burden of proof. From this perspective, we are not satisfied with § 6103 as currently written, but we strongly oppose any attempt to further dilute its protections of taxpayer privacy.

I will now highlight the specific objections we have to the proposed amendments. Most of them involve changes embodied in S. 2402.

NARROWING OF THE DEFINITION OF PROTECTED TAXPAYER INFORMATION

The bill collapses the current three-tier classification of IRS information into two categories. This change would substantially diminish the protection afforded the information in IRS records. Under existing law, the government must obtain a court order to gain access both to taxpayer returns and to what is called "return information." The later category includes any information the IRS collects or obtains from the taxpayer with reference to the return. Such information might include documents substantiating claims for deductions, contributions or related expenditures. Current law protects this information with the court order requirement precisely because it is at least as sensitive as the information on the face of the return.

Under the proposed two-tier classification scheme of S. 2402, any taxpayer information or documents which are not taxpayer returns would be available to the government upon receipt of a written request by an attorney for the government. No independent judicial check on these disclosures is required. Moreover, the bill places on the IRS an affirmative duty to disclose any such information to the government which may be pertinent to a federal criminal investigation.

We submit that this change in definitions eliminates much of the protection of § 6103. The comment to the proposed change explains that the bill "enables us to separate those items which deserve a higher degree of privacy and hence a court order for disclosure, from those items that IRS, like any other investigative agency, uncovers in a typical investigation." This is misleading. It is by no means clear that the information on the return is the information deserving of a higher degree of privacy. Indeed, there is good reason to believe that other information compiled and maintained by IRS is of an even more private nature.

The proposed new definition of protected taxpayer information draws a distinction between an individual's tax returns and a corporation's tax returns, apparently on the assumption that a corporation's returns do not contain sensitive information concerning individuals. Such a premise is unjustifiable. A corporation's tax return can reflect a person's stock holdings, how he or she voted on internal matters and confidential communication between the corporation and an individual.

STANDARDS OF PROOF

S. 2402 would substantially lower the standards of proof that a government agency must meet in order to obtain access to taxpayer information.

Prior to the enactment of the Tax Reform Act, the Privacy Commission recommended that when another government agency requests taxpayer information from IRS, the taxpayer be given notice, and an opportunity to contest the disclosure. Disclosure could then be authorized by a court only if it found:

a. probable cause to believe that a violation of civil or criminal law has occurred.
b. probable cause to believe that the tax information requested from the IRS provides probative evidence that the violation of civil or criminal law has occurred; and
c. that no legal impediment to the applicant agency acquiring that information sought directly from the taxpayer exists.

REPORT OF THE PRIVACY PROTECTION STUDY COMMISSION, PP. 553-4

The Tax Reform Act clearly fell short of these proposed safeguards. An *ex parte* proceeding requiring a demonstration of reasonable cause is considerably less rigorous than an adversary proceeding demanding probable cause. Further, the third consideration, that no legal impediment exist to direct solicitation from the individual, was overlooked altogether.

The proposal in S. 2402 would further undermine taxpayer privacy by eliminating altogether the requirement of a court proceeding, or demonstration of reasonable cause with respect to the disclosure of non-return information. Substituted for these safeguards would be the word of the government attorney that the information sought is material to an ongoing investigation. In short, the proposed legislation eliminates any protection of tax information held by the IRS, other than the tax return itself.

S. 2402 also reduces the standard of proof required to justify issuance of an ex parte order for dissemination by the IRS of the actual tax return. We oppose this further erosion of taxpayer privacy protection.

Section 6103 of the Tax Reform Act now requires a showing that there is reasonable cause to believe that:
a. a specific crime has been committed;
b. the information sought is probative evidence of a matter related to that criminal act; and
c. the information cannot be obtained elsewhere.

Again, these statutory standards fall short of the Privacy Commission recommendations. However, S. 2402 would further reduce the safeguards. Under S. 2402, the government need show only that:
a. the application is made in connection with a lawful judicial or administrative proceeding or an investigation that may result in such a proceeding; and
b. there is reasonable cause to believe that the information sought is material and relevant to such a proceeding or investigation.

While the "reasonable cause" language is retained, the bill affects several changes damaging to taxpayer privacy. There is no requirement that the evidence be probative; there is no requirement that the information be otherwise unobtainable. Materiality to an ongoing investigation is considerably less than probative of a specific crime.

For example, if the Department of Justice were engaged in an ongoing investigation of a suspected criminal enterprise, the proposed standard would allow the Department to gain access to tax records of any individuals associated in any way with that enterprise. No specific crime need be alleged, nor any demonstration that the information is itself probative of a suspected crime. While it may be argued that the focus of the amendment is on drug trafficking and organized crime, it is too easy to forget that similarly loose standards created the enormous record of abuses of IRS disclosures prior to the enactment of the Tax Reform Act.

There is little factual documentation of the need for these changes in the standard of proof in the Tax Reform Act. When asked to supply such information, the General Accounting Office was unable to do so. In fact, in March 1979 the GAO issued a study of the disclosure and summons provisions of the Tax Reform Act, which concluded that "the adverse impact on coordination between IRS and other members of the law enforcement community as a result of the disclosure provisions has not been sufficiently demonstrated to justify revising the law." Report by the "Comptroller General, Disclosure and Summons Provisions of 1976 Tax Reform Act—Privacy Gains and Unknown Law Enforcement Effect," March 12, 1979. Not only are the good intentions of the sponsors inadequate to justify legislation of such potentially harmful consequences, but there is no clear evidence that the proposals would achieve their intended goal.

REDISSEMINATION

S. 2402 contains no check on the chain of dissemination of taxpayer information within the government. Indeed, the bill explicitly provides that: "The attorney for the Government may further disclose non-return information to such government personnel as he deems necessary to assist him. . . ."

The comment to the bill notes that this provision is almost identical to the grand jury secrecy rules. This comment overlooks the crucial fact that in grand jury proceedings, the government cannot compel self-incriminating testimony, at least without a grant of immunity. Since the fundamental issue here is the use of information that is coerced without a grant of immunity, the analogy the comment draws is inapproriate.

The government must meet an extraordinarily high burden to justify dissemination. Once that burden is met at the outset, the removal of all barriers to further dissemination is not justifiable. We suggest that in effect, walls be placed at every step of the process so that highly sensitive information not be disseminated throughout the government on the judgment of the government attorney.

DISSEMINATION TO STATE AGENCIES

The bill provides for disclosure of IRS information to state law enforcement officials if the information is relevant to investigative or prosecution of a state felony. This proposal is flatly at odds with a Privacy Commission recommendation that disclosure of tax information to the states be limited to tax related prosecutions. Indeed, the Commission was sufficiently concerned about the potential for abuse that exists in inter-governmental disclosure that it suggested limitations even on tax related disclosure. "Commission Report," pp. 546-47. Dissemination of taxpayer information is an extraordinary invasion of the privacy of individuals, justified only in extraordinary circumstances. The provision allowing dissemination to state agencies is not justified by such circumstances. Rather, it treats intergovernmental disclosure as a routine matter of coordinating law enforcement, so as to make it more effective. Tax returns should not be treated as a common resource for criminal investigations at all levels of government.

DISCLOSURE FOR FEDERAL CIVIL LITIGATION

S. 2402 would allow a government attorney further to disclose information if the attorney believes that the information is relevant to any federal civil litigation. Again, the basic threat inherent in this provision is that disclosure of information that is sensitive, and has been divulged under governmental coercion, is treated not as the extraordinary matter that it is, but as a commonplace component of federal investigation.

The sponsors of these measures have touted them as essential to the federal government's fight against organized crime and large-scale drug trafficking. Even assuming the validity of that claim, it certainly does not justify this extraordinary additional measure of permitting disclosure for civil litigation. Furthermore, the proposal does not even require that the attorney seeking disclosure establish any connection between the criminal investigation for which the original IRS disclosure was justified, and the civil investigation for which disclosure is sought. The official comment to S. 2402 claims that GAO found that the government had "lost" federal civil cases of substantial size because of the disclosure provisions of § 6103. In fact, the GAO reported only one such case, and in that one case, it appears that the disclosure provisions had nothing to do with the investigating agency's inability to obtain the information sought. GAO Report, p. 17.

DISCLOSURE TO FOREIGN GOVERNMENTS

S. 2402 also authorizes disclosure of information to foreign governments with whom the United States has mutual assistance treaties. Apart from the objection we noted to disclosure to state officials, which applies with equal or greater force to this provision, such disclosure is problematic for another reason. A nation with whom the United States has a mutual assistance treaty could seek access to taxpayer records for use in criminal investigation for which the standards of proof are dissimilar from those in the United States. Moreover, what is a crime in a foreign country may not be criminal in the United States. The extraordinary coercive powers of the IRS should not be used to gain information about individuals which would then be used for purposes not only different from those for which the information was obtained, but also unsupported by any legitimate United States interest.

SUMMONS PROCEDURES

As for S. 2403, which changes existing law (26 U.S.C. § 7609), we have two objections. First, the bill would shift the burden in a summons enforcement proceeding from the government to the taxpayer. This change reverses the basic presumption of our legal system, which is that the party seeking disclosure of information must bear the burden of going to court in order to justify that disclosure. Propo-

nents of this change argue that S. 2403 simply brings the summons procedure into accord with procedures established by the Right to Financial Privacy Act of 1978 for all other agencies of the federal government. However, since IRS routine access to information about the financial dealings of individuals is vastly greater than any other agency, that analogy makes little sense. The special powers of IRS create a presumption against additional compulsory disclosure.

We also oppose the part of S. 2403 which would abolish the automatic stay provisions of § 7609. Proponents cite the excessive delays which allegedly are created by existing law. However, the problem of time delays exists separately from the question of issuance of a stay to disclosure proceedings. Current law provides for automatic stays precisely because of the presumption against disclosure that exists as a basic component of the process. The question of time delays is properly dealt with by imposing time limits, which are provided for elsewhere in S. 2403, and not by altering a provision which enacts an important policy of privacy protection.

EXPEDITING PROCEDURES

We do support some of the proposed changes that would facilitate the process, provided adequate standards of privacy protection are met. We endorse the imposition of time limits; the extension to magistrates of the authority rule on government applications; and the provision allowing attorneys for the government, rather than heads of agencies, to apply for disclosure. In short, we endorse changes in the Tax Reform Act that will allow a constitutionally sound process, which respects individual rights, to proceed more expeditiously.

CONCLUSION

The claim that the proposed amendments put the IRS back into the fight against organized crime and drug traffic is a distortion. The IRS does not belong in that fight. Its special powers are not granted to facilitate law enforcement. To the extent that IRS in the past has been used as an investigative resource for other government agencies, its special authority was abused. The Tax Reform Act of 1976 was passed to correct those abuses. The current amendments threaten to undermine the Act by redefining the information that deserves protection, lowering the standard of proof necessary to justify disclosure and opening broader channels of dissemination. These changes carry with them an enormous potential for abuse and should not be adopted.

Summary of Statement of Charles M. Walker, Chairman, Section of Taxation, American Bar Association

PART A—S. 2402, S. 2404 AND S. 2405

1. We support S. 2402's retention of the requirement that another federal agency must obtain a court order before tax returns may be disclosed by the Internal Revenue Service for use in a non-tax criminal investigation or proceeding. We recommend, however, that the definitions of "return" and "non-return information" be restated and that the bill provide that information from tax returns or information obtained from the taxpayer or his representatives also will not be disclosed without a court order.

2. We support the provisions of S. 2402 that would eliminate the requirement that it be proved that the information sought cannot reasonably be obtained from another source or that the tax information is the most probative evidence of the matter in issue before such information can be disclosed. However, we oppose the elimination of the present law requirement that there must be reasonable cause to believe that a specific criminal act has been committed. It is not enough to require only that the disclosure be in connection with an investigation relating to enforcement of a criminal statute.

3. We agree that the procedures in present law relating to the Service's disclosure of non-return information that may constitute evidence of a federal crime are improved by making such disclosures mandatory. However, we recommend that the definitions of "return" and "non-return information" be restated, and that the bill provide that procedures proposed for disclosure without a court order apply only to tax information other than a return, information obtained from a return or information obtained from a taxpayer or his representative. We also object to the disclosure of information in "exigent circumstances" unless that term is more precisely defined.

4. We agree that the provisions of present law should be broadened to permit U.S. Attorneys to seek returns and tax information and to permit District Directors to

disclose returns and tax information within the limits S. 2402 describes. However, we recommend that the bill's delegations of authority be narrowed somewhat.

We recommend that within the Department of Justice the authority to make application for a court order and request for the disclosure of tax information should not be granted to any head of a Regional Office of the Department of Justice or a supervisory attorney specifically "designated by the Attorney General". We recommend that within the Internal Revenue Service the authority to disclose properly disclosable information should not be granted to any Assistant Regional Commissioner in charge of the Criminal Investigation Division of the Internal Revenue Service or to any chief of the Criminal Investigative Division of any local Internal Revenue Service office.

5. We recommend: (*a*) the retention, as in present law, of a monetary penalty applicable to the Internal Revenue Service employee who discloses tax information protected from disclosure; (*b*) the imposition of a monetary penalty on the federal government employee who receives such improperly disclosed information; (*c*) we support the bill's provision setting forth an affirmative good faith defense against such penalties; and (*d*) we support the elimination of civil damage awards against IRS employees in most situations.

6. In connection with non-tax related law enforcement, we oppose the disclosure, merely upon the written request of the appropriate Justice Department attorney, of a taxpayer's address and social security number and whether he has filed a tax return for any year. We recommend instead that this information be disclosed only on court order, as under current law.

7. We support S. 2402's requirement for judicial review of an Internal Revenue Service decision not to disclose returns and non-return information that would identify a confidential informant or seriously impair a civil or criminal tax investigation, but we oppose the provision that the suit for judicial review be instituted by the Internal Revenue Service rather than by the Department of Justice.

8. We oppose the re-disclosure of returns and non-return information by a Justice Department attorney to state law enforcement officials or to other federal officials in connection with federal civil litigation, and recommend instead that disclosure remain limited as under current law.

9. Although the proposed legislation does not contain a distinction between books, records and tax information of individuals and books, records and tax information of other taxpayers so as to permit federal agencies to obtain corporate tax books and records without a court order, we understand that such a proposal may be presented to this Subcommittee. We oppose such a distinction between individuals and corporate taxpayers.

PART B—S. 2403

1. The Section of Taxation supports the basic amendment contained in section 4 of S. 2403 which would shift the burden of initiating judicial proceedings for a review of an administrative summons from the Interal Revenue Service to the taxpayer, provided satisfactory provisions are adopted with respect to the suspension of the Statute of Limitations. Procedures should be established which would guarantee that the motion to quash procedures provided for in S. 2403 will not, in fact, confer upon the Government or an individual employee of the Government the ability to arbitrarily force a suspension of the running of the Statute of Limitations on the assertion of a tax claim. We have noted a number of procedures in our written statement that might be considered.

2. In the absence of strong evidence that the requirement of existing law that courts give priority to enforcement proceedings causes substantial delays, we support the proposal that District Courts must rule in such proceedings within 10 days, and we oppose the elimination of the taxpayers' rights under existing law to appeal an adverse decision in such proceedings. Furthermore, we strongly urge the retention of the existing right of a third-party recordkeeper to appeal an adverse decision.

3. We are concerned that the provisions of S. 2403 will result in an unnecessary multiplicity of legal proceedings. We believe that a better judicial procedure, which would simplify procedures for assertion of alleged defects in a summons and which would provide for a speedier judicial consideration, is to require that all issues regarding enforcement of the summons be raised in a single proceeding. The statute should also provide that an order entered by a District Court or magistrate is a final order, which is appealable under 28 U.S.C. section 1291.

4. We oppose the provisions of S. 2403 that would limit the third-party recordkeeper summons provision to records of individual taxpayers or partnerships consisting of five or fewer individual members. The right to notice and to contest an administrative summons is in the nature of a Fourth Amendment right applicable

to all taxpayers, including corporations, as distinguished from Fifth Amendment rights, which are generally not available to corporations.

5. We have a series of technical changes with respect to S. 1403 that we discuss commencing on page 41 of our written statement. We will be pleased to discuss these at greater length at the convenience of the Subcommittee and its staff.

Statement of Charles M. Walker, Chairman, Section of Taxation, American Bar Association

INTRODUCTION

The Section of Taxation of the American Bar Association is joined by the Section on Individual Rights and Responsibilities in expressing the views set forth below with respect to S. 2402, S. 2404 and S. 2405. The Section of Taxation alone is expressing its views with respect to S. 2403. The views expressed are those of the Sections only and should not be construed as the views of the Association. Neither the House of Delegates nor the Board of Governors of the Association has considered the matter and has not established a position.

The Section of Taxation and the Section on Individual Rights and Responsibilities will be referred to in Part A by use of joint terms.

PART A—S. 2402, S. 2404 AND S. 2405

I. Summary

We are sympathetic with the bills' objective to simplify procedures and remove unnecessary roadblocks applicable when a federal agency seeks information from the Service to aid law enforcement in other areas. Some revisions to the bills are necessary, however, to strike a better balance between effective law enforcement and taxpayers' important substantive rights of privacy. Our positions on the changes the proposed legislation would make to section 6103 and related sections of the Code are as follows:

1. We support S. 2402's retention of the requirement that another federal agency must obtain a court order before tax returns may be disclosed by the IRS for use in a non-tax criminal investigation or proceeding. We recommend, however, that the definitions of "return" and "non-return information" be restated and that the bill provide that information from tax returns or information obtained from the taxpayer or his representatives also will not be disclosed without a court order.

2. We agree with some, and disagree with some, of S. 2402's proposed changes in the standard of court-ordered disclosure of returns and return information.

3. We agree that the procedures in present law relating to the Service's disclosure of non-return information that may constitute evidence of a federal crime are improved by making such disclosures mandatory. Again, however, we recommend that the definitions of "return" and "non-return information" be restated and that the bill provide that procedures proposed for disclosure without a court order apply only to tax information other than a return, information obtained from a return, or information obtained from the taxpayer or his representative. We also object to the disclosure of information in "exigent circumstances" unless that term is more precisely defined.

4. We agree that the provisions of present law should be broadened to permit U.S. Attorneys to seek returns and tax information and to permit District Directors to disclose returns and tax information within the limits S. 2402 describes, but recommend that the bill's delegations of authority be narrowed somewhat.

5. We (*a*) recommend the retention, as in present law, of a monetary penalty applicable to the Internal Revenue Service employee who discloses tax information protected from disclosure; (*b*) recommend the imposition of a monetary penalty on the federal government employee who receives such improperly disclosed information; and (*c*) support the bills' provision of an affirmative good faith defense against such penalties.

6. In connection with non-tax related law enforcement, we oppose the disclosure, merely upon the written request of the appropriate Justice Department attorney, of a taxpayer's address and social security number and whether he has filed a tax return for any year, recommending instead that this information be disclosed only on court order, as under current law.

7. We support S. 2402's requirement for judicial review of an IRS decision not to disclose returns and non-return information that would identify a confidential informant or seriously impair a civil or criminal tax investigation, but oppose the provision that the suit for judicial review be instituted by the IRS instead of by the Department of Justice.

8. We oppose the re-disclosure of returns and non-return information by a Justice Department attorney to state law enforcement officials or to other federal officials in connection with federal civil litigation, recommending instead that disclosure remain limited as under current law.

9. Although the proposed legislation does not contain a distinction between books, records and tax information of individuals and books, records and tax information of other taxpayers so as to permit federal agencies to obtain corporate tax books and records without a court order, we understand that such a proposal may be presented to this Committee. We oppose such a distinction between individual and corporate taxpayers.

II. Discussion

As chairman of the Section of Taxation of the American Bar Association, I welcome the opportunity to express the views of that Section, which, I am authorized to say, also reflect the views of the Section on Individual Rights and Responsibilities, on S. 2402, S. 2404 and S. 2405. Those bills would amend sections 6103, 7213 and 7217 of the Internal Revenue Code of 1954 insofar as they relate to the disclosure by the Internal Revenue Service of tax returns and tax information to other federal agencies for use in non-tax investigations and proceedings. The Section of Taxation has maintained a continuing interest in the privacy and confidentiality of tax returns and tax information since the introduction of legislation affecting Section 6103 which eventually became part of the Tax Reform Act of 1976, and to that end has maintained a Special Committee on Confidentiality of Tax Returns to review proposed legislation, regulations and other developments in this area.

The Section of Taxation and the Section of Individual Rights and Responsibilities support the federal government's efforts to investigate and prosecute non-tax crimes forcefully and effectively. In our view, S. 2402, S. 2404 and S. 2405 would improve the government's investigative and prosecutorial tools. However, the need for privacy and confidentiality of taxpayers' returns and tax information, on which much of our tax system depends, requires some modifications in the proposed legislation to protect privacy interests while streamlining law enforcement processes. The Tax Reform Act of 1976 generally struck a proper balance between the need for taxpayer privacy and the government's need to investigate and prosecute non-tax crime, and some of the changes proposed in S. 2402, S. 2404 and S. 2405 would upset a desirable balance and improperly violate taxpayers' right to privacy. The major objective of the bills can be achieved, however, without significantly reducing taxpayer privacy, if certain modifications are made.

1. Court order requirement.—Prior to the 1976 Tax Reform Act amendments to Section 6103, a Justice Department attorney or U.S. Attorney was able to obtain tax information from the Service whenever "necessary in the performance of his official duties." A written application, signed by the Attorney General, Deputy Attorney General, and Assistant Attorney General, or the U.S. Attorney involved in the case was required. As a practical matter, Justice Department attorneys and U.S. Attorneys obtained requested tax information at their own discretion because there were no standards for or restrictions on disclosure of this kind of information.

In 1975, for example, U.S. Attorneys made 1,350 disclosure requests relating to 17,678 tax returns of 4,330 taxpayers. S. Rep. No. 938, 94th Cong., 2d Sess. 327 (1976). A significant proportion of these requests were for criminal investigative purposes. Justice Department Strike Forces made 166 requests for tax information relating to 8,103 tax returns of 1,711 taxpayers, and the DOJ's Criminal Division made an additional 62 requests for tax information.

In 1976, the Section of Taxation stated its opposition to the unlimited disclosure of returns and return information for non-tax administrative or judicial proceedings. Congress agreed that pre-1976 law did not afford citizens the degree of privacy to which they we entitled. As a result, the Tax Reform Act of 1976 amended Section 6103 to require a federal agency to obtain an ex parte court order from a federal district judge for disclosure of tax returns and other tax information obtained from the taxpayer or his representative for use in non-tax investigations and proceedings. Under the 1976 law, a court order was not necessary to obtain disclosure of tax information received from third parties.

The 1976 legislation represents a delicate balance between the efforts of government agencies to investigate and prosecute illegal activities and taxpayers' substantive rights of privacy and confidentiality. The Senate Report explains that subtantial controversy arose as to whether actual and potential disclosures of tax return and return information to other federal and state agencies breached the American citizens' reasonable expectation of privacy in regard to such information. See S. Rep. No. 938 at 317. Another important issue was whether the public's reaction to a perceived abuse of privacy would impair the effectiveness of this country's "very successful voluntary assessment system, which is the mainstay of the federal tax

system." Id. Another more general concern was whether tax returns and tax information should ever be used for any purposes other than tax administration. Id. Thus, the 1976 Tax Reform Act represents a broad consensus as to the appropriate degree of intrusion on taxpayer's privacy in aid of non-tax law enforcement. See Parnell, "The Right to Privacy and the Administration of the Federal Tax Laws," 31 *Tax Lawyer* 113 (1977).

S. 2402 would retain the requirement of a court order for some disclosures for non-tax purposes. It would, however, significantly amend the definitional provisions (proposed new section 6103(b)(1) and (2)), changing the present three categories—"returns," "taxpayer return information," and "return information"—to only two categories, "returns" and "non-return information." The bill provides that the court order is required only for the returns themselves (proposed new Section 6103(i)(1)), thus permitting Justice Department attorneys and U.S. Attorneys upon mere written request to obtain all other tax information, including tax information obtained from the taxpayer or his representative (proposed new Section 6103(i)(2)).

The Internal Revenue Code not only requires taxpayers to file tax returns, but also requires them to maintain books and records adequate to prove their tax liabilities. Under the three-part definition of present law, a court order is required before tax returns, information from tax returns or other information obtained from the taxpayer or his representative may be disclosed. Taxpayers are entitled to a high degree of privacy for tax returns and tax information obtained from them or their representatives and supplied to the Service to support the tax return. Moreover, the American taxpayers' expectation of privacy is a significant factor in the high overall compliance with our self-assessment system. Any erosion of this privacy right, at a time when taxpayer compliance already is under great pressure, would adversely affect taxpayers' willingness to comply with tax reporting requirements and voluntarily to supply, directly or through a representative, tax information to the Internal Revenue Service.

Moreover, a March 12, 1979 General Accounting Office Report concluded that the effectiveness of federal law enforcement under current law has not suffered sufficiently to warrant revisions in the disclosure provisions. We suggest that problems in coordinating federal law enforcement efforts that have arisen since the effective date of the 1976 Tax Reform Act are due to the administrative adjustments necessary under that law. Since the publication of the GAO Report, press accounts have noted that administrative improvements and greater cooperation between the Service and the Justice Department have resulted in more effective investigation and prosecution of non-tax crimes under present law.

Consequently, we urge that S. 2402 be revised to provide that a court order be required not only for disclosure of a taxpayer's tax return, but also for disclosure of any tax information obtained from the taxpayer or his representative. Without such revision, the proposed legislation risks invading substantive rights of taxpayers and upsetting the delicate balance established under the 1976 Tax Reform Act.

2. Standards for court-ordered disclosure.—Present Section 6103(i)(1) provides that before a court will issue a disclosure order there must be reasonable cause to believe (1) that a specific criminal act has been committed; (2) that the return or return information is probative evidence of a matter in issue related to the commission of the criminal act; and (3) that either the information cannot reasonably be obtained from any other source, or that tax information is the most probative evidence of the matter in issue.

S. 2402 (in proposed new Section 6103(i)(1)(A)) would eliminate the third standard and restate the first two standards as: (1) disclosure is sought in connection with a lawful administrative, judicial, or grand jury proceeding or investigation relating to the enforcement of a specifically designated federal criminal statute, and (2) there is reasonable cause to believe that the information is material and relevant to such a proceeding or investigation.

We understand that the courts have considered the third standard of present Section 6103(i)(1) to be virtually impossible to satisfy. As a result, the courts have interpreted the section along the lines S. 2402 proposes. Consequently, we agree with the portion of S. 2402 which drops the third standard. We do not agree, however, with elimination of the present law's requirement that there must be reasonable cause to believe that a specific criminal act has been committed. It is not enough to require only that the disclosure be in connection with an investigation relating to enforcement of a criminal statute.

3. Mandatory disclosure of tax information obtained from third parties.—Section 6103(i)(3) now provides that the Service may disclose return information that may constitute evidence of a violation of federal criminal laws to apprise the head of the appropriate federal agency of the possible commission of a crime. The area of

permissible disclosure includes only tax information obtained from persons other than the taxpayer or his representative.

S. 2402 would amend Section 6103(i)(3), renumbering it as Section 6103(i)(4), to require the Service, on its own initiative, to disclose (described here as "phase 1 disclosure") to a Justice Department attorney or U.S. Attorney all tax information except returns that may constitute evidence of a violation of any federal criminal statute, or which may be pertinent to a federal criminal investigation, to the degree necessary to permit the attorney to request tax information (described here as a "phase 2 disclosure request") pursuant to Section 6103(i)(2), discussed above.

Again, we support a revision to S. 2402 to require a court order for a phase 1 disclosure of tax information obtained from the taxpayer or his representative. With this revision, we approve S. 2402's mandatory phase 1 disclosure rule, i.e., the disclosure should be mandatory, not merely discretionary. Since there is not the same right or expectation of privacy for tax information obtained from a third party, the absence of a court order from S. 2402's mandatory phase 1 disclosure rule will not unduly prejudice taxpayers' rights in the process of aiding federal law enforcement.

We do not believe, however, that phase 1 disclosure of tax information should be left to the discretion of the particular Service employee who has the information. Consequently, we recommend that the persons authorized to make such disclosures be limited to those described in Part 4 of this statement, and that the criminal penalty and civil damage provisions be revised as discussed in Part 5 of this statement. Those revisions to the requirement of mandatory phase 1 disclosure should not place too great a burden on Service employees.

S. 2402 (in proposed Section 6103(i)(4)(B)) would require mandatory disclosure of returns and any other tax information "Under exigent circumstances, including a possible threat to persons, property or national security." Disclosure would be directly to the appropriate federal investigative agency charged with enforcing the applicable law, and would encompass information necessary to apprise the agency of the possible threat. The Service then would be required to notify a Justice Department attorney or U.S. Attorney and the appropriate federal district court of the disclosure.

While we generally support the idea behind the proposed change, we are deeply concerned about the vagueness and deficiencies of the proposed statutory language, particularly the term "national security." The term "exigent circumstances" must be defined more specifically, and all-inclusively, in the statute. Without a satisfactory definition, we oppose the provision.

4. Persons authorized to apply for court order or to request and make disclosures.—Present Sections 6103(i) (1) and (2) require that application for court ordered-disclosure and requests for disclosure of tax information obtained from third parties must be made by agency heads or the Attorney General, Deputy Attorney General or an Assistant Attorney General. Until very recently, the practice of the Internal Revenue Service was that disclosure of requested returns and tax information, including information obtained from third parties, had to be approved in the National Office of the Service. Effective June 1, 1980, however, Delegation Order No. 156 (Rev. 1) was amended (Amendment 1, 45 Fed. Reg. 38199, June 6, 1980) to delegate the authority to disclose requested returns and tax information to additional officials of the Service, and more particularly to Service officials in the field.

S. 2402 (by the definition in proposed Section 6103(b)(9) and the applicable portions of proposed Sections 6103(i) (1) and (2)) would centralize within the Justice Department the authority to apply for the court order to request tax information. Thus, the bill deletes agency heads and, in the Justice Department, goes below an Assistant Attorney General to a "Deputy Assistant Attorney General, United States Attorney, Attorney in charge of a Criminal Division Organized Crime Strike Force, any other head of a Regional Office of the Department of Justice or a supervisory attorney specifically designated by the attorney General." Additionally, S. 2402 (proposed new Section 6103(b)(1)) would authorize certain field personnel designated by the Secretary of the Treasury, including Regional Commissioners and Assistant Regional Commissoners in charge of the Criminal Investigation Division, District Directors, and Chiefs of the CID of any local IRS office, to make requested disclosures.

We agree that the present law has been unnecessarily cumbersome and time-consuming in centralizing requests for disclosure and in making disclosures. However, we strongly believe that there should not be as broad a delegation of authority as the bill provides both for making requests and making disclosures. Rather, we recommend that within the Justice Department, the authority to make applications for a court order and requests for the disclosure of tax information should not

include "any other head of a Regional Office of the Department of Justice or a supervisory attorney specifically designated by the Attorney General."

Similarly, we recommend that within the Internal Revenue Service, the authority to disclose properly discloseable tax information, consistent with the Commisisoner's amended Delegation Order No. 156, not include an Assistant Regional Commissioner in charge of the Criminal Investigation Division of the Internal Revenue Service or the chief of the Criminal Investigation Division of any local Internal Revenue Service Office.

5. Monetary penalties.—Section 7213 states it is a felony to make an unauthorized disclosure of a tax return of tax information. S. 2404 provides as an affirmative defense to prosecution under that section that the disclosure resulted from a good faith, but erroneous, interpretation of Section 6103 while a federal employee was acting within the scope of his employment duties.

Section 7217 presently provides that civil damages can be obtained from a government employee and be awarded to a taxpayer for unauthorized disclosure of his return or return information. S. 2405 would amend that section to provide that if the disclosure was made within the scope of employment, such damages will be paid by the federal government, rather than the government employee, except where the disclosure was willful, corrupt, malicious or for money. The possibility that substantial civil damages could be imposed on Internal Revenue Service employees may in some instances have made them overly cautious when asked to disclose tax information. To avoid those situations and to facilitate proper disclosure, we support S. 2405.

While it may be that the affirmative defense provided by S. 2404 may already be in practical operation by court interpretation of existing law, we agree that S. 2404 should be enacted to assure that result. Certainly, we do not agree with some who have urged repeal of section 7213 on the ground that it would be emasculated by S. 2404. As Senator Nunn said in introducing S. 2402, the criminal penalty section of the Tax Reform Act has served the useful purpose of making IRS agents very cautious about disclosing tax returns, and thus enhances the "privacy of every individual's tax returns." See page S2376 of the March 11, 1980 Congressional Record.

We think it is relevant to point out here that where there is an illegal disclosure of tax information, there are always two parties involved—the one who discloses and the one who receives the disclosed information.Where they are both government employees, should they not be equally liable for penalties and civil damages? Accountability of the government employee-receiver of the illegal disclosure would assure against his exerting undue pressure for the disclosure. We therefore recommend that the Code be amended to provide for this additional penalty.

A jail sentence, however, is not a necessary penalty on either the giver or the receiver of an unauthorized disclosure because it would cause Service and other government employees to be overly cautious. A criminal fine should be adequate.

We support the "good faith" defense provided in S. 2404. No penalty should be imposed where proper procedures have been followed for securing and disclosing tax information, so long as there is no reason to believe otherwise, even if the disclosure turns out to have been improper.

6. Disclosure or taxpayer identification information.—Present section 6103(b)(6) defines the term "taxpayer identity" as the taxpayer's name, address and social security number. In connection with non-tax law enforcement, current law generally applies the court order requirement to any item of "taxpayer identity," although disclosure of information obtained from third parties under Sections 6103(i) (2) and (3) may include the taxpayer's name and address.

S. 2402 would replace present Section 6103(b)(6) with proposed new Section 6103(b)(3) defining the term "taxpayer identity" to include not only the former components but also information as to whether the taxpayer has or has not filed a tax return for any given year. The bill also would add a new Section 6103(i)(3), to require the Service to disclose taxpayer identity information to a Justice Department attorney or U.S. Attorney merely upon written request.

We submit that the current law as to disclosure of "taxpayer identity" in connection with non-tax law enforcement is adequate. The 1976 Tax Reform Act, which was the product of much discussion and compromise, deleted a rule of unlimited disclosure from the law. We recommend that the present court order requirement be retained as to identifying information. Accordingly, we oppose the disclosure of any information related to a taxpayer's name, address, Social Security number and filing status upon the mere written request of a Justice Department attorney in connection with non-tax law enforcement.

7. Requirement that the service rather than the Justice Department institute suit to maintain the confidentiality of an informant.—Under present law (Section 6103(i)

(1), (2) and (4)), the Service may not disclose tax information if disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation. The Service's determinaion is not subject to challenge. S. 2402 would permit a district court to rule on the Service's decision not to disclose such information, a change we approve. The proposed legislation, however, requires the Service to institute suit to maintain the confidentiality of such information (rather than requiring the Justice Department to institute suit to compel disclosure), a provision we do not support.

S. 2402's requirement (proposed new section 6103(i)(6)) that the Service, rather than the Justice Department, seek court review would place an unacceptable burden on Service employees to go to court to protect information, even where the Justice Department request might be made without sufficient care. If, in the considered judgment of the Service, disclosure would identify a confidential informant or impair a tax investigation, the presumption should be against disclosure.

A more workable approach is to permit the Justice Department to seek court-ordered disclosure enabling DOJ to contest the Service's decision. Thus, the information could be made available—a change from current law but only after the Justice Department is required to evaluate more than casually its need for the information.

8. Redisclosure to State officials and for Federal civil litigation.—S. 2402 would add a new Section 6103 (i)(7) authorizing a Justice Department attorney or U.S. Attorney to whom disclosure of tax information has been made and who possesses information which is evidence of or material to the violation of a state felony statute to apply to a federal district court for an ex parte order to disclose the information to a state law enforcement official. The bill also would add a new Section 6103(i)(8) authorizing these attorneys to seek an ex parte order to disclose information relative to federal civil litigation to the appropriate federal agency.

Although we strongly support federal law enforcement efforts, in our view the privacy and confidentiality of tax returns and tax information also are important federal interests. The Tax Reform Act of 1976 was an excellent first effort to reach a proper balance between the sometimes competing needs for confidentiality of tax information and effective federal law enforcement. We agree that some further refinements are necessary to achieve a more appropriate balance and support portions of S. 2402, S. 2404 and S. 2405 as a step toward that goal.

On the other hand, there is no justification for redisclosures to either state law enforcement officials in connection with felonies charged under state law, or to federal officials in connection with litigation on federal civil claims. Taxpayers' rights of privacy and confidentiality clearly should prevail in these situations. Accordingly, we oppose proposed Sections 6103(i) (7) and (8).

9. Tax information of persons other than individuals.—S. 2402 does not distinguish between tax information pertaining to individuals and information pertaining to corporations and other entities. We understand that a proposal may be advanced which would essentially retain present disclosure law as to individual taxpayers, but relax the rules for other taxpayers. Under such a proposal, a Justice Department attorney or U.S. Attorney would be required to obtain a court order for the disclosure of tax returns or any other tax information obtained from an individual taxpayer or his representative, but would not need to obtain a court order with respect to other taxpayers for information beyond the return itself.

We oppose any such distinction between individuals and other taxpayers. Despite the fact that corporations and other entities do not enjoy the protection of the Fifth Amendment, such taxpayers are entitled to privacy and confidentiality for all tax information they are required by law to submit to the Internal Revenue Service. Tax information submitted by business associations normally includes a substantial amount of confidential commercial and financial data. In addition, a company's tax information frequently includes personal information about individual officers and other employees.

Compliance under the American voluntary tax assessment system might suffer if the confidentiality of return information is reduced for corporations and other non-individual entities required to furnish tax information. If a corporation's tax books and records are available to the Justice Department and U.S. Attorneys merely for the asking because a non-tax investigation is in progress, some businesses may be tempted to maintain less complete books and records. In addition, the choice of form of business organization of smaller businesses might be distorted to obtain the broader protection.

Moreover, corporate taxpayers may be less cooperative in submitting tax information requested during an audit examination, requiring the Service to issue an administrative summons or prove in a summons enforcement action the relevancy of the information requested and the fact that it is not already in the Service's possession. Quite clearly, substantial inroads on taxpayers' privacy would signifi-

cantly slow the Service's examination process and, absent funds for additional agents, further reduce the Service's audit coverage of taxpayers generally—possibly encouraging more taxpayers to "play the audit lottery." Consequently, we urge that Congress reject any proposal to reduce the confidentiality accorded to the tax information of non-individual taxpayers.

PART B—S. 2403

Senate bill S. 2403 would amend Section 7609 of the Internal Revenue Code. 26 U.S.C. § 7609. Sections 7609 and 7610 were added by Congress as part of the Tax Reform Act of 1976. The Section of Taxation supported enactment of those provisions in 1976 and in subsequent hearings on February 24, 1977 which considered a postponement of their effective date.

Congress enacted these provisions to remedy various problems in the use of summons by the Service, principally arising from the use of summons to obtain information (chiefly financial records) regarding a taxpayer from a third party, such as a bank or other financial institution. In addition, these provisions provided a mechanism for the use of John Doe summons which had been involved in *United States* v. *Bisceglia*, 420 U.S. 141 (1975). S. 2403 proposes amendments to the third-party recordkeeper summons provisions. The Section of Taxation supports some of the proposed amendments and opposes others.

A review of the existing procedures under Section 7609 is essential to understanding the changes proposed by S. 2403. To obtain records regarding any taxpayer from a third-party recordkeeper, the Service must first serve a summons upon the third-party recordkeeper which meets the requirements of Section 7602 regarding the manner of service and which specifically describes the records requested. The summons must also identify the taxpayer and taxable periods under examination and investigation. The Service must notify the taxpayer within three days that the summons has been served and provide a copy of the summons, together with instructions regarding the taxpayer's rights under Section 7609. The Service may not obtain the records summoned from the third-party recordkeeper for a period of 14 days from the date of notice to the taxpayer unless the taxpayer consents.

After notice has been provided by the Service, the taxpayer may stay compliance with the summons by properly serving a written notice (usually in the form of a letter) upon the third-party recordkeeper with a copy to the Service within 14 days. If the taxpayer properly serves a stay of compliance notice, the Service may not obtain the summoned records until it obtains a court order or the taxpayer consents.

In order to obtain a court order, the Service must refer the summons to the Department of Justice for enforcement. Attorneys in both the Chief Counsel's Office and the Department of Justice review the summons to determine if it has been properly issued. (The government declines to seek judicial enforcement of a significant number of summons because they are technically deficient. This led the General Accounting Office to conclude as follows: ". . . IRS' initial experience with the summons provisions indicates that the Service needs to improve its controls to ensure that only technically, procedurally, and substantively accurate summonses are issued in the first place." GAO Report GGD-78-110, "Disclosure and Summons Provisions of 1976 Tax Reform Act—Privacy Gains With Unknown Law Enforcement Effects," March 12, 1979.) If both the Service and the Department of Justice conclude that the summons was properly issued and should be enforced, the government files a petition in the appropriate district court requesting an order to compel enforcement of the summons under Section 7604.

A petition for enforcement is brought by the government against the third-party recordkeeper. The taxpayer is given notice either by a show cause order issued by the court or by service of a copy of the petition. However, the proceeding is between the government and the third-party recordkeeper. The taxpayer has the right to intervene in that proceeding under Section 7609(b)(1). The District Court usually conducts a hearing upon the petition at which the government presents the agent who issued the summons as a witness and the taxpayer presents witnesses, if the taxpayer has intervened. Infrequently the third-party recordkeeper appears at the hearing. (The district court has wide latitude to limit or control the scope of the hearing. *E.g., United States* v. *Church of Scientology of California*, 520 F.2d 818 (9th Cir. 1973).)

Upon the issuance of an order by the District Court, either the government, the taxpayer or the third-party recordkeeper may appeal to the proper United States Court of Appeals. 28 U.S.C. § 1291; *Tillotson* v. *Boughner*, 327 F.2d 982 (7th Cir. 1964); *Bouscher* v. *United States*, 316 F.2d 451 (8th Cir. 1963); *United States* v. *McDonald*, 313 F.2d 832 (2d Cir. 1963). However, if the district court orders enforcement of the summons, the third-party recordkeeper must produce the records in

compliance with the summons immediately, unless the District Judge or the Court of Appeals issues a stay of compliance pending a determination upon appeal. Thus, although the taxpayer has a right to an appeal, the taxpayer does not have a right to further stay compliance with the summons.

The Service may issue a summons without notifying the taxpayer in the case of hardened criminals or organized crime activities. If the Service believes that providing notice to the taxpayer might lead to attempts to conceal, destroy or alter records, to prevent communication of information or to flee prosecution, it may obtain an ex parte court order which would eliminate the requirement to notify the taxpayer. Section 7609(g).

During the pendency of a summons enforcement proceeding against a third-party recordkeeper as a result of a stay of compliance obtained by the taxpayer under Section 7609, the statute of limitations for assessment and collection of tax or institution of criminal tax proceedings is suspended. As a result, the government is not prejudiced by the expiration of the statute of limitations as a result of proceedings instituted or directed by a taxpayer under Section 7609.

Senate bill S. 2403 would make four major changes in the existing procedures for enforcement of summons served upon third-party recordkeepers.

1. The burden of instituting procedures for judicial review would be shifted from the government to the taxpayer. Under S. 2403 the taxpayer would be required to file a motion to quash the summons within 14 days after service of notice of the summons in order to obtain judicial review.

2. The taxpayer would lose his right to appeal from an order of the district court enforcing the summons.

3. Duplicative judicial proceedings may be required. At the present time a taxpayer must intervene in the summons enforcement proceedings brought by the government to compel the third-party recordkeeper to produce the summoned records. All objections to the summons are heard at that time. Under S. 2403 the taxpayer would obtain a hearing upon his motion to quash. If the summons were procedurally deficient, a further hearing could be required under Section 7604.

4. Section 7609 would be limited to summons issued for records of individuals and partnerships of five or fewer individuals. These are the major changes. We support the first change, but we do not support the other changes. We also have technical comments upon other aspects of S. 2403.

I. Burden of instituting procedures

The major criticism of the third-party recordkeeper summons provisions enacted in the Tax Reform Act of 1976 has been that certain taxpayers use the automatic stay of compliance procedures merely to delay an investigation. That conclusion was supported by statistics recited by Sponsors of S. 2403—Senators Nunn and Percy—that over 80 percent of the time the taxpayer who had initiated a stay of compliance failed to intervene and appear in the judicial summons enforcement proceedings. Cong. Rec., pp. S.2376 and S.2387, March 11, 1980. Those statistics are persuasive.

Somewhat more extensive statistics were compiled by the Service and reviewed by the General Accounting Office for summons served during the period March 1, 1977 through March 31, 1978—the first thirteen months that the third-party recordkeeper summons provisions were in effect. Those statistics show that during that period the Service issued 29,895 summons; automatic stays of compliance were obtained in approximately 8 percent of those summons or with regard to 2,313 summons; of those summons in which stays were obtained, taxpayers intervened in only 217 summons enforcement actions. GAO Report GGD-78-110, supra, at p. 32.

As noted by the General Accounting Office, these statistics are not completely accurate, because additional summons enforcement actions could be brought and taxpayers could intervene in those actions subsequent to March 31, 1978 with regard to summons issued prior to that date.

In any event experience with the new stay of compliance procedures is clear—many taxpayers who obtain automatic stays of compliance do not pursue their objections to the summons by intervening in summons enforcement proceedings. One reason for the failure to intervene is that the objections of the taxpayers are resolved administratively. See GAO Report GGD-78-110, supra, at p. 35. However, that is by no means a complete explanation. It appears to be the inescapable conclusion that taxpayers are delaying examinations or investigations by use of the stay of compliance procedures but do not avail themselves of their day in court. Granting taxpayers a day in court was the intent and purpose of these Tax Reform Act provisions. It was not intended to impede investigations by permitting automatic delays.

It also appears to be true that many of the taxpayers who stay compliance are alleged to be engaged in illegal activities or to be tax protestors. A sample of 42 summons cases in five IRS districts indicated that 12 of the taxpayers were sus-

pected to be involved in illegal activities and eight were suspected to be tax protestors. GAO Report GGD-78-110, supra, at p. 33. A significant aspect of that study is that a majority of the taxpayers (22 of 42 or 60 percent) are not believed to be engaged in illegal activities or to be tax protestors. In providing a remedy for delays in investigations, it must be borne in mind that most taxpayers who obtain stays of compliance are not alleged criminals or tax protestors, although a substantial minority are alleged to be involved in such activities.

More recent statistics are not available. We understand the Service has undertaken a further study which would not have the deficiencies found by the General Accounting Office in their first study. However, to date the results of that further study are unavailable. The significance of a further study would be to determine whether problems involved in the initiation of these procedures have been resolved. Moreover, there has developed substantial case authority favorable to the Service which may have reduced the number of stays of compliance obtained by taxpayers.

As you can see, the Section of Taxation has some concerns with the conclusions which may be drawn from the available data. That data is essentially limited to the first year of use of the new procedures and may not provide a fair or complete test. For this reason we believe that changes in these procedures should be made with care and should be well chosen to resolve clear problems, rather than to effect a wholesale revision of existing procedures.

The Section of Taxation supports the basic amendment contained in Section 4 of S. 2403 to shift the burden of initiating judicial proceedings from the Service to the taxpayer, provided satisfactory provisions are adopted regarding suspension of the statute of limitations. The motion to quash summons procedures should eliminate substantial delays in obtaining records from third-party recordkeepers and may reduce the number of instances in which stays of compliance are sought. We believe both of these effects are desirable if done in a manner which is consistent with preserving the ability of taxpayers to obtain full and fair judicial review and which does not prejudice taxpayers' rights by unfairly suspending the statute of limitations.

This change in the summons enforcement procedures may reduce the number of instances in which a stay is sought because the taxpayer must file a motion to quash in District Court in order to obtain a stay. A letter to the third-party recordkeeper with a copy to the Service will no longer be sufficient. In response to the General Accounting Office report, the Department of Justice expressed the view that this shift in initiating judicial proceedings patterned after the Right to Financial Privacy Act of 1978 should reduce the potential for delays, because they "would stay compliance only as to those customers (taxpayers) who have demonstrated that they intend to participate in the court proceeding and can come forward with evidence that the summons was improperly issued." GAO Report GGD-78-110, supra, at p. 43. The Section of Taxation shares that view.

Significantly, the major cause of delays in obtaining enforcement of summons under the existing procedures has been the length of administrative review by the Service and the Department of Justice after service of the summons and prior to filing a petition to enforce the summons. A study by the General Accounting Office showed that on the average 82 days were required for review of summons after the taxpayer stayed compliance for the recommended enforcement to reach the Department of Justice Civil Trial Section. GAO Report GGD-78-110, supra, at p. 36. Those delays have hopefully been reduced by subsequent adoption of streamlined review procedures. Nevertheless, administrative review prior to initiation of judicial proceedings will always constitute a substantial delay. That delay will be eliminated by the new procedures which will result in the filing of a motion to quash by the taxpayer within 14 days and an answer by the government within ten days.

Under present procedures the running of the statute of limitations is suspended from the time the government files a petition to enforce the summons until all appeals are final. (This applies only if the enforcement action is required by the action of the taxpayer.) Under S. 2403 the statute of limitations would be suspended from the time the motion to quash is filed by the taxpayer until all appeals are final. This change may seriously prejudice the rights of taxpayers, particularly individuals without representation by counsel.

Prejudice to taxpayers would result, because the statute of limitations would be suspended before the summons is to reviewed by counsel for the government. For example, if the statute of limitations were about to expire, a special agent conducting an investigation could attempt to extend the statutory period by serving a summons upon the taxpayer's attorney requesting all correspondence with the taxpayer. Such a summons would compel the taxpayer to file a motion to quash the summons. Filing the motion to quash would begin suspension of the statute of limitations which is what the special agent intended. Admittedly, this is an extreme

example of potential abuse. However, the General Accounting Office study found that 88 of 340 summons enforcement requests made by district offices were refused by the Chief Counsel's office. GAO Report GGD-78-110, supra, at pp. 28-29. Thus, a substantial percentage of summons referred for enforcement were not forwarded to the Department of Justice, because attorneys in the Service concluded the summons should not be enforced. In addition, the Department of Justice refuses to enforce some of the summons referred to it by the Service. Id., p. 29.

There should be some guarantee that the motion to quash procedures in S. 2403 will not, in fact, confer upon the government, or worse, an individual special agent the ability to suspend the statute of limitations. If expedited judicial procedures are enacted, it may be appropriate to eliminate Subsection (e) of 7609 which provides for suspension of the statute of limitations. This would be appropriate if as proposed in S. 2403 a final judicial ruling would be obtained within 37 days after service of the summons. (Three days to provide notice to the taxpayer; 14 days within which to file a motion to quash; 10 days for the government to file a response; and 10 days for the court to enter an order.)

On the other hand, if somewhat less expedited procedures are enacted, other suspension of the statute of limitations provisions should be considered. Among the alternatives we have considered are the following: One, provide that the statute of limitations would be suspended from the 60th day following the filing of a motion to quash by the taxpayer until a final order is entered. This would limit the use of a summons to obtain an extension of an imminently expiring statute of limitations. Two, provide that the statute of limitations is suspended only after the government files a response to the motion to quash which includes a representation by the Department of Justice that the summons was properly issued. This would require the same administrative review now given to summons before a petition for enforcement is filed. Three, require administrative review by the Chief Counsel's office and the Department of Justice of a summons before it is served. The summons form would be modified to require signatures on behalf of each office.

We have not yet had an opportunity to discuss these alternatives with government representatives or to sufficiently study them. We believe this is a serious problem which should be resolved by this Subcommittee in the context of S. 2403 as reported by this Subcommittee.

The principle underlying the suspension provisions is that if the taxpayer has initiated action which delays the government's investigation, the statute should be suspended during the pendency of that action. The government should not be able to initiate the action which suspends the statute. Nor should a third-party recordkeeper be able to suspend the statute. Thus, the statute of limitations should not be suspended after entry of a final order simply because the third-party recordkeeper is unable to locate the records or otherwise fails to deliver them promptly on that date.

We believe that this amendment will go a long way toward eliminating the problems in existing procedures identified by studies conducted to date. Accordingly, we support this amendment, provided satisfactory provisions are adopted regarding suspension of the statute of limitations.

II. Right of appeal

Under the second group of changes, S. 2403 would delete Section 7609(h)(2) which requires the courts to give priority to summons enforcement proceedings. Instead, it would substitute an automatic rule that the District Court must rule within ten days. Moreover, S. 2403 would eliminate taxpayers' existing right to appeal from an adverse decision.

Both amendments are designed to reduce delays, but they are heavy handed. There is, moreover, no indication that substantial delays have been caused by hearings conducted by District Courts or magistrates or by appeals taken by taxpayers from adverse decisions. In the absence of evidence that these procedures are a cause of significant delays, we urge that these amendments be rejected and that Subsection (h)(2) of Section 7609 be retained. In any event, the third-party recordkeeper should retain its right to appeal.

In considering taxpayers' rights of appeal, it should be noted that there is no automatic stay pending appeal. After a District Court has ordered enforcement of a summons, the third-party recordkeeper must comply, unless either the District Court or the Court of Appeals grants a stay. A separate application for a stay is required and generally stays pending appeal are only granted if the taxpayer is able to make an unusual showing regarding the likelihood he will prevail upon appeal and irreparable harm from enforcement of the summons pending appeal.

III. Duplicative judicial proceedings

If existing rights of appeal are eliminated we are concerned that taxpayers will be frustrated because they will believe they have not had a full and fair judicial review. In that event, many actions such as injunctions, etc., may be instituted similar to those brought by taxpayers prior to enactment of Section 7609. That would be an unfortunate result which can and should be avoided.

Under S. 2403 it is not clear whether a third-party recordkeeper could intervene in the motion to quash proceedings. The third-party recordkeeper, however, could resist the summons and require the government to institute summons enforcement proceedings. The third-party recordkeeper could appeal from an adverse decision in those proceedings, but the taxpayer could not appeal directly from denial of the motion to quash. That would be an anomalous result which would undoubtely lead to confusion.

We believe a better judicial procedure which would simplify procedures for assertion of alleged defects in a summons and which would provide for speedier judicial consideration is to require that all issues regarding enforcement of the summons be raised in a single proceeding. That proceeding would be upon the taxpayer's motion to quash as contemplated by S. 2403, if the taxpayer files a motion to quash. If a motion to quash is not filed by the taxpayer, any objections to enforcement of the summons could be raised by the third-party recordkeeper in a summons enforcement action brought by the government under Section 7604. Instead of limiting the issues which may be raised, either the taxpayer or the third-party recordkeeper should be able to assert any legal grounds why the summons should not be enforced, including such grounds as improper service, failure to provide the required notice or lack of a specific description of records. These enumerated grounds are presently considered to be objections which only the third-party recordkeeper, as the person summoned, may raise. That distinction should be eliminated.

In summary, if the taxpayer files a motion to quash, the taxpayer could raise any objections to the summons. The third-party recordkeeper should be required to intervene in those proceedings if it also wished to object to the summons. If the taxpayer does not wish to object to the summons, the third-party recordkeeper could refuse to comply which would require the government to initiate a summons enforcement proceeding as under existing law. This latter situation might occur when the only objection was that the summons imposed an undue burden upon the third-party recordkeeper.

Either the taxpayer, the third-party recordkeeper or the government should be able to appeal from an adverse decision. The statute should provide that an order entered by a District Court or magistrate is a final order which is appealable under 28 U.S.C. § 1291. Present procedures which give discretion to the District Judge or Court of Appeals to grant a stay pending appeal should be retained.

A final word regarding the time for response to a motion to quash. The ten-day period for a response by the government and the third-party recordkeeper may be too short to permit preparation of a complete response. Further consideration should be given to an appropriate period for response, bearing in mind the proceeding is to be expedited in order to reduce any delays.

IV. Limited applicability of new proposals

The fourth change under S. 2403 proposes to limit the third-party recordkeeper summons provisions to records of individual txpayers or partnerships consisting of five or fewer individual members. Although this provision appears in the Financial Right to Privacy Act of 1978, we recommend that it be rejected. First, the right to notice and to contest the summons is in the nature of a Fourth Amendment right equally applicable to all taxpayers, including corporations. (This is to be distinguished from Fifth Amendment rights, which are not available to corporations.) Second, there have been no suggestions that corporations or other entities have been a source of any problems in enforcing summons under the present provisions. Third, and of significant administrative importance, the provision would cause substantial practical problems.

At the time the summons is served, neither the Service nor the third-party recordkeeper may know whether a particular partnership consists of more or less than five partners. To protect their customers' interests, third-party recordkeepers would be required to object to the summons if notice were not provided. That would result in more, instead of fewer, delays. Also, records relating to many closely-held corporations and their individual shareholders are frequently commingled. That is particularly true of records regarding loans to a closely-held corporation secured by guarantees from the individual shareholder. Summons requesting records of the individual and the corporation would require separate proceedings and would result

in delays in order to delete from the records relating to the corporation information regarding the individual and visa versa.

For these reasons we recommend that Section 2 of S. 2403 not be enacted. The pertinent definitions of a "third-party recordkeeper" presently appear in Section 7609(a)(3). Proposed Subsection (a)(3)(B) of Section 7609 which would define "persons entitled to notice" would not be added. The existing definition as the "person (other than the person summoned) who is identified in the description of the records contained in the summons" in Subsection (a)(1)(B) of Section 7609 would be retained.

V. Technical changes

A recurring problem in the summons procedures is the lack of express provisions whereby the taxpayer or his representative may obtain copies of the records produced in response to the summons. There have been several instances in which the Service has agreed to provide copies. The records relate to the taxpayer's financial transactions and could be obtained by him. There is no apparent reason why copies of the records obtained by the Service should not be provided to the taxpayer by the Service at the taxpayer's expense. This procedure, of course, should not apply to any summons issued pursuant to Subsection (g) of Section 7609 or to any other summons or request as to which the taxpayer is not entitled to notice. We believe adoption of a provision which so entitles the taxpayer to obtain copies will eliminate some of the basis for objections by taxpayers to compliance with third-party recordkeeper summons.

Another problem with the existing procedures is that there is no mechanism to notify the third-party recordkeeper when the 14-day period has expired. Under S. 2403 it would also be necessary to notify the third-party recordkeeper of a final court order as it might not be a party to the motion to quash proceedings. We recommend that the Service be required to provide to the third-party recordkeeper a copy of the notice sent to the taxpayer under Subsection (a) or to issue a certificate which states that the 14-day period has expired without the filing of motion to quash or that a final order has been entered. This should reduce delays in compliance by third-party recordkeepers.

In addition to these major points, we also wish to raise certain technical issues or alternative provisions which we hope the Subcommittee will consider.

Senator Percy indicated in his remarks sponsoring S. 2403 that it was intended that a form of a motion to quash be provided to the taxpayer as part of the notice required by Subsection (a)(1) of Section 7609, as amended by S. 2403. He said that a taxpayer could easily seek the stay ". . . by filing motion papers provided by the IRS along with the notice." Cong. Rec. S2387, March 11, 1980. This could be particularly helpful to individual taxpayers not represented by counsel and we recommend that such procedures be adopted. The effectiveness of such notice, forms or instructions, of course, depends upon the specific instructions and forms provided. However, the revised summons forms and instructions provided by the Service under the Tax Reform Act provisions have been a substantial improvement over prior summons.

In the event our recommendation to retain Subsection (h)(2) of Section 7609 is not followed and specific time requirements are imposed upon the trial court, we believe it important to amend lines 4-8 on page 4 of S. 2403 to read as follows: "The United States shall file a sworn response to the motion within 10 days from service of the motion to quash. The court may rule on the basis of the parties initial allegations and response or conduct such further proceedings as it deems appropriate. All such proceedings shall be completed and the district court judge or United States magistrate shall enter an order on the motion within 10 days of the filing of the response of the United States."

This amendment follows the language of the Right to Financial Privacy Act of 1978 and makes it clear that the district court or magistrate may conduct whatever proceedings it deems appropriate in order to fairly rule upon the motion to quash. Without such an amendment, the provisions could be interpreted to require the District Court or magistrate to enter an order based upon the pleadings.

In order to permit a third-party recordkeeper to intervene in the motion to quash proceedings, Subsection (b)(1) of Section 7609 should be amended to read as follows: "(b)(1) A third party recordkeeper may intervene in any proceedings upon a motion to quash brought under subsection (b)(2) to raise objections to compliance with the summons."

The suspension of the statute of limitations provisions in Section 6 of S. 2403 may be ambiguous. The intent is clearly to continue existing law by suspending the running of the statute of limitations under Sections 6501 and 6531 during the period any litigation which the taxpayer directs contesting a summons is pending. The provisions of S. 2403, which state the taxpayer may appeal denial of a motion to quash only in subsequent proceedings when coupled with the suspension provisions, could result in suspension of the statute until after a criminal or civil tax case is

final. That was not intended. It should be corrected by amending lines 1 and 2 on page 6 of S. 2403 to read as follows: ". . . with respect to any litigation relating to the motion to quash is pending."

If our recommendations that the taxpayers' right of appeal be retained are not followed, S. 2403 should nevertheless be amended to make it clear that an order denying the motion to quash could be appealed as an interlocutory order under 28 U.S.C. § 1292.

The sentence appearing on lines 19 through 21 of page 3 of S. 2403 should be amended to read as follows: "A motion to quash a summons shall be filed in the United States District Court for the judicial district in which the person summoned resides or has its principal place of business."

Present law provides that jurisdiction is in the district in which the person to be summoned (third-party recordkeeper) resides. S. 2403 would change that to grant jurisdiction to the district in which the taxpayer resides. There is a basis for choosing either of these districts, and we believe either could be properly designated by Congress. Our recommendation is that existing law not be changed because we are unaware of any problems arising from those provisions and because the records sought are subject to process in that district.

The word "title" in line 24 on page 4 of S. 2403 should be changed to "section".

Lastly, Subsection (i) of Section 7609 set forth in Section 8 of S. 2403 should be amended by substituting the word "to" for the word "must" on line 12 of page 6 of S. 2403. Providing directions to third-party recordkeepers to begin to accumulate the summoned records and to produce them upon expiration of the 14-day period or receipt of a court order will help reduce delays. However, the language should be directory.

I appreciate this opportunity to appear before you today to present the views of the Section of Taxation of the American Bar Association upon S. 2403. We have prepared a mock-up version of Section 7609 amended as described in my comments. We, of course, will be happy to continue to work with you, the Service and the Department of Justice to implement these recommendations.

Statement of the American Bankers Association

Mr. Chairman, my name is John S. Stephan. I am Chairman of the Taxation Committee of the American Bankers Association and General Tax Counsel and a Senior Vice President of Bank of America NT & SA. The ABA, which is composed of over 90 percent of the Nation's 14,000 full service banks, appreciates the opportunity to testify with regard to S. 2403. This bill amends Section 7609 of the Internal Revenue Code of 1954 relating to "Special Procedures for Third-Party Summons." As banks are third-party recordkeepers for purposes of this provision, and the majority of such summonses issued by the IRS are for the production of records of bank customers, this bill is of special concern to banks.

At the outset, I would like to say that the current provisions of Section 7609, from the standpoint of banks and other financial institutions, have been substantially successful in providing much needed clarity and precision with respect to the legal rights and obligations of such institutions vis-a-vis an IRS summons.

While some abuse may be present in the use of the stay provisions solely for delaying purposes, Section 7609 has been largely successful in eliminating the casual attitude by which "pocket summonses" were previously issued by IRS field personnel. A survey conducted by the ABA in 1975 indicated that the banking industry alone was receiving in excess of 100,000 IRS summonses annually. The provisions of Section 7609 have had a major impact on reducing the number of IRS summonses received by banks and in eliminating many of the problems which previously existed.

The provisions of Section 7609 have also been successful in enhancing the rights of taxpayers with respect to the confidentiality and privacy of records pertaining to their financial and business affairs.

Although Section 7609 did not increase substantive defenses of a taxpayer against the production of documents pursuant to an IRS summons, the added procedural rights have provided a legitimate forum in which any irregularities in the summons process or in the underlying investigation can be tested without regard to whether the taxpayer or the third party "owns" the records and without regard to the willingness of the third party to object to the summons. The significant benefits of such procedural rights to the administration of the tax laws and to the creditability

of the self-assessment tax system should not be discounted merely because a limited degree of abuse may exist.[1]

Similarly, any modifications, which are now proposed to deal with tax protestors and others who may be abusing their procedural rights under Section 7609, should not be so drastic as to eliminate, as a practical matter, those rights for all taxpayers. It is submitted, however, that that may well be the practical result of S. 2403 in its present form.

Under the existing provisions of Section 7609, to obtain records from third-party recordkeepers (defined generally as attorneys, accountants and financial institutions) the Service must serve an administrative summons on the recordkeeper and within three days give the taxpayer with respect to whom the records pertain notice of and a copy of the summons. The taxpayer may then stay compliance with the summons by notifying the Service and the third-party recordkeeper within fourteen days of receipt of notice of the summons. In order to enforce the summons, the IRS requests the Department of Justice to initiate a summons enforcement action in federal district at which the third-party recordkeeper, as well as the taxpayer, may assert any objections they have to the summons.

The major changes to Section 7609 proposed by S. 2403 are threefold:

(1) The taxpayer rather than the government would have to initiate judicial proceedings by the filing of a motion to quash in federl district court within fourteen days after service of a notice of summons.

(2) No appeal would be allowed by the taxpayer from the order of a district court enforcing the summons.

(3) The provisions of Section 7609 would be limited to summonses issued for records pertaining to individuals and partnerships of no more than five individuals.

The United States urges adoption of S. 2403 because the ability of the taxpayer or noticee to stay compliance by letter permits a delay in the production of records in cases where there is no intent to participate in the subsequent enforcement proceedings. It is argued that these delays have hindered legitimate tax investigations involving tax protestors and persons involved in illegal activities.

A March 12, 1979 report of the Comptroller General of the United States—entitled "Disclosure and Summons Provisions of 1976 Tax Reform Act—*Privacy Gains* With *Unknown* Law Enforcement Effect" [emphasis added]—does not support these contentions. The Report noted significant instances of stayed summonses not being enforced because of IRS failure to satisfy procedural aspects of the Tax Reform Act, as well as defective or unnecessary summonses.[2] Given the GAO finding of need for further controls to protect taxpayers' rights in summons matters, it seems inappropriate and premature to make more difficult the procedures for taxpayers to challenge defective summonses. (GAO Report, p. 24.)

When the IRS sought during the 1976 Tax Reform Act hearing to impose similar requirements upon the taxpayers to stay compliance, it was concluded that the IRS had greater financial and manpower resources than most taxpayers whose records were summoned. As the situation remains the same today, many taxpayers without the financial means to retain counsel will be denied protection of the courts. This potential loss of protection should only be based upon the strongest demonstration that the countervailing ability of the IRS to conduct its investigations is being severely impeded. The report of the GAO indicates that the IRS—at least as of the date of the report—was not maintaining sufficient or adequate data to demonstrate the need for any changes in the present law. (GAO Report, pp. iv and 30–32.)

As to the contentions that the stay provisions are primarily used by tax protestors and criminals, the GAO Report indicates that there is no statistical validity to such claims (p. 29). Secondly, it would appear that if tax protestors and criminals are using the automatic stay procedures to delay or impede tax investigations, they are just as likely to file a motion to quash as to give notice not to comply. Furthermore, the current provisions of Section 7609(g) enable the Service to deal specifically with such taxpayers and to avoid the notice and stay provisions of Section 7609 where the Service can show that the giving of notice would result in efforts to conceal, destroy, alter the records or to avoid production of the records.

While S. 2403 mandates more prompt or timely adjudication of proceedings to stay compliance than Section 7609, the GAO Report notes that the lengthy delays were due, in substantial part, to the IRS' and Justice's own administrative review

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[1] During the period March 1, 1977 through March 31, 1978—the first thirteen months that the third-party recordkeeper summons provisions were in effect—only 2,313 summonses (or 8 percent) of the 29,895 summonses on which the Criminal Enforcement Division has statistics were stayed. GAO Report, p. 32.

[2] Our of 340 requests submitted to the Chief Counsel, IRS, for summons enforcement between March 1, 1977 and May 26, 1978, 88 or 23 percent were returned to IRS district offices due to various defects.

process (pp. 24 and 28). Therefore, the investigation delays may be mitigated or avoided by adoption of the GAO's recommendation to streamline the summons enforcement process (pp. 35-37).

Finally, in the absence of any significant experience under the Right to Financial Privacy Act, it seems premature to suggest adoption of its procedures in an area involving a much greater number of governmental requests for records. A better solution would be to adopt the suggestion of the GAO to monitor and compare the effectiveness of the different procedure for staying compliances of that Act before considering adoption of similar provisions for IRS summonses (pp. 38-39).

If, however, Congress should decide to amend Section 7609, we suggest the following changes to S. 2403:

(*a*) Adopt the alternative suggested by the GAO requiring that IRS administrative summonses be reviewed by IRS attorneys or other supervisory personnel prior to issuance to insure that all summonses comply with the statutory procedures and legal requirements.

(*b*) Add to Section 4 language similar to that in Section 1105 of the Right to Financial Privacy Act, requiring that a person entitled to notice be provided with the motion paper, and specific instructions as to how to file a motion to quash a summons.

(*c*) Amend Section 5 of the bill to provide language similar to Section 1105(b) of the Right to Financial Privacy Act that the third-party recordkeeper shall not produce the summoned records until the Secretary certifies in writing to the third-party recordkeeper that he has complied with the applicable provisions of Section 7609.

(*d*) Add a new subsection providing that any third-party recordkeeper providing records in reliance upon a certificate by the Secretary shall not be liable to any person entitled to notice for the production of such records. See Section 1117(c) of the Right to Financial Privacy Act.

(*e*) Amend Section 4 of the bill to add language similar to Section 1110(b) of the Right to Financial Privacy Act providing that if the Court is unable to decide the motion on the basis of the affidavit and the response to the United States, the Court may conduct prompt, additional proceedings as it deems appropriate.

(*f*) Delete that paragraph of Section 4 of the bill that would deny the person entitled to notice the right of an interlocutory appeal of a court ruling denying a motion to quash and adopt the recommendation of the American Bar Association that such a ruling would be a final, appealable order.

(*g*) Finally, there is no justification for adopting Section 2 of the bill, which would define persons entitled to notice as any individual or partnership of not more than five persons. The reasons advanced for amending Section 7609 do not indicate any abuse of the procedures by corporations of large partnerships. As taxpayers, subject to other administrative provisions of the Code, corporations and members of large partnerships are entitled to similar protections. Moreover, as a practical matter, third-party recordkeepers would in many cases be unable to verify whether a given partnership is not a person entitled to notice.

In summary, the major changes to the summons enforcement procedures which are proposed by S. 2403 are not supported by IRS data. Until, and only if, the Service fully demonstrates that the current provisions of Section 7609 are being abushed by taxpayers on a large scale, should the major burden of summons enforcement proceedings be shifted to the taxpayers.

Senator BAUCUS. This hearing is adjourned.

[Whereupon, at 2:10 p.m., the subcommittee was adjourned, subject to the call of the Chair.]

[By direction of the chairman the following communications were made a part of the hearing record:]

STATEMENT OF SENATOR DECONCINI

Mr. President, I am pleased to join my colleague from Georgia in sponsoring and speaking in favor of this much needed legislation to reform the disclosure provisions of the Internal Revenue Code. Its passage will represent one of the most significant steps in the fight against organized crime and white collar crime in recent years.

The present disclosure provisions were added to the Tax Reform Act of 1976 and were in response to abuses by the White House in the use of tax returns and tax information. Unfortunately, the reaction to these abuses was probably overbroad and although I support the vast number of changes to the disclosure provisions made in 1976, the time has come to refine them in light of the experience of the past four years.

65-628 O—80——21

Extensive hearings before my Subcommittee on the issue of organized crime and fraud and before Senator Nunn's Permanent Subcommittee on Investigations has built a convincing record that the major beneficiaries of the 1976 amendments are the criminal element of our society. Witness after witness has come forward with horror stories about the chilling effect of the 1976 amendments on law enforcement. The modest amendments made by today's bill will fine tune the disclosure provisions to allow law enforcement officials to make the maximum use of information legally within their possession on an individual's privacy. Last year I drafted potential legislation on this subject and circulated it to interested parties. Among the responses I received was a letter from Nick Ackerman, Assistant U.S. Attorney in the southern district of New York, and a former member of the Watergate Prosecution team in charge of the tax related abuses. His comments are noteworthy and represent the views of a person who has seen abuses of the disclosure laws, seen the legislative reaction to those abuses, and then had to prosecute under them. His remarks follow:

U.S. DEPARTMENT OF JUSTICE,
U.S. ATTORNEY, SOUTHERN DISTRICT OF NEW YORK,
New York, N.Y., November 14, 1979.

SENATOR DENNIS DECONCINI,
Chairman, Subcommittee on Improvements in Judicial Machinery,
Dirksen Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: Pursuant to your letter of November 13, 1979, I have reviewed your proposed amendment to the Tax Reform Act of 1976 which would restore the ability of the Justice Department to obtain ready access to federal income tax returns whenever such returns are relevant to investigations into violations of federal criminal law. With the exception of several minor suggestions which I have conveyed to the Subcommittee's counsel, Robert Feidler, I believe that this amendment is long overdue and is badly needed by the Government in its fight against organized crime and white collar crime.

As I testified before your subcommittee last month, before becoming an Assistant United States Attorney in the Southern District of New York, I was an Assistant Special Watergate Prosecutor under Archibald Cox, Leon Jaworski and Henry Ruth. One of my prime responsibilities during my two and a half year tenure with the Watergate Special Prosecution Force was to investigate the allegations surrounding the Nixon Administration's misuse of the Internal Revenue Service and its compilation of an enemies list to harrass opponents of the Administration through the IRS.

Unfortunately, the reform legislation which the Congress enacted to remedy these abuses and to prevent them from reoccurring was overly broad and has resulted in severely impeding effective criminal investigations by federal law enforcement officials. This post-Watergate reform legislation unwittingly created two major problems for the federal prosecutor. First, it has made the securing of federal tax returns so cumbersome and enmeshed with red tape that it has hampered the Government's ready access to these returns in investigations where speed can make the difference between success or failure. Second, in a number of instances where tax returns would assist a criminal investigation, the Government has not been able to obtain returns because of the restrictions imposed by the act. Obviously, the reforms aimed at curing the Watergate abuses did not contemplate the impeding of legitimate law enforcement goals.

In that connection, federal tax returns are an extremely invaluable investigative tool in prosecuting crime and are particularly useful in ferretting out complicated business and financial crimes. By impeding the federal prosecutor's access to tax returns this reform legislation of 1976 has ironically made it more difficult for the Government to prosecute the very kind of white collar criminal which was so successfully prosecuted by the Watergate Special Prosecution Force. Your narrowly drafted amendment to that legislation would remove the benefits presently enjoyed by the white collar criminal while at the same time maintaining those reforms which were designed to protect the privacy of law abiding citizens.

Please feel free to call upon me for any further assistance in this matter.

Very truly yours,

NICK AKERMAN,
Assistant U.S. Attorney.

Mr. President, I give great credence to the experience and remarks of Mr. Ackerman. I believe the bill introduced today to be fully in accord with Mr. Ackerman's thoughts and suggestions. I would urge my colleagues to work for the swift passage of these amendments.

STATEMENT OF SENATOR JIM SASSER BEFORE THE "OVERSIGHT OF THE INTERNAL REVENUE SERVICE," SUBCOMMITTEE OF THE SENATE FINANCE COMMITTEE CHAIRED BY SENATOR MAX BAUCUS.

"SUGGESTED AMENDMENTS TO S. 2402"

OPENING STATEMENT

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE, I AM PLEASED TO OFFER TESTIMONY TODAY IN THE FORM OF THREE SPECIFIC SUGGESTIONS IN SUPPORT OF INCREASED COOPERATION BETWEEN THE INTERNAL REVENUE SERVICE AND THE DEPARTMENT OF EDUCATION WITH A VIEW TO IMPROVING THE COLLECTION OF DEFAULTED STUDENT LOANS. THE THREE SPECIFIC SUGGESTIONS ARE (1) A PILOT TEST AT THE INTERNAL REVENUE SERVICE THAT WOULD WITHHOLD INCOME TAX REFUNDS TO OFFSET STUDENT LOAN DEFAULTS; (2) ENACTMENT OF HR 4155 OR SIMILAR LEGISLATION THAT WOULD EXTEND THE EXISTING PROGRAM OF DISCLOSING INTERNAL REVENUE SERVICE MAILING ADDRESSES TO THE SECRETARY OF EDUCATION SO AS TO BETTER PURSUE STUDENT LOAN DEFAULTERS; AND (3) ENACTMENT OF LEGISLATION THAT WOULD EXTEND THE CONCEPT ENNUMERATED AS (2) ABOVE SO AS TO ALLOW THIRD PARTIES SUCH AS UNIVERSITY COLLECTION AGENCIES AND CREDIT BUREAUS TO HAVE ACCESS TO THE INTERNAL REVENUE SERVICE ADDRESSES OF THE DEFAULTERS.

MAGNITUDE OF THE DEBT COLLECTION PROBLEM

MR. CHAIRMAN, THE COMPTROLLER GENERAL OF THE UNITED STATES, MR. ELMER STAATS, RECENTLY TESTIFIED BEFORE MY LEGISLATIVE BRANCH APPROPRIATIONS SUBCOMMITTEE ON THE MAGNITUDE OF THE DEBT COLLECTION PROBLEM--AND IT IS ENORMOUS AND GROWING.

FEDERAL AGENCIES RECENTLY REPORTED THAT FOR THE YEAR ENDED SEPTEMBER 30, 1979, THEY HAD WRITTEN OFF ABOUT $1.2 BILLION AS UNCOLLECTIBLE. THESE FIGURES INDICATE THE MAGNITUDE OR THE PROBLEM OF COLLECTING DEBTS OWED THE GOVERNMENT.

PRESIDENT'S MANAGEMENT IMPROVEMENT COUNCIL

THE GOVERNMENT IS BEGINNING TO RESPOND TO THIS PROBLEM BY GIVING INCREASED ATTENTION TO THE EFFECTIVENESS OF AGENCY COLLECTION PROGRAMS. NEW GOVERNMENT-WIDE POLICIES CONCERNING ACCOUNTING FOR RECEIVABLES, CHARGING INTEREST, AND REPORTING DEBTORS TO CREDIT BUREAUS ARE ALSO RECIEVING INCREASED ATTENTION. FURTHER, THE DEBT COLLECTION PROJECT OF THE PRESIDENT'S MANAGEMENT IMPROVEMENT COUNCIL PLANS TO COMPLETE IN AUGUST 1980 A MAJOR STUDY OF COLLECTION PROBLEMS. I BELIEVE THIS IS A STEP IN THE RIGHT DIRECTION, BUT MORE NEEDS TO BE DONE.

DELINQUENT STUDENT LOANS

AMONG THE MAJOR CONTRIBUTORS TO THE DEBT COLLECTION PROBLEM ARE THE HIGH DEFAULT RATES OF THE STUDENT LOAN PROGRAMS OF THE DEPARTMENT OF EDUCATION. ACCORDING TO ESTIMATES FROM THE GENERAL ACCOUNTING OFFICE, AS OF FISCAL YEAR 1979, THERE WAS $1.3 BILLION IN DEFAULT UNDER THE GUARANTEED STUDENT LOAN PROGRAM AND $.7 BILLION IN DEFAULT UNDER THE NATIONAL DIRECT STUDENT LOAN PROGRAM.

MR. CHAIRMAN, I OFFER FOR THE RECORD A TABLE SUPPLIED BY THE GENERAL ACCOUNTING OFFICE SHOWING THE AMOUNTS LOANED, PAID AND DEFAULTED IN DEPARTMENT OF EDUCATION LOAN PROGRAMS:

GUARANTEED STUDENT LOAN PROGRAM	AMT. IN BILLIONS
AMOUNT LOANED AS OF FISCAL YEAR 1979	$15.3
AMOUNT REPAID BY STUDENTS	6.2
AMOUNT DEFAULTED	1.3
AMOUNT OUTSTANDING	7.8
IN REPAYMENT	3.2
STUDENTS IN SCHOOL	4.6

National Direct Student Loan Program	Amt. in billions
Amount loaned as of fiscal year 1979	$5.6
Amount repaid by students	1.6
Amount outstanding	4.0
Defaults	.7

Mr. Chairman, the General Accounting Office has supplied me with 10 examples of student loan defaulters--all with the ability to pay. Each has a good credit rating outside the Government. They pay their bills to everybody except the taxpayers of this country. These cases represent the type of loans which would be susceptible to collection through increased cooperation between the Internal Revenue Service and the Department of Education.

Each of the following examples have been in default since 1976 or earlier, and efforts to collect the amounts due have been unsuccessful.

None of the students have disputed the amount owed. In most cases, they simply refused to acknowledge the collection efforts.

CASE 1

The person defaulted for $454 in 1975. During the period 1975-1979, he satisfactorily paid off four unsecured bank loans in the amounts of $1,900, $1,700, $500, and $1,100.

CASE 2

The person defaulted for $595 in 1973. In 1977, he was granted an automobile loan for $8,900, and as of July 1979, he had paid about $3,000 on that loan.

HE IS RIDING AROUND IN A NEW AUTOMOBILE BUT HE CANNOT BRING HIMSELF TO PAY THE FUNDS OWED TO THE U.S. GOVERNMENT, WHICH LOANED HIM THE MONEY TO GET THE EDUCATION WHICH PERHAPS ENABLED HIM TO GET THE LOAN FOR THE AUTOMOBILE.

HE HAS ALSO PAID OFF OVER $600 ON A $1,300 INSTALLMENT SALES CONTRACT WITH A MAJOR DEPARTMENT STORE.

CASE 3

THE PERSON DEFAULTED FOR $754 IN 1976. DURING 1978, HE WAS GRANTED AN UNSECURED BANK LOAN FOR $1,300 WHICH WAS SATISFACTORILY PAID OFF IN 6 MONTHS.

CASE 4

The person defaulted for $571 in 1972. During 1978-1979 he satisfactorily paid off an $1,000 secured loan. He was then granted a $1,000 unsecured loan in March 1979, of which $88 has been paid off as of June 1979.

CASE 5

The person defaulted for $832 in 1976. She has a "bank card" account with a credit extension of $2,000 and two charges accounts at department stores with credit lines of $700 and $500. She has an estimated income of $10,000 and shares a $350 a month apartment with another person.

CASE 6

The person defaulted for $549 in 1976. In March 1979, she was granted an unsecured loan for $6,600. As of June 1979, she paid almost $2,000 on this loan.

CASE 7

The person defaulted for $301 in 1975. In 1979, he had been granted a charge account with a credit line of $900 at a local department store. He also had been given two bank card accounts with a credit line of $1,400 on each account. He is employed with an estimated annual income of about $12,000.

CASE 8

The person defaulted for $328 in 1976. In March 1979, she was granted a $6,400 car loan by a bank. She paid off almost $400 of the loan through June 1979.

CASE 9

The person defaulted for $505 in 1974. As of 1979, she had been granted two bank card accounts with lines of credit of $700 and $200. She has also had two department store charge accounts with lines of credit of $400 and $500.

CASE 10

The person defaulted for $829 in 1976. She has been granted a bank card account with a credit line of $1,600. She also has department store charge accounts with credit lines of $800 and $500.

I MIGHT SAY PATENTHETICALLY, MR. CHAIRMAN, THAT THE ABOVE-MENTIONED TABLE AND 10 EXAMPLES THAT I DEVELOPED AND FIRST USED LAST YEAR ON THE SENATE FLOOR APPEAR TO BE POPULAR AND TO HAVE FOUND FAVOR IN THE HOUSE. I FOUND THEM ON PAGE H5071 OF THE CONGRESSIONAL RECORD OF JUNE 17 DURING HOUSE FLOOR DEBATE ON HR 4155.

PROPOSAL FOR A PILOT TEST

MR. CHAIRMAN, IN THE PAST I HAVE URGED A ONE MILLION DOLLAR (30 STAFF YEARS) PILOT TEST THAT WOULD MATCH A TARGET GROUP OF 100,000 DEFAULTED STUDENT LOANS FROM THE DEPARTMENT OF EDUCATION--WORTH OVER $100 MILLION--AGAINST INCOME TAX REFUNDS. IN THE PAST, THIS EFFORT HAS BEEN SUPPORTED BY THE APPROPRIATIONS COMMITTEE AND THE CHAIRMAN OF THIS SUBCOMMITTEE (MR. MAX BAUCUS), THE CHAIRMAN OF THE FULL SENATE FINANCE COMMITTEE (MR. LONG), AS WELL AS THE DISTINGUISHED SENIOR SENATOR FROM VIRGINIA (MR. HARRY F. BYRD, JR., WHO IS A MEMBER OF THIS SUBCOMMITTEE). LET ME SAY THAT I VERY MUCH APPRECIATE THAT SUPPORT.

THE WAY THE PILOT TEST WOULD WORK IS THAT ONCE THE AMOUNT DUE THE GOVERNMENT HAS BEEN FIRMLY AND CONCLUSIVELY ESTABLISHED BY DUE PROCESS, BEYOND A REASONABLE DOUBT, THE REFUND WOULD BE WITHHELD AS AN OFFSET AGAINST THE DEFAULTED LOAN.

IMMEDIATE SAVINGS OF $35 MILLION

THE GENERAL ACCOUNTING OFFICE, WHICH SUPPORTS THIS INIATIVE, ESTIMATES THAT AT LEAST $35 MILLION OF THE $100 MILLION IN DEFAULTED LOANS IN THE TARGET GROUP COULD BE COLLECTED THROUGH THIS LIMITED INVESTMENT--AND THE AMOUNT COLLECTED COULD RANGE MUCH HIGHER.

ULTIMATE SAVINGS POTENTIAL

ONCE ESTABLISHED, THIS MECHANISM HAS THE POTENTIAL OF SAVING THE TAXPAYER FROM ONE TO TWO BILLION DOLLARS.

FAIRNESS OF THE PILOT TEST

MR. CHAIRMAN, THIS PILOT TEST IS FAIR AND EQUITABLE. IT WILL TARGET INDIVIDUALS WHO HAVE HAD THEIR HIGHER EDUCATION COSTS SUBSIDIZED BY THE TAXPAYER, BUT WHO REFUSE TO PAY THEIR JUST DEBTS. BECAUSE OF THOSE SUBSIDIES, THE AFFECTED INDIVIDUALS HAVE BEEN ABLE TO ENJOY THE BENEFITS AND INCOME SECURITY DERIVING FROM HIGHER EDUCATION. IT IS ONLY FAIR THAT THESE DEFAULTED LOANS BE REPAID OUT OF THOSE HIGHER EARNINGS.

I THINK IT IS ABSOLUTELY UNFAIR AND IRRESPONSIBLE TO EXPECT THE TAXPAYERS TO SUBSIDIZE HIGHER EDUCATION AND THEN ALLOW THE RECIPIENTS OF THAT EDUCATION TO SCOFF AT THEIR FELLOW TAXPAYERS

MR. CHAIRMAN, I ASK UNANIMOUS CONSENT THAT THERE BE PRINTED IN THE HEARING RECORD AT THE CONCLUSION OF MY REMARKS, TWO LETTERS FROM THE COMPTROLLER GENERAL AND A MEMORANDUM FROM OMB DIRECTOR MCINTYRE ON THE SUBJECT OF DEBT COLLECTION. THE LETTERS ARE IN SUPPORT OF THIS EXPERIMENT. THEY ALSO ADDRESS SOME OF THE CONCERNS THAT HAVE BEEN RAISED ABOUT THE PILOT TEST BY SEVERAL OF MY COLLEAGUES.

THE MEMORANDUM SHOWS THAT THE ADMINISTRATION IS ALSO CONCERNED ABOUT THE MATTER OF DEBT COLLECTION AND RECOGNIZES MORE NEEDS TO BE DONE IN THIS AREA.

QUESTIONS OF CONFIDENTIALITY

MR. CHAIRMAN, I MIGHT SAY, IN ADDITION, THAT THERE HAVE BEEN QUESTIONS RAISED ABOUT CONFIDENTIALITY AND THE TAX RETURN BEING SACROSANCT, AND THAT ITS CONFIDENTIALITY SHOULD BE AND MUST BE PROTECTED. MR. CHAIRMAN, I COULD NOT AGREE MORE WITH THOSE EXPRESSIONS, BUT I ASK, HOW IS THE CONFIDENTIALITY OF THE TAX RETURN TO BE BREACHED BY THE ADDITION OF 30 STAFF MEMBERS TO THE INTERNAL REVENUE SERVICE STAFF? DOES NOT THE

STAFF OF THE INTERNAL REVENUE SERVICE PRESENTLY HAVE ACCESS TO THE TAX RETURNS OF THE CITIZENS OF THIS COUNTRY?

THE QUESTION WAS RAISED, IS THERE ADEQUATE DUE PROCESS? I SAY, MR. CHAIRMAN THAT I AM AS CONCERNED AS THE NEXT SENATOR ABOUT GUARANTEEING AND INSURING THAT OUR CITIZENS HAVE ACCESS TO DUE PROCESS OF LAW. THE SYSTEM THAT HAS BEEN SET UP TO COLLECT THESE DELINQUENT ACCOUNTS WOULD GUARANTEE DUE PROCESS.

GUARANTEE OF DUE PROCESS

FIRST AND FOREMOST, THE DELINQUENT BORROWER WILL HAVE SIGNED A NOTE AND, AT THE TIME THAT THIS NOTE IS SIGNED, THERE WOULD HAVE BEEN FULL DISCLOSURE OF THE RIGHTS AND THE OBLIGATIONS THAT FLOW BETWEEN THE PARTIES WITH REGARD TO THIS PROMISSORY NOTE. AT THE TIME THAT THE DEBTOR OR THE BORROWER LEAVES THE SCHOOL, THERE WOULD BE AN EXIT INTERVIEW AND THERE WOULD BE PROVIDED TO THE BORROWER OR THE DEBTOR A REPAYMENT SCHEDULE, THE SCHEDULE BY WHICH THEY ARE EXPECTED TO REPAY THIS LOAN.

THEREAFTER, A WRITTEN RECORD IS MAINTAINED OF THE EXIT INTERVIEW, INCLUDING A SIGNED COPY, SIGNED BY THE DEBTOR, OF THE REPAYMENT SCHEDULE.

THEREAFTER, CONTACT IS MAINTAINED WITH THE BORROWERS AFTER THEY LEAVE THE SCHOOL, ALSO ESTABLISHING AND MAINTAINING REGULAR BILLING AND FOLLOW-UP PROCEDURES DURING THE PERIOD IN WHICH THE OUTSTANDING LOAN BALANCE REMAINS UNPAID.

SHOULD, FOR SOME REASON, IT BECOME IMPOSSIBLE TO CONTACT THE DEBTOR THROUGH THE ORDINARY COURSE OF EVENTS OR THROUGH THE MAIL, THEN A COMMERCIAL SKIP-TRACING ORGANIZATION OR SOME ORGANIZATION PERFORMING THE EQUIVALENT SERVICE FOR THE INSTITUTIONS ARE EMPLOYED TO LOCATE THE BORROWERS. AFTER THE BORROWERS ARE LOCATED, IF THERE IS STILL NO PAYMENT, THEN A COLLECTION AGENCY IS EMPLOYED IN AN EFFORT TO COLLECT THE REMAINING INDEBTEDNESS.

AFTER ALL OF THESE STEPS ARE TAKEN AND AFTER ALL OF THESE STEPS HAVE BEEN FRUITLESS AND ALL OTHER AVENUES HAVE BEEN

EXHAUSTED, THEN A LETTER WOULD GO FORWARD TO THE DEBTOR FROM THE DEPARTMENT OF EDUCATION, INDICATING THAT THE DEBT IS OWED ASKING IF THERE IS ANY DISPUTE ABOUT THE AMOUNT THAT IS OWED AND, IF SOME RESPONSE IS NOT FORTHCOMING, THEN THE DEBTOR WOULD BE SUBJECT TO OFFSET: THAT IS, THE AMOUNT COMING TO THE DEBTOR BY WAY OF TAX REFUND WOULD BE SUBJECT TO AN OFFSET OF THIS PARTICULAR DEBT.

NOW, SHOULD THE DEBTOR COME FORWARD AND SAY, "I DO NOT OWE THIS MONEY," OR THERE IS SOME DISPUTE, THEN THE DEBTOR'S NAME WOULD BE AUTOMATICALLY REMOVED FROM THE PILOT PROJECT AND HE WOULD NOT BE SUBJECT TO THE OFFSET PROVISIONS.

MR. CHAIRMAN, I DO NOT SEE HOW WE COULD MORE FULLY GUARANTEE AND PROTECT THE DUE PROCESS OF CITIZENS THAN THIS--ONE PROCEDURE AFTER ANOTHER, AND ALWAYS THERE IS PRESENT THE SIGNED PROMISSORY NOTE, WHICH IS THE BASIS FOR ANY EFFORT IN DEBT COLLECTION.

HONEST CITIZENS WOULD BE GRATEFUL

MR. CHAIRMAN, I AM IN FULL AGREEMENT WITH THE STATEMENT OF THE COMPTROLLER GENERAL ON THIS ISSUE. I FIRMLY BELIEVE THAT THE VAST MAJORITY OF HONEST CITIZENS--WHO PAY THEIR JUST DEBTS TO THE GOVERNMENT--WOULD BE GRATEFUL TO SEE THE GOVERNMENT TAKING ACTION TO RECOVER DELINQUINT DEBTS. BUT, THAT ACTION CANNOT BEGIN TO TAKE PLACE IN THE WAYS I HAVE EXPLAINED--UNLESS THIS COMMITTEE SUPPORTS THIS PILOT TEST.

HR 4155

MR. CHAIRMAN, ON JUNE 17, HR 4155 PASSED THE HOUSE BY A YEA-AND-NAY VOTE OF 411 YEAS. THIS LEGISLATION WOULD AMEND THE INTERNAL REVENUE CODE OF 1954 TO ALLOW THE INTERNAL REVENUE SERVICE TO DISCLOSE TO THE SECRETARY OF EDUCATION THE MAILING ADDRESS OF INDIVIDUALS WHO HAVE DEFAULTED ON CERTAIN STUDENT LOANS.

Current Situation

Under present law, the Secretary of the Treasury may disclose to the Secretary of Education the mailing address of any taxpayer who has defaulted on a National Direct Student Loan under the fund established under part E of Title IV of the Higher Education Act of 1965. The addresses disclosed by the Secretary may be used only for the purpose of locating taxpayers who have defaulted on student loans in order to collect the defaulted amounts.

Any mailing addresses which have been disclosed to the Secretary of Education may, in turn, be disclosed to any educational institution with which there is an agreement under this loan program. Officers, employees, or agents of such an institution, whose duties relate to the collection of student loans, may use the addresses for purposes of locating individuals who have defaulted on student loans.

Success of Existing Program

Mr. Chairman, in preparation for this hearing, I contacted the Department of Education to find out how the existing law relating to the $700 million in defaults at National Direct Student Loan program was working.

This is what I found out:

--Beginning in the Fall of 1979 Department of Education began sending names of defaulted NSDL borrowers to IRS for addresses.

--About 90,000 names have been referred

--IRS provided addresses for 79,100 individuals.

--The process works as follows:

-Schools give the names of defaulted borrowers to the Department of Education

-The names are put on a computer tape which is sent to IRS

-IRS matches the tape with its taxpayer address file

-THE MATCHED ADDRESSES ARE RETURNED TO THE DEPARTMENT WHICH GIVES THE ADDRESSES TO THE SCHOOLS

--THE DEPARTMENT HAS INFORMALLY CHECKED ABOUT THE PROGRAM'S EFFECTIVENESS WITH SOME SCHOOLS.

--GENERALLY THE SCHOOL OFFICIALS SAID THAT THE ADDRESSES WERE GOOD ADDRESSES WHICH THEY DID NOT HAVE IN THEIR FILES AND THEY WERE ABLE TO CONTACT MANY DELINQUENT BORROWERS.

IN VIEW OF SUCH SUCCESS, I FULLY SUPPORT THE ENACTMENT OF HR 4155 OR SIMILAR LEGISLATION WHICH WOULD EXTEND THE EXISTING PROGRAM TO THE $1.3 BILLION IN DEFAULTS AT THE GUARANTEED STUDENT LOAN PROGRAM AT THE DEPARTMENT OF EDUCATION. HR 4155 WOULD ALSO EXTEND THE CONCEPT TO COVER THOSE WHO HAVE DEFAULTED ON LOANS MADE UNDER THE CUBAN LOAN PROGRAM.

THIRD SUGGESTION--REDISCLOSURE

MR. CHAIRMAN, THIS BRINGS ME TO THE THIRD SUGGESTION FOR IMPROVED COOPERATION BETWEEN THE INTERNAL REVENUE SERVICE AND THE DEPARTMENT OF EDUCATION.

I AM ADVISED BY THE ACTING COMPTROLLER GENERAL, MR. MILTON SOCOLAR, THAT THE IRS INTERPRETS CURRENT LAW AS PRECLUDING REDISCLOSURE OF ADDRESSES TO THIRD PARTIES SUCH AS CREDIT BUREAUS OR CONTRACTORS ASSISTING IN THE COLLECTION WORK. THE ACTING COMPTROLLER GENERAL HAS CONCLUDED THAT THE PRESENT RESTRICTION ON REDISCLOSURE OF ESSENTIAL IRS ADDRESS INFORMATION HAS THE EFFECT OF PRECLUDING FEDERAL AGENCIES FROM FULLY CARRYING OUT THEIR COLLECTION RESPONSIBILITIES. THE RESTRICTION CAUSES AGENCIES TO SPEND MONEY AND TIME ATTEMPTING TO OBTAIN ADDRESSES FROM LESS EFFECTIVE LOCATOR SOURCES, OR TO OBTAIN ADDRESSES FROM IRS, BUT TERMINATE COLLECTION ACTION BEFORE ALL AVENUES THAT COULD RESULT IN COLLECTION HAVE BEEN EXHAUSTED. CONSEQUENTLY, I AM OFFERING FOR THE RECORD SUGGESTED LANGUAGE FOR AN AMENDMENT TO 26 USC 6103(M)(2), WHICH WOULD RESOLVE THIS

PROBLEM.

THE LANGUAGE FOLLOWS:

PROPOSED REVISION OF 26 U.S.C. 6103 (M)(2)

THE SECRETARY MAY, UPON WRITTEN REQUEST, DISCLOSE THE MAILING ADDRESS OF A TAXPAYER TO AGENCY OFFICERS AND EMPLOYEES FOR USE, INCLUDING REDISCLOSURE, IN CARRYING OUT COLLECTION ACTIVITIES IN ACCORDANCE WITH SECTION 3 OF THE FEDERAL CLAIMS COLLECTION ACT OF 1966 OR OTHER STATUTORY AUTHORITY.

CONCLUSION

MR. CHAIRMAN, I HOPE YOU AND YOUR COLLEAGUES WILL SUPPORT THESE THREE SUGGESTIONS WHICH HAVE THE POTENTIAL OF EVENTUALLY SAVING THE TAXPAYER IN EXCESS OF $1 BILLION.

THESE THREE SUGGESTIONS CONSTITUTE, MR. CHAIRMAN, A VERY MODERATE PROPOSAL--AN OPENING GUN--TO COMBAT A VERY SERIOUS PROBLEM.

IF THE THREE SUGGESTIONS ARE APPROVED, I BELIEVE WE WILL BE SENDING THE CORRECT MESSAGE TO THE TAXPAYERS--THAT IS, THAT WE RECOGNIZE THAT IT IS PATENTLY UNFAIR TO THE HONEST CITIZEN WHO PAYS HIS DEBTS TO THE GOVERNMENT TO ALLOW OTHER DEBTS TO GO UNCOLLECTED.

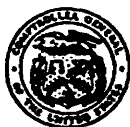
IT SEEMS TO ME THAT IF WE DO NOT APPROVE THE THREE SUGGESTIONS, WE MAY BE CONVEYING JUST THE OPPOSITE MESSAGE--THAT THE U.S. GOVERNMENT DOES NOT HAVE THE WILL TO COLLECT FROM THE DEADBEATS, EVEN WHEN THE INDIVIDUAL HAS THE ABILITY TO PAY AND THE AMOUNT OF THE DEBT IS NOT IN DISPUTE.

LIKE ALL OF MY COLLEAGUES, MR. CHAIRMAN, I HAVE VISITED MY STATE OVER THE PAST FEW WEEKS. WE RECOGNIZE THE MOOD OF THE COUNTRY. THE CITIZENS WE HAVE BEEN ELECTED TO SERVE ARE CONCERNED ABOUT INFLATION, RECESSION, THE FEDERAL DEFICIT, AND TAXES. SUPPORT FOR THESE THREE SUGGESTIONS IS ONE WAY WE CAN TELL THEM WE, AS THEIR ELECTED REPRESENTATIVES, APPRECIATE THOSE CONCERNS AND STAND READY TO DO SOMETHING ABOUT IT. EACH MILLION DOLLARS COLLECTED UNDER THE PROVISIONS OF THE SUGGESTIONS I HAVE MADE REDUCES THE DEFICIT, REDUCES THE NATIONAL DEBT,

AND HAS THE CONSEQUENT MODERATING INFLUENCE ON TAXES AND INFLATION.

MR. CHAIRMAN, I URGE YOU AND YOUR COMMITTEE TO SUPPORT THE THREE SUGGESTIONS. I BELIEVE VERY STRONGLY IN THESE THREE SUGGESTIONS. I AM CONFIDENT THAT THE SUBCOMMITTEE WILL TREAT THESE SUGGESTIONS FAIRLY, AS ALWAYS.

I THANK THE CHAIRMAN AND THE MEMBERS OF THE SUBCOMMITTEE FOR ALLOWING ME TO TESTIFY TODAY.



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

August 22, 1979

B-159687

The Honorable James R. Sasser
United States Senate

Dear Jim:

This letter discusses the additional views which were included in the Committee on Appropriations Report on the Treasury, Postal Service, and General Government Appropriation Bill for Fiscal Year 1980 (H.R. 4393). These additional views concern a provision which would provide funding necessary for IRS to test the collection of delinquent debts by keeping tax refunds as offsets.

The provision would support a test program by providing $1 million to fund 30 authorized positions for IRS to perform the test. For this test, 100,000 debts due the Office of Education under the National Direct Student Loan Program would be selected. These debts would be delinquent loans on which the debtor had signed a promissory note to an educational institution and subsequently defaulted. These defaulted loans have all been assigned to the Office of Education by the educational institutions.

On all delinquent loans included in this test, the educational institutions will have exercised due diligence in their collection effort. Due diligence efforts include:

--fully disclosing to borrowers their rights and obligations when they sign the promissory notes,

--conducting an exit interview with borrowers and providing them a copy of the repayment schedule before they leave school,

--maintaining a written record of the exit interview including a signed copy of the repayment schedule,

--maintaining contact with borrowers after they leave school,

--establishing and maintaining regular billing and follow-up procedures during the period in which any outstanding loan balance remains unpaid,

--using a commercial skiptracing organization or performing the equivalent service with institutional personnel to locate borrowers, and

--engaging a collection agency or performing collection activities with school personnel or resorting to litigation in those cases in which a borrower fails to make loan payments.

In addition to these efforts by the educational institutions, the Office of Education would be required to meet normal due process requirements prior to referring the debt for offset. Any disputed debts would be dropped from the sample of cases referred to IRS for possible offset. The remaining debts which would be transferred to IRS for offset would be ones in which both the school's and the Office of Education's debt collection process has proved unsuccessful.

We respect the views of your colleagues on this important legislation; however, we believe it is important that they consider all factors in arriving at a final decision on this matter. I would like to provide the following specific comments on points raised in the additional views of Senators Schmitt, Laxalt, Weicker, McClure and Hatfield.

1. The additional views make the statement that "... the four committees having direct jurisdiction over this new endeavor, the Ways and Means Committee, the Senate Finance Committee and the House and Senate Committees on Appropriations, have not held one hearing where evidence was received that would justify this expenditure allowing the IRS to enter into the vast unexplored area of debt collection by setoff". The Senators were apparently unaware that, on March 20, 1979, you presided over the Senate Committee on Appropriations, Subcommittee on Legislative Branch hearings on "Improving Government Debt Collection Operations." During these hearings, the feasibility of utilizing IRS to collect debts was discussed. In addition, in December 1978, we testified at length on Federal debt collection before the Senate Finance Subcommittee on Taxation and Debt Management Generally. While we did not discuss the subject of IRS setoff

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since our report had not been issued, the Finance Subcommittee received a copy of our March report.

2. As pointed out in the additional views, departments and agencies have not been aggressive in pursuing collection of debts. Also, although GAO has recommended certain improvements, actions to tighten debt collection procedures have not been completed.

   We recognize the need for agencies to retain primary responsibility for collecting any debts due the Government resulting from their operation. The proposed method of collecting amounts due the Government by reducing future refunds due the taxpayer would work in conjunction with the present collection system. The Office of Education would retain primary responsibility for collection of amounts due. Only after the Office of Education has taken appropriate collection action and has determined that further efforts, including legal action, would not be economically feasible, would they then refer the debt to IRS.

   In this test, the agency would transfer loans to IRS for offset only after the existing collection process has been aggressively pursued. Thus, this method would not replace normal agency debt collection procedures or eliminate the requirement for aggressive action on the part of the Office of Education. Instead, this process would be used as a last resort after the existing debt collection process has proved unsuccessful. However, as there were 841,181 students with $702,542,830 outstanding on defaulted loans at September 30, 1978, there will be many debts which cannot be economically collected by conventional methods.

3. The concern that "...taxpayer confidence in the tax administration system could be seriously compromised by turning the IRS into a bill collecting agency" would probably be unfounded. A widespread public outcry against using IRS as the Government's debt collector should not be heard if offset is used under the constraints discussed. Instead, quite the opposite reaction would likely occur if this collection procedure were publicized. The majority of

honest citizens who pay their debts to the Government would be gratified to see the Government taking actions to recover delinquent debts.

4. The statement that, under the proposal, the burden of proof of the debt is shifted from the Government to the individual is unfounded. Under the National Direct Student Loan Program, the debtor signed legally binding promissory notes. These notes have since been reassigned to the Office of Education. Further, no collection action will be taken in any instance where the amount of the debt is in dispute.

5. Due process requirements and rights of the individual have been carefully considered. The Office of Education would be required to meet normal due process requirements prior to referring the debt. Also, we believe collection by offset is warranted by equity concerns. It's patently unfair to the honest citizen who pays his debts to the Government to allow other debts to go uncollected. This inequity is especially acute when the individual owing the debt has the ability to pay but does not, and the validity or amount of the debt is not in dispute.

6. The fact that "the relationship between a taxpayer and the Government is one of extreme confidentiality and must be protected in every way" was fully considered during our review. We recognize that tax return information is confidential under the Internal Revenue Code. However, no individual's tax return information will be released outside IRS. This test of offset will not contravene the intent of the Tax Reform Act of 1976. Instead, all limitations required by law will be strictly adhered to.

7. The conclusion that "IRS is given new authority to deduct from moneys due and owing a taxpayer those sums allegedly due the Government" is without legal basis. The Federal Government's right to collect delinquent debts by offsetting against amounts due the debtors is strongly supported by statutes and court decisions. IRS has on occasion, reduced tax refunds when agencies have requested that an offset be made.

8. The additional views discuss the need for the Congress to act in a deliberative manner and to make

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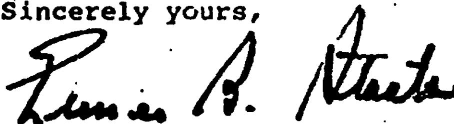
a decision based on full consideration of all available facts. We recognize the need for congressional consideration of the impact of any debt collection initiative of this magnitude. Also, we recognize that some of your colleagues will continue to have reservations about the desirability and practicability of this program. However, our report recommended that such a program first be tested by IRS to determine the extent to which there are problems and how they should be overcome before a full scale program is implemented. Further, we urged the IRS to keep Congress fully informed on the status of the test effort and to fully coordinate its approach with the appropriate committees. The action initiated by the Senate Appropriation Committee would provide funds for such a test and would provide additional data for use in any hearings or other deliberation deemed necessary by the Congress.

Because of the substantial amounts that could be collected under this program, we believe funding for this test offset program should be retained in the Treasury, Postal Service, and General Government's Appropriation Bill.

Sincerely yours,



Comptroller General
of the United States

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-199382

JULY 17, 1980

The Honorable Jim Sasser
Chairman, Subcommittee on the
Legislative Branch
Committee on Appropriations
United States Senate

Dear Mr. Chairman:

Subject: Oregon's Offset Program for Collecting Delinquent Debts Has Been Highly Effective (FGMSD-80-68)

Your letter of October 24, 1979, asked us to evaluate Oregon's program for collecting uncontested delinquent debts by keeping State tax refunds as offsets. You were interested in knowing the success of this program and its applicability to the Federal Government.

Oregon's offset program has been very successful in collecting delinquent debts. In 1979 alone, over $2.4 million in delinquent debts that most likely would have been lost to the State were collected by offset. The State spent only about $200,000 to collect this amount.

Oregon has collected significant amounts of money that would otherwise be uncollected while at the same time protecting the rights of the debtors. Only acknowledged debts of an undisputed amount are subject to offset. Strict controls have been implemented to ensure that (1) the debtor has every opportunity to establish that the debt is invalid and (2) tax refunds are not arbitrarily offset.

The Oregon program is similar to a Federal offset program we recommended in our March 9, 1979, report "The Government Can Collect Many Delinquent Debts By Keeping Federal Tax Refunds As Offsets" (FGMSD-79-19). In that report we proposed that, on a test basis, agencies refer to the Internal Revenue Service for offset those debts which the agencies have been unable to collect through normal collection procedures. The test program would include provisions to ensure that only undisputed debts were offset and to fully protect the debtor's right to due process. The Internal Revenue Service was unable

(901335)

to test the offset program because the Congress did not appropriate funds for the test.

We believe that a Federal offset program would repeat Oregon's success and result in significantly increased collections at relatively little additional cost. A discussion of Oregon's collection program and of how the State protects the rights of debtors follows.

OREGON COLLECTS DELINQUENT DEBTS BY OFFSET

In 1971 Oregon's Department of Revenue established a collection unit to collect delinquent amounts owed State agencies and State-supported hospitals, colleges, and universities. Among the debts collected are welfare overpayments, hospital bills, and student loan payments, including payments on National Direct Student Loans and Health Professions Student Loans. The unit collects only debts that are not in dispute--that is, the debtor has not denied owing the debt. The collection unit uses a variety of collection methods, including offset against State income tax refunds and refunds due debtors under a homeowners and renters relief program. In 1979, the collection unit collected \$2.6 million--\$2.4 million through offset--at a total cost of about \$200,000.

Oregon's State agencies have primary responsibility for debt collection. However, if a debt becomes delinquent and the agency is unable to collect from the debtor, the agency may submit the debt to the collection unit for either restricted or unrestricted collection, as discussed below.

Restricted program uses offset exclusively

Under the restricted program, known as Setoff of Individual Liability, the only collection procedure used is offset. Twice a year agencies submit the names and social security numbers of delinquent debtors to the collection unit. The agency referring a debt continues its collection efforts even though it has referred the debt to the collection unit.

The collection unit prepares a computer tape and computer cards with the names and social security numbers that were provided by the individual agencies. Before an income tax or homeowner and renters relief refund is issued, the computer tape of delinquent debtors is compared to the computer tape of refunds. If there is a match, the refund is put into a suspense account and the dollar amount of the refund is manually recorded on the computer card. This card is sent to the submitting agency which enters the dollar amount that is delinquent and returns the card to the

collection unit. The returned card is the collection unit's authority to make the offset.

Once the agency gives the collection unit this authority, the amount of the debt offset against the refund, less a collection fee, is sent to the agency. The agency is responsible for properly recording the full amount of the offset to the debtor's account. The collection fee is an administrative expense not chargeable to the debtor's account. In 1978, 10,195 accounts--totaling $1.2 million--were offset through the restricted program. During 1979, 16,526 accounts totaling $1.7 million were offset.

Unrestricted program uses offset and other methods to collect delinquent debts

Under the unrestricted program, agencies provide the collection unit with all available information on the debt and debtor, such as name, address, phone number, and name of relatives. Once the agency provides this information, it stops trying to collect and the collection unit takes all responsibility for collecting from the debtor.

The collection unit sends a letter notifying the debtor that the account has been assigned to the Oregon Department of Revenue for collection. The balance of the account is shown and the debtor is asked to contact the collection unit to discuss the debt. If the debtor does not respond to the letter, collection unit personnel telephone the debtor. If the debtor cannot be reached by telephone, collection unit personnel check the division of motor vehicles, credit bureaus, utility companies, and local merchants for the debtor's current address. In addition, if the debtor is due an income tax or homeowner and renters relief program refund, the refund will be applied against the debt.

All collections, including offsets, are provided to the creditor agency, less a collection fee. The agency is responsible for ensuring that the full amount collected is credited to the debtor's account.

During 1979, $924,000 was collected using the unrestricted program; $744,000 was by offset. As of February 1, 1980, the collection unit was responsible under the unrestricted program for collecting on 13,603 accounts totaling $7 million.

DEBTORS' RIGHTS ARE PROTECTED

Oregon's Department of Revenue has established strict controls to ensure that debtors' rights to due process are protected and that tax refunds are not arbitrarily offset.

B-199382

State agencies submit only uncontested debts to the collection unit for offset. These are debts which the debtor acknowledges are owed and there is no question as to the amount owed. The submitting agency must document that the debt is not in dispute before submitting it to the collection unit.

Before the collection unit offsets a refund it informs the debtor in writing that the refund is being held to be applied against a delinquent debt. The debtor is told that the offset will become final unless, within 30 days, the debtor requests a hearing with the creditor agency. Since the debts are not in dispute, few hearings are requested--only about 350 in 1978. Although the Department of Revenue does not keep data on the disposition of the hearings, officials stated that most hearings are resolved in the State's favor and seldom is the debtor relieved of responsibility for the debt.

Debtors who request hearings usually question the legality of the offset program, not the debt's validity. The legality of the program was affirmed in a June 1978 decision by the Oregon Court of Appeals. The court stated that the State has the right to offset funds in its possession against debts owed by its citizens and that debtors are not denied due process since each debtor has an opportunity to discuss with the appropriate creditor the validity and amount of the debt in question.

The procedures which are operating effectively in Oregon to protect debtors' rights are similar to procedures we proposed for the Internal Revenue Service test of a Federal offset program. In a July 31, 1979, letter to you, we stated that to protect the debtor's right to due process the agency referring a debt for offset must

--establish the debt's validity by giving the debtor ample opportunity to dispute the Government's claim,

--notify the debtor that the receivable was being transferred to the Internal Revenue Service for collection,

--give the debtor an opportunity to request a hearing on the offset, and

--notify the debtor when the debt was collected by offset.

As clearly demonstrated in Oregon, these procedures would fully protect the individual debtor's rights.

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OFFSET WILL SUPPLEMENT
AGENCY COLLECTION SYSTEMS

As discussed in our March 9, 1979, report, although offset is a needed and useful tool for collecting delinquent debts, Federal agencies will still be primarily responsible for collecting debts resulting from their operations. This responsibility will not be shifted to the Internal Revenue Service by a tax refund offset program. The offset program will supplement, not replace, effective agency collection systems.

We strongly support and encourage the efforts agencies have made to collect all the money they are owed and to aggressively pursue delinquent debtors. However, as discussed in our January 15, 1980, report entitled "Unresolved Issues Impede Federal Debt Collection Efforts--A Status Report," (CD-80-1), a number of our reviews have disclosed that Government collection efforts are generally weak, particularly when debts are delinquent. We have recommended that agencies adopt more aggressive collection procedures, including such practices used by commercial firms as

--reporting delinquent debtors to credit bureaus,

--using locator services to locate delinquent debtors,

--making greater use of automation in the collection process, and

--improving demand for payment letters.

If agencies adopt and effectively implement these common commercial practices, collections would increase. However, some debts would remain uncollected simply because the debtor, while acknowledging the debt was valid, refused to pay. In many cases these debts are small and it is uneconomical for the Government to obtain a judgment against the debtor. These are the type of debts that could be economically collected by a tax refund offset. The offset would be made only when all other agency collection efforts fail.

Oregon officials told us that officials from other States have contacted them about establishing offset programs. In addition, the Council of State Governments recently completed a review of Oregon's offset program and will disseminate the information to all States. The Council expects more States to establish offset programs as a result.

B-199382

CONCLUSIONS

We continue to believe that an income tax refund offset program is a logical, simple, and economical method of collecting debts that are uncollectible by any other means. An effective offset program would substantially reduce the over $1 billion the Federal Government loses annually by writing off uncollectible debts.

The evidence favoring a test of a Federal offset program is overwhelming. Our March 9, 1979, report recommending such a test and the success of Oregon's offset program document the feasibility of collecting otherwise uncollectible debts by offsetting Federal income tax refunds. Also, collection by offset is warranted by equity concerns. It is patently unfair to citizens who pay their debts to allow other just debts owed the Government to go uncollected. This inequity is especially acute when the individual owing the debt does not dispute the debt or its amount and can pay but does not.

RECOMMENDATION

We continue to strongly support a Federal income tax refund offset program for collecting otherwise uncollectible debts and reiterate our earlier recommendation that the Congress provide funding for the Internal Revenue Service to test and adopt an offset program.

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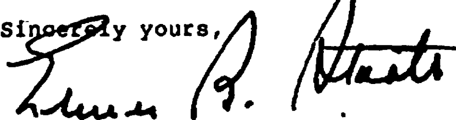
At the request of your office, we did not obtain comments on matters discussed in this letter from the Internal Revenue Service. We discussed the part of the report covering Oregon's offset program with officials of the State's Department of Revenue. They said the information presented was accurate.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this letter until 30 days from its date. At that time we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,



Comptroller General
of the United States

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

AUG 21 1979

MEMORANDUM FOR HEADS OF EXECUTIVE DEPARTMENTS AND AGENCIES

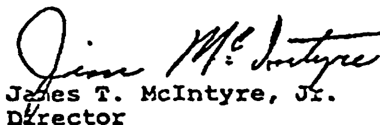
SUBJECT: Debt Collection

The amount of overdue debts owed the Government is a matter of increasing concern. Since I last wrote you in March, our recognition of the issue has been matched by a growing awareness in Congress and the media.

While we have included debt collection in the Financial Priorities Program, we believe stronger measures are required to collect the monies owed. Toward that end, we have created a Debt Collection Project under the newly formed President's Management Improvement Council. Following the lines of the successful President's Cash Management Project, the Debt Collection Project will seek answers to individual agency problems while pursuing solutions at the general government-wide level as well. The project is intended to build on initiatives already planned and underway, including those mentioned in responses to my March memorandum.

Mr. Wayne Granquist, our Associate Director for Management and Regulatory Policy will be responsible for the Debt Collection Project. In order to coordinate this joint effort, we request you designate a representative to help us in developing specific plans, coordinating the work in your agency and keeping you informed as the work progresses.

To begin early consideration of the work plan, we would appreciate receiving word of your representative designee during the next two weeks. For any additional information, please call Jerry Bridges at 395-3967.



James T. McIntyre, Jr.
Director

STATEMENT OF THE NEW YORK STATE BAR ASSOCIATION TAX SECTION

The Tax Section of the New York State Bar Association is pleased to submit this preliminary statement of its views, in connection with the hearing scheduled for June 20, 1980, by the Subcommittee on Oversight of the Internal Revenue Service, of the Senate Finance Committee in regard to certain bills to amend Section 6103 and related sections of the Internal Revenue Code, which have been introduced by Senator Nunn and other members of the Permanent Subcommittee on Investigations of the Committee on Government Affairs of the United States Senate. The amendments are designed to facilitate disclosure of income tax returns and related information by the Internal Revenue Service to other federal law enforcement agencies for use in the investigation and prosecution of non-tax crimes.

This statement is confined to S. 2402, S. 2404, and S. 2405, and addresses only certain of the more important features of those bills. The Tax Section may submit a further statement after it has had an opportunity to give additional consideration to this important package of legislation.

The impetus for the subject bills, as stated by Senator Nunn, Chairman of the Permanent Subcommittee on Investigations, is an alleged significant decline in the assistance furnished by the Internal Revenue Service to other federal law enforcement agencies since the enactment of the Tax Reform Act of 1976. Causes for this decline are found to be ambiguities and unnecessary hurdles to disclosure imposed by the Tax Reform Act, coupled with a supposed reluctance on the part of IRS officials to become involved in law enforcement matters unrelated to tax administration. The stated objective of the proposed amendments is to achieve a balance between the privacy of tax returns and the legitimate needs of law enforcement agencies without scrapping the privacy safeguards which were written into the 1976 Tax Reform Act. 126 Cong. Rec. S. 2373-77 (March 11, 1980) (remarks of Sen. Nunn).

PRECIS OF TAX SECTION POSITION

The Tax Section of the NYSBA supports the foregoing general objective of balancing privacy and law enforcement which these bills seek to achieve, but believes that insufficient evidence has been adduced that the present statutory provisions of Code Section 6103 do not achieve approximately the correct balance between considerations of privacy and enforcement. While we can support certain of the proposed changes which would clarify provisions of the 1976 Tax Reform Act and facilitate its administration, we are opposed to the principal provisions of the major bill (S. 2402) in its present form, to wit: according different treatment to tax returns, on the one hand, and to other information submitted to the IRS by or on behalf of the taxpayer, on the other hand; significantly lowering the standards for issuance of ex parte orders in certain cases; and imposing affirmative obligations of disclosure on IRS vis-a-vis other law enforcement agencies. In any event, the Section would recommend deferral of enactment of S. 2402 pending the completion of interagency arrangements between IRS and the Department of Justice for the implementation of the present law.

We favor the enactment of provisions designed to accomplish the objectives of S. 2404 and S. 2405.

BACKGROUND

Prior to 1976 federal tax returns were public records open to inspection in accordance with the terms of executive orders of the President, and rules and regulations promulgated by the Secretary of the Treasury and approved by the President. In the wake of the Watergate investigations, with the attendant revelation of the use by the White House of tax returns and related information to bring pressure on individuals listed on the "enemies' list", Congress included limitations on disclosure in the Tax Reform Act of 1976 ("the Act").

One of the pertinent provisions of the Act classified all tax information obtained by the IRS into three categories: (1) "tax returns", consisting of tax returns and similar documents required to be filed by a taxpayer with the IRS; (2) "taxpayer return information", consisting of pertinent financial and other information furnished to the IRS by or on behalf of the taxpayer; and (3) "return information other than taxpayer return information", consisting of information obtained by the IRS from third parties unconnected with the taxpayer. The Act specified that all three types of information are "confidential", but differentiates between the first two types and the third type insofar as disclosure to other federal agencies is concerned.

Under the Act, tax returns and taxpayer return information are disclosable for administration of federal laws not relating to tax administration only upon the grant, by an ex parte order by a federal district judge, of an application brought by

the Attorney General, the Deputy Attorney General or an Assistant Attorney General of the United States, or the heads of certain federal agencies.

The application may be granted only on a showing that there is (i) reasonable cause to believe that a specific criminal act has been committed, (ii) reason to believe that the tax return would be "probative evidence of a matter in issue relating to the commission of such criminal act", and (iii) evidence that the information cannot reasonably be obtained from any other sources, unless the information constitutes the "most probative evidence" of a matter in issue. In contrast, return information other than taxpayer return information does not require court approval prior to disclosure, but can be disclosed to other federal agencies upon an application by the agency head requesting the information and stating the specific reasons why disclosure is or might be material to another proceeding or investigation. The IRS is precluded from disclosing all three types of information if it determines that disclosure would identify a confidential informant or seriously impair a tax investigation.

TAX REFORM ACT IN PRACTICE

The Permanent Subcommittee on Investigations concluded, after five days of hearings in December 1979, that the Act has created a series of impediments to disclosure, with the result that little information is currently being exchanged between the IRS and other federal law enforcement agencies. Among other things, the Subcommittee concluded that under the current application procedure the applicant is required to specify what he expects to find in a return in order to obtain permission to see it, but is precluded from seeing the return in order to fill out the application. As stated by Senator Nunn: "In other words, the Tax Reform Act requires federal investigative agencies to go through the elaborate request procedures to obtain IRS information they do not even know exists." 126 Cong. Rec. S. 2374 (March 11, 1980).

The Subcommittee also concluded that IRS officials, perhaps motivated by concern over the Act's criminal penalties applicable to them personally for unauthorized disclosure, have taken an overly conservative position with respect to whether particular information is "taxpayer return information", requiring a court order for disclosure, or "return information other than taxpayer return information", for which no court order is necessary, erring in many instances on the side of requiring a court order. The Subcommittee noted in this connection that corporate records, bank records, agent interviews and FBI information concerning a taxpayer have been considered by the IRS to fall into the category of "taxpayer return information".

PROPOSED AMENDMENTS

S. 2402: Amending section 6103

This bill would modify Section 6103 to classify information obtained by the IRS into two categories: (1) "return", defined as any document the taxpayer is "required by law to file", including the same items mentioned in existing 6103(b) (1), and (2) "non-return information", defined as any information other than a return obtained by the IRS, regardless of source. Disclosure of a "return" could be made only upon the order of a federal district judge, as is the case under the present law. No court order would be required, however, for the disclosure of "non-return information", which would be disclosable upon a written request specifying the fact that the request was being made in connection with an administrative, judicial or grand jury proceeding, or an investigation pertaining to the enforcement of a specifically designated federal criminal statute, and further stating the reasons why the disclosure was or might be material to such proceeding or investigation.

In other major changes from the present law this bill would:

(1) impose on the IRS the affirmative obligations (a) to disclose to other federal law enforcement agencies any information it discovers which may constitute evidence of a federal crime, other than information from the tax return itself, and (b) to advise a government attorney of such information in order to enable the attorney to request all pertinent "non-return information" from the IRS with sufficient specificity to satisfy the statutory requirements;

(2) expand the class of persons entitled to apply for ex parte orders permitting disclosure of tax returns, to include United States Attorneys and other local federal attorneys, thus eliminating bureaucratic delay under the present law which requires such local and regional attorneys to obtain approval from higher authorities within the Justice Department in Washington before applying to the court for disclosure;

(3) modify the factual determinations of a federal judge would be required to make in order to grant an ex parte application for disclosure, by replacing the

presently required findings of "reasonable cause to believe . . . that a specific criminal act has been committed" and "reason to believe" that the return "is probative evidence of a matter in issue related to the commission of such criminal act", with a finding that the application was "made in connection with a lawful administrative, judicial, or grand jury proceeding, pertaining to the enforcement of a specifically designated Federal criminal statute" and that "there is reasonable cause to believe that the information contained in the return is material and relevant to such a proceeding or investigation";

(4) impose time limits upon both the courts and IRS within which to respond to disclosure applications;

(5) require IRS to apply to a court to prevent disclosure of information if it determines that such information would identify a confidential informant or seriously impair a civil or criminal tax investigation, instead of leaving IRS as the ultimate authority to make such determinations as is the case under the present law; and

(6) require IRS to disclose taxpayer identification information to government attorneys upon written request.

S. 2404: Amending section 7213

The bill would amend § 7213, which makes it a felony wilfully to disclose tax returns or tax return information in violation of the Act, by adding an affirmative defense provision to relieve an IRS agent of criminal liability when he can establish that he made the disclosure in the good faith though erroneous belief that disclosure was permitted under the Act. IRS agents testified during hearings on the bill that they never could be sure under the existing law if they were violating the Act when they disclosed information (presumably "return information" not filed by or on behalf of the taxpayer, as to which no court order was required as a prerequisite to disclosure). The result was, according to the Subcommittee, that agents refused to take the initiative and erred on the side of non-disclosure.

S. 2405: Amending section 7217

The present civil damage provision, § 7217, makes any person who wilfully or negligently discloses a tax return or tax return information in violation of the Act personally liable to the taxpayer for civil damages, although there is no civil liability for disclosures which result from good faith but erroneous interpretations of the Act. The proposed amendment would make the United States Government responsible for the civil liability of any federal official or employee so long as the disclosure occurred within the scope of his employment and was not maliciously or wilfully in violation of the disclosure provisions of the Act. It is designed to encourage IRS agents to make bona fide disclosures to other federal officials without fear of personal economic exposure.

TAX SECTION COMMENTS

The Tax Section believes that the objectives of S. 2404 and S. 2405 are desirable. To the extent IRS agents have been reluctant to cooperate with other federal officials without a court order for fear of personal exposure to civil and criminal penalties, the proposed amendments would allegiate that situation.

One could also make a case for some of the proposed changes contained in S. 2402, in particular those which facilitate the handling of applications and requests for information. Thus, the expansion of the category of persons who may apply for an ex parte order would obviate the necessity for a United States Attorney to make requests through his superior and thereby reduce administrative costs. To some extent, the Section suspects, federal law enforcement agencies engaged in legitimate investigations and non-tax prosecutions may have been unduly shackled by the Congressional effort in 1976 to correct widely reported abuses of the tax function during the Nixon Administration.

However, in assessing the proposed legislation, one must be ever mindful of the need for an appropriate accommodation of an individual's privacy interests in regard to his tax information and law enforcement needs for that information. The problem is principally one of line-drawing, since the privacy and enforcement interests are both compelling. Concern for tax return privacy is not simply a private interest. It is generally believed to be essential to our voluntary self-assessment tax system that taxpayers feel assured of a high degree of privacy. Thus, while the introduction of restrictive new rules, in the Tax Reform Act of 1976, regarding access to tax information is generally viewed as part of the post-Watergate syndrome, it must be recognized that these rules have an equally, if not more, important foundation in the Nation's need for an efficient voluntary compliance system.

It has been clear since the Supreme Court decision in *Garner* v. *U.S.*, 424 US 648 (1976), that tax return disclosures are properly admissible in evidence in the prosecution of federal non-tax crimes, even against assertion of a Fifth Amendment privilege. Hence, it must be presumed that the choice offered to criminally active taxpayers to make a good-faith declination to file an incriminating return will be availed of in some reasonable proportion to the frequency and ease of the circulation of tax returns in the federal enforcement pipeline. Thus, the Nation will be increasingly denied both the revenues from criminal gain and the opportunity for prosecution of those crimes.

Moreover, we must be concerned even more with the potential for invasion of the privacy and other harassment of the vast majority of taxpayers who are not criminals. Even as they are entitled to be free of unreasonable search in their homes, so they are entitled to freedom from search parties roaming freely over their tax returns. It was Justice Brandeis who characterized the right of privacy ("the right to be let alone") as "the right most valued by civilized man". *(Olmstead* v. *U.S.*, 277 U.S. 438, 478 (1928), disenting opinion). That right extends to all manner of intrustion in and interference with an individual's person, property and papers, and, indeed, is an essential buttress to such other inalienable rights as speech, association and non-self-incrimination.

We recite these somewhat self-evident truths so that our preference for retaining a certain band of restrictions around tax return data can be seen not as insensitivity to the need for effective criminal enforcement, so much as a particular regard for the delicate balance that we believe is required to maintain a tax self-assessment system and other precious rights. Hence, we are not necessarily averse to some redressing of the balance struck in 1976, but believe generally that a heavy burden should rest on the proponents of change.

As noted at the outset, the Tax Section opposes the proposed amendments to the extent they would differentiate between tax return information provided by a taxpayer, as to which a court order would still be required as a prerequisite to disclosure, and other information submitted by or on behalf of a taxpayer, as to which court approval would apparently no longer be necessary. Assuming the intent of Congress remains steadfastly in favor of the preservation of the confidentiality of tax returns, there would appear to be no substantive difference from the taxpayer's standpoint between the return itself and other data submitted on his behalf.

The problem is created by the proposed elimination of the separate category of "taxpayer return information" and the proposed new definition of "return" which would include only those documents which "the taxpayer is required by law to furnish". Any data submitted voluntarily by the taxpayer, or on his behalf, would thus appear to constitute "non-return information" under the new definition. If such a distinction was not intended by the draftsmen, it could presumably be easily eliminated by redefining "return" to include not only the return itself but all documents filed by the taxpayer or on his behalf, whether or not filed voluntarily or because required by law.

It would appear from the statements accompanying the bill, however, that the distinction was intentionally made in order to circumvent an alleged overbroad interpretation by IRS, which classified various third party records as "taxpayer return information" requiring a court order for disclosure, rather than as "return information other than taxpayer return information".

Such a sharp reversal of the Congressional determination of only several years back to strengthen the safeguards of taxpayer privacy, for no apparent reason other than a perceived overzealousness on the part of IRS officials in protecting the confidentiality of taxpayer records, lacks a sufficient foundation, and is as destructive of the voluntary self-assessment system as similar treatment of taxpayers' returns themselves would be. Any data furnished by the taxpayer or on his behalf are as "confidential" from the taxpayer's standpoint as the tax return itself. Moreover, the existing law, as modified by certain of the other proposed changes in these bills, would appear to furnish an adequate basis on which other federal enforcement agencies could obtain such additional data, as well as the tax returns themselves, in proper cases. The Section has concluded that the more appropriate remedy for any misclassification of data by IRS agents would be a revision of internal IRS guidelines rather than a fundamental change in the confidential treatment accorded taxpayer records.

Regarding the provision of S. 2402 that would lower the standards for granting ex parte orders, the Tax Section can appreciate the objective of the bill sponsors to facilitate the issuance of such orders in appropriate cases and can understand the concern of some that the present provision may impose too formidable an obstacle, in requiring showings that are incapable of being readily made under both the "specific criminal act" and "probative evidence" tests. Our concern, though, is that

the proposed amendment may go too far in the other direction, making all too easy the showing a prosecutor must make, namely, the mere pendency of a proceeding, be it administrative, judicial or grand jury, "pertaining to the enforcement of a . . . criminal statute". No crime need have been committed by the target, nor even the suspicion of one, no judicial proceedings need have been undertaken, and the information sought from the return may never enter into the evidence of any case, but merely be relevant to a pending (or perhaps only contemplated) investigation. Our Section would want to study this particular matter further before being able to reach a satisfactory judgment; but our preliminary assessment is that the proposed language is too conducive of a reversion to the pre-1976 "open door" practice.

It is obvious that many of the difficulties experienced by federal prosecutors since 1976 are due more to inexperience with the workings of the new provisions of Section 6103, and with the lack of established interagency procedures, than with the inherent flaws in the language. Hopefully, these difficulties are in the process of being ironed out in a series of extensive meetings between Departmet of Justice and IRS officials, as reported by Assistant Attorney General M. Carr Ferguson in his testimony before the Senate Appropriations subcommitee April 22, 1980. It would, thereofore, seem to us far preferable to solve as many of the problems as possible through this administrative process. At the very least, deferral of consideration of those provisions of S. 2402 that are the subject of present interagency discussions would appear to be indicated.

In this connection, we would draw particular attention to the provision of S. 2402 mandating that IRS inform other federal law enforcement agencies of non-return information it derives that may constitute evidence of a federal crime. Such a provision poses substantial administrative difficulties. If these are to be overcome, it is more likely that this will occur through negotiations between the agencies concerned than by legislative fiat. We learn from Assistant Attorney General Ferguson's testimony that IRS is now developing procedures and Internal Revenue Manual revisions to place higher priority on alerting DOJ and other Federal agencies to the commission of non-tax crimes and to the existence of tax information relevent to those crimes. It is reported that IRS is contemplating training its revenue agents as to the type of non-tax criminal offenses to which they should pay special attention and as to the nature of the information which can and should be disclosed to Justice.

We also learn from Mr. Fergusons' testimony that the Attorney General has established a new centralized Office of Legal Support Services, to assure that application for tax information under Code Section 6103(i) will be processed by disclosure specialists, and that IRS has also centralized its handling of disclosure requests. IRS is also reportedly instituting a National Office Section 6103 "hot line" to provide field personnel with immediate guidance and interpretifve assistance. United States attorneys are being instructed, through Attorneys' Conferences and workshops, in the most effective procedures for obtaining disclosures; and consideration is being given to clarification and updating of the disclosure provisions of the U.S. Attorneys' Manaual. The disclosure pipeline between IRS and the Attorney General has been shortened by eliminating many of the intervening levels between discloser and disclosee.

Proposals are also under consideration in both DOJ and IRS for facilitating the authorization of joint tax/non-tax grand juries, as a further means of assuring cooperative efforts, and interchange of information, and the joint investigation of related tax and non-tax offenses.

All these developments augur well for expanded and expedited disclosure and use of tax information in criminal cases, under suitable safeguards. Certainly, arrangements developed by the affected agencies, albeit under the spur of threatened Congressional action, seem better calculated to achieve the necessary fine tuning than a legislative solution forced upon the agencies. At least, the agencies should be given a reasonable amount of time to disprove this premise.

CONCLUSION

The sponsors of the proposed legislation have been particularly harsh in their condemnation of the IRS as having become, more by attitude than by requirement of law, an uncooperative member of the federal total enforcement effort. We do not share that view. We are sure that the criticism of the IRS would be even harsher if its were to become, like some other elements of government, a leaky sieve.

There is and will always be a tension between the proper exercise of the police power and the improper use of information held by the Government. We believe that the IRS has consistently endeavored to maintain the necessary tautness on that line. At a time when the public is becoming increasingly apprehensive about the extent of information maintained about private citizens in government data

banks, and the uses thereof, the Congress should go slow in forcing IRS to relax its grip and to give further stimulus to the public's fears.

STATEMENT OF VICTOR THURONYI, LEGISLATIVE DIRECTOR AND THOMAS F. FIELD, EXECUTIVE DIRECTOR, TAXATION WITH REPRESENTATION FUND

I. DISCLOSURE OF RETURNS AND RETURN INFORMATION

The principal purpose of S. 2402 is to facilitate the disclosure of IRS information to other government personnel. We leave it to others to comment on the wisdom of this measure. Our concern is that this bill is being used as a means of restricting legitimate public access to IRS records. This restriction is being accomplished by changing the present law definitions of "return information" and "taxpayer return information."

As the following analysis will show, it is entirely unnecessary and inappropriate to change the definitions of these categories to accomplish the purposes of the bill. We therefore recommend that the definitions in section 6103(b) be retained, and that any changes in the procedure for disclosing these categories of information be made in terms of these existing categories.

A. The IRS and the Freedom of Information Act

The Internal Revenue Service has traditionally been among the most secretive of federal agencies. This secretiveness results from ingrained tradition, which has only been curbed by protracted litigation. Our own group (along with our predecessor organization, Tax Analysts and Advocates) has been a leader in this effort. Other notable contributions have been made by Public Citizen's Tax Reform Research Group, and by Philip and Susan Long of Seattle, Washington.

As a result of the combined efforts of these groups and individuals, the Internal Revenue Service has been forced, during the past decade, to make public its letter rulings and technical advice memos, the comments received from the public regarding its regulations, the Internal Revenue Manual, general counsel's memoranda, actions on decision, technical memoranda underlying regulations, and its taxpayer compliance measurement program documents.

None of these documents, in the form disclosed, contains information that can be associated with a particular taxpayer. In each of these cases, the courts have determined, first, that the public had a right under the Freedom of Information Act to the information contained in these documents, and, second, that release of this data would not jeopardize the work of the Internal Revenue Service. Our experience, and that of other groups, has confirmed the correctness of both these judgments by the courts.

Secrecy legislation.—However, the struggle with the Internal Revenue Service has not been confined to the courts. The Service has periodically tried to obtain from Congress more-or-less blanket exemptions from the Freedom of Information Act. The most recent instance of an effort along these lines came during the 1976 Tax Reform Act consideration of amendments to sections 6103 and 6110 of the Internal Revenue Code. The upshot of this legislative struggle was a compromise provision, under which modified definitions of the terms "return" and "return information" were incorporated into section 6103 of the Code, at the same time that detailed rules for the disclosure of IRS rulings and technical advice memoranda were enacted as section 6110 of the Code.

The language of S. 2402 suggests that the IRS wants to reopen the information disclosure question once again. One reason appears to be the Service's concern regarding our recent victory in the courts in our suit to obtain disclosure of general counsel's memoranda, actions on decision, and technical memoranda; and the recent decision by the Ninth Circuit Court of Appeals that the Service must disclose the data underlying its taxpayer compliance measurement program, in response to a suit by Philip and Susan Long.

We have read the recent remarks of the Commissioner of Internal Revenue in an interview, expressing concern about both these decisions. While we have great respect for the Commissioner, we believe that his comments misconstrue the scope of our victory in our GCM, AOD, and Tech Memo suit. The Commissioner fears that this suit may inhibit internal decision-making in the IRS, and the free flow of advice from subordinate to superior. But the courts have repeatedly made it clear in Freedom of Information Act cases that the mandate of the Act does not apply to predecisional memoranda of advice, unless and until the agency begins to use those memoranda as the basis for subsequent decisions affecting the public. At that point, as the courts have repeatedly declared, the memoranda must be made available for

public scrutinity, since, in the words of one of our Freedom of Information Act decisions, "secret law is an abomination."

Clearly, general counsel's memoranda, actions on decision, and technical memoranda—which are carefully retained, classified, indexed, and consulted by the IRS—constitute a body of secret law. Nothing should be done by this Committee that will jeopardize their prompt disclosure to the public in accordance with court order and with any deletions that may be necessary to preserve privacy.

Similarly, the data underlying the Service's Taxpayer Compliance Measurement Program is an appropriate subject for disclosure. In our view, the IRS kept secret for too long the data showing the rapid growth of the underground economy, thus slowing public consideration and debate regarding this serious problem.

In addition, secrecy regarding this data has made it difficult to analyze and critique discrepancies in IRS administrative handling of taxpayer audits and returns. Susan Long's work makes it very clear that some IRS districts are "tough" while others are "lenient" in their dealings with taxpayers. This critique, leading as it should to more equal inter-district treatment of similarly situated taxpayers, could not have taken place without the information that Ms. Long obtained under the Freedom of Information Act.

Information restrictions are premature.—This is not the time, in our view, to reopen the question of IRS compliance with the Freedom of Information Act. The ink is hardly dry on the 1976 amendments to section 6103, and the courts have only just begun to construe the new legislative language. There is no indication that their decisions, properly read and interpreted, are likely to jeopardize IRS administration of the tax law. Speculation about possible future problems, from an agency that has determinedly refused to comply with the Freedom of Information Act in the past, is hardly a sound basis for overturning a statutory compromise that is less than four years old.

Accordingly, we recommend that the proposed provisions of S. 2402 which would establish a new, protected category of "nonreturn information," be dropped from the bill. Those provisions are a threat to court-ordered public disclosure and are nongermane to the main purposes of S. 2402. At a later date, after we have more experience regarding the scope and meaning of the 1976 information disclosure provisions, changes in the Code may be in order. But changes now are certainly premature.

B. The proposed redefinition is not necessary to accomplish the bill's objectives

Current law divides confidential IRS Information into three categories: returns, return information, and taxpayer return information. Return information is defined by a list of items including such things as taxpayer identity, receipts, and deductions collected with respect to a return or with respect to a determination of liability. However, return information does not include "data in a form which cannot be associated with * * * a particular taxpayer." Finally, taxpayer return information means return information which is furnished as the IRS by a taxpayer.

S. 2402 does not substantially change the definition of returns, except for a wording change. However, instead of retaining the categories of current law, the bill amalgamates the categories of "return information" and "taxpayer return information," and rewords their definition. In two respects, the definition is broadened. First, nonreturn information includes "information * * * which the Secretary collects * * * with respect to a taxpayer." Since we are all taxpayers, presumably any information pertaining to anyone is collected with respect to a taxpayer. It is not clear why this phrase is needed, since the current definition includes information collected "with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person." This seems to be a broad and adequate definition and should not be changed unless the IRS makes out a case for change.

Second, and more important, the new category of nonreturn information leaves out the provision of current law that return information and taxpayer return information do not include "data in a form which cannot be associated with * * * a particular taxpayer." The purpose of this provision is to make publicly disclosable information to which the public is entitled and which will not violate the privacy of a particular taxpayer. As noted in our argument in the preceding section, we strongly object to the deletion of the current exception.

Further, the change is not necessary to accomplish the bill's purposes. Since the category of "nonreturn information" is meant to subsume the existing categories of return information and taxpayer return information, the bill could be redrafted to accomplish the same disclosure to governmental personnel by just substituting the term "return information or taxpayer return information" wherever the term "nonreturn information" occurs in the bill. Thus, the bill's objectives can be accom-

plished without upsetting the existing delicate balance in the area of disclosure to the public.

C. The GAO draft

The GAO Draft (See Disclosure and Summons Provisions of 1976 Tax Reform Act, GAO Report No. GGD-80-76, June 17, 1980, Appendix II) also amalgamates two categories of existing law, but it consolidates returns and taxpayer return information and renames return information as non-return information. Under the draft, the same protection is extended to taxpayer return information as to returns. Again, it is difficult to see why the draft could not just keep the categories as they are, referring to returns and taxpayer return information in conjunction.

The GAO definition of non-return information is even broader than that contained in S. 2402. It includes "any information which the Secretary collects, obtains, or receives * * * which is not a return." This would make secret any information coming into the Treasury Department and is hence extremely overbroad. The GAO draftsperson attempts to meet our concern about the omission of the qualification that return information should not include data that cannot be associated with a particular taxpayer. However, this qualification is grafted onto the definition of returns, but is omitted from the definition of nonreturn information. Since nonreturn information is defined as anything the Secretary receives that is not a return, anything that is excepted by the qualifying clause becomes nonreturn information, which may not be disclosed to the public.

The moral of the GAO exercise seems to be that the rather technical definitions that have been worked out in the 1976 law should be left as they are, absent a good reason for change. The GAO report (page II-2) asserts that the current definitions are unclear but gives only one example of an ambiquity: "It is not clear, however, whether information qualifies as taxpayer return information when, for example, the taxpayer's witness decides to testify against the taxpayer and supplies information harmful to the taxpayer's case." If the only problem with the definitions of the three existing categories is the rather obscure possibility cited by the GAO report, then the definitions seem to be more airtight than many in the law. There are ambiguities in any definition, and there will be as many in the proposed changes as under existing law. To the extent that existing law is ambiguous, the courts should be given time to perform their traditional role of eliminating ambiguity through judicial construction—but they cannot perform this role if the statute is subject to constant change. In the absence of a rather stronger showing of problems than that furnished by the GAO report, the definition should be left alone.

II. S. 2403: IRS SUMMONS ENFORCEMENT PROCEDURE

S. 2403 deals with the procedure for enforcing third-party summonses. These are summonses issued to a party not under investigation, such as a bank, to obtain records relating to a taxpayer under investigation. Section 7609 currently requires the IRS to give notice to the taxpayer at least two weeks before the day on which the third party's records relating to the taxpayer are to be examined. The taxpayer then has two weeks to stay compliance with the summons simply by writing the third party recordkeeper and sending a copy to the IRS. If the IRS wants to enforce the summons, it then has to go into court under section 7604 and initiate a civil action. Apparently, at this stage many taxpayers don't even show up in court, with the result that they have obtained a delay of at least several weeks. If the investigatee does show up, he does not have as broad rights of discovery as in the usual civil action. Rather, under Rule 81(a)(3) of the Federal Rules of Civil Procedure, the district court has discretion to grant limited discovery, and usually even limited discovery is granted only if a colorable claim is made out at an evidentiary hearing at which the IRS agent in charge of the investigation is deposed. After the district court issues an order enforcing the summons, the taxpayer may appeal, and can often have the court stay compliance with the summons pending appeal.

The problem with summons enforcement proceedings which the Nunn bill seeks to address is that most of them are not meritorious and are used as a technique for delay. In addressing this problem, the Nunn bill goes too far, and removes virtually all the procedural rights open to a taxpayer. By requiring the district court to enter an order within ten days of the filing of the government's response to the taxpayer's motion, the bill seems to contemplate the abolition of any possibility of an evidentiary hearing in a context in which such a hearing, and in an appropriate case discovery from the IRS, is necessary in order to sort out the few cases that may have some merit from the many that are initiated solely for delay. In addition, the Nunn bill cuts off a taxpayer's right to appeal the district court's order. It is true that it leaves open the possibility of challenging the summons in a later proceeding in which information obtained through the summons is used. This challenge is

unlikely to be of much use, however, unless the application of the exclusionary rule is to be greatly broadened.

It may be appropriate to streamline the procedures for enforcing a summons. But such streamlining should not eliminate the taxpayer's rights to an evidentiary hearing, to limited discovery, and to appeal from the order enforcing the summons. The denial of an appeal seems particularly offensive, since it seems under S. 2403 that while an order enforcing a summons is not appealable, an order refusing to enforce a summons is appealable by the government. This creates a "Heads I win, tails you lose" situation for the government that overcorrects for the problems that are now experienced in obtaining timely compliance with valid summonses.

We would like to suggest that one way of ameliorating these problems would be to redefine the substantive standards of what summonses are considered valid by means of a bright line test that would simplify enforcement proceedings and eliminate those proceedings that deal only with the criminal purpose issue.

The criminal purpose defense to an IRS summons grew out of court cases misconstruing the statute authorizing the issuance of IRS summonses. The enclosed excerpt from Developments in the Law—Corporate Crime, 92 Harv. L. Rev. 1227, 1320-33 (1979) develops the argument in greater detail.

The basic point of that article is that under current law, the IRS does have the authority to conduct criminal tax investigations, and it uses the summons for this purpose up to the point that the case is turned over to the Justice Department for prosecution. This authority has been upheld by the courts, but in a way that still enables taxpayers to challenge summonses under the criminal purpose defense as a means of delay. There is no good reason not to give the IRS the authority it has already, but to do so in objective language that leaves open no possibility for taxpayer challenge on this ground.

If this is done, then persons challenging summonses on other grounds, such as harassment or overbroadness, will be able to proceed in the context of a docket that has been cleared of the worthless criminal purpose issue. Judges will then be able to concentrate on the grounds for challenge that may actually be of some merit, and cases will be able to proceed more expeditiously, without any abridgment of procedural rights. If this change is insufficient to move cases along with the requisite speed, then some procedural streamlining may also be appropriate, but it will not have to be as draconian as proposed in S. 2403. We would note also that the suggested change would be applicable to ordinary summonses (where the taxpayer is summoned directly) as well as third party cases, and so would have a beneficial effect on and treat equally all IRS summons cases.

Draft of suggested substantive amendment.—The substantive amendment to the IRS's investigatory authority suggested in the accompanying article is very easily drafted. Section 7602 of the Internal Revenue Code should be amended by inserting after the words "for any internal revenue tax" the words "or the guilt of any person of a crime or offense defined in Chapter 75 of this Title." This clarifies the IRS's authority to use the summons to develop a criminal tax case.

B. Use of Administrative Summonses for Criminal Investigation

Agencies empowered to investigate violations of economic regulatory legislation may issue summonses to obtain testimony and documents.[56] When the result of the agency's investigation is a criminal prosecution (whether or not in addition to separate civil proceedings), responsibility for the criminal prosecution is vested in the Justice Department. Such criminal cases commence formally with the convening of a grand jury and, after an indictment is returned, are governed exclusively by the Federal Rules of Criminal Procedure.

This Section addresses problems which arise from the division of responsibility sketched above. Courts have supervised agency investigations implicating a potential or pending criminal prosecution by attempting to fix the point at which the criminal element of an investigation predominated, so that only the Justice Department, and not the agency, might proceed. Bound up with this determination are procedural issues of intervention and discovery at proceedings to enforce summonses, and standing to suppress evidence at trial.

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[53] *See* p. 1315 & note 23 *supra*.

[54] The statement in text refers only to antitrust matters enforced by the Department of Justice. *See generally* 2 P. AREEDA & D. TURNER, ANTITRUST LAW ¶ 305c (1978).

[55] *See* 15 U.S.C. §§ 1311–1314 (1976).

[56] *See* 15 U.S.C. §§ 46, 49, 50 (1976) (FTC); 47 U.S.C. § 409(e) (1976) (FCC); 49 U.S.C. § 1484 (1976) (CAB); 29 U.S.C. § 657(b) (1976) (OSHA); 15 U.S.C. §§ 77s(b), 77uuu(a), 78u, 79r, 80a–41, 80b–9 (1976) (SEC); 15 U.S.C. § 1714 (1976) (Office of Interstate Land Sales Registration, HUD).

1. The Improper Purpose Doctrine. — In the leading case of *United States v. O'Connor*,[57] Judge Wyzanski refused to enforce an IRS summons[58] issued after indictment and at the informal request of the Justice Department. He noted that the criminal process contemplated only one "agency of compulsory disclosure" — the grand jury — so that after indictment the government possessed no power to obtain compulsory discovery.[59] Thus, where issuance of a summons was not justified by a bona fide independent investigation,[60] the court would not allow the government to obtain discovery by this means.

In subsequent cases, some circuits began to develop a doctrine that an IRS summons issued *before* indictment would not be enforced if issued for the "improper purpose" of solely criminal investigation.[61] The Supreme Court first gave full consideration

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[57] 118 F. Supp. 248 (D. Mass. 1953).

[58] Because most litigation has arisen in connection with enforcement of IRS summonses, the analysis will focus on these. *See generally* Gilbert, *Emanations of the "Shift-of-Emphasis" Theory — The "Improper Purposes" Doctrine Revisited*, 5 SUFFOLK U.L. REV. 35 (1970); Lyon, *Government Power and Citizen Rights in a Tax Investigation*, 25 TAX LAW. 79, 79–85 (1971); Nuzum, LaSalle National Bank *and the Judicial Defenses to the Enforcement of an Administrative Summons*, 32 TAX LAW. 383 (1979); Saltzman, *Supreme Court's* LaSalle *decision makes it harder to successfully challenge a summons*, 49 J. TAX. 130 (1978); Stroud, *The Criminal Prosecution Defense: A Defense to a Section 7602 Summons?*, 4 AM. J. CRIM. L. 152 (1975–1976); Wilson & Matz, *supra* note 13, at 653–83; *Symposium on Federal Civil and Criminal Income Tax Fraud Investigations*, 2 HOFSTRA L. REV. 129, 135–52 (1974); Comment, *Constraints on the Administrative Summons Power of the Internal Revenue Service*, 63 IOWA L. REV. 526 (1977); Comment, *Taxpayer Intervention at Summary Proceedings to Enforce an Internal Revenue Service Summons*, 32 MD. L. REV. 143, 150–55 (1972); Comment, *The Improper Purpose Challenge to the Section 7602 Summons*, 31 TAX LAW. 226 (1977); 54 TEX. L. REV. 1147 (1976).

Any IRS agent may issue a summons. *See* I.R.C. §§ 7602, 7701(a)(11)(B); Delegation Order No. 4 (Rev.), 22 Fed. Reg. 3894 (1957). A summons is not self-executing, so that if the person summoned refuses to comply, which he may do without penalty, *see* Reisman v. Caplin, 375 U.S. 440, 446–49 (1964) (as long as he does so in good faith, *see* United States v. Murdock, 290 U.S. 389, 397–98 (1933)), the agency must petition a district court for enforcement under I.R.C. § 7604.

[59] 118 F. Supp. at 250–51.

[60] The court argued that since the IRS agent did not have "any specific matter involving [the taxpayer]" pending before him, he could not claim authority to issue the summons under a statute which authorized issuance only for the purpose of investigation. *See* 118 F. Supp. at 250.

[61] *See* United States v. Morgan Guaranty Trust Co., 572 F.2d 36, 39–41 (2d Cir.), *cert. denied*, 99 S. Ct. 79 (1978). In Boren v. Tucker, 239 F.2d 767, 772–73 (9th Cir. 1956), an IRS summons was challenged on the ground that it was being employed for criminal investigation. In rejecting the challenge, the court distinguished *O'Connor* as involving a summons issued after indictment. *See also In re* Magnus, Mabee & Reynard, Inc., 311 F.2d 12, 14–15 (2d Cir. 1962), *cert. denied*, 373 U.S. 902 (1963). Later, confusion was engendered by dictum

to this issue in *Donaldson v. United States*.[62] There a taxpayer had sought to intervene in a proceeding to enforce a third-party summons, arguing that the summons should not be enforced because it was issued "in aid of an investigation that ha[d] the potentiality of resulting in" a criminal prosecution.[63] After denying intervention, the Court nevertheless went on to consider the merits of the challenge to the summons. Reviewing the statutory grant of investigatory authority, it concluded that "Congress clearly has authorized the use of the summons in investigating what may prove to be criminal conduct."[64] The Court adopted, however, the developing improper purpose doctrine, which it indicated was "applicable to the situation of a pending criminal charge" and perhaps to "an investigation solely for criminal purposes."[65] A summons would be upheld if "issued in good faith and prior to a recommendation for criminal prosecution."[66] Lower courts were left to decide, first, when the "recommendation for criminal prosecution" took place; and second, whether a prerecommendation summons issued "solely" for the purpose of criminal investigation would necessarily fail the good faith requirement.

Most courts which addressed the first issue decided that the relevant recommendation was referral from the IRS to the Justice Department,[67] rather than any recommendation within the IRS

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in Reisman v. Caplin, 375 U.S. 440 (1964), a case not involving the criminal purpose issue, in which the Court said that a summons could be challenged "on any appropriate ground . . . includ[ing] . . . the defense that the material is sought for the improper purpose of obtaining evidence for use in a criminal prosecution," *id.* at 449 (citation omitted). Lower courts after *Reisman* assumed that this "improper purpose" defense applied to summonses issued before indictment, despite the citation of *Boren*, a case refusing to apply the doctrine before indictment. *See* United States v. Erdner, 422 F.2d 835 (3d Cir. 1970); United States v. Roundtree, 420 F.2d 845, 851 (5th Cir. 1969); United States v. Michigan Bell Tel. Co., 415 F.2d 1284 (6th Cir. 1969); DiPiazza v. United States, 415 F.2d 99, 102–03 (6th Cir. 1969), *cert. denied*, 402 U.S. 949 (1971); Wild v. United States, 362 F.2d 206 (9th Cir. 1966). *But see* Howfield, Inc. v. United States, 409 F.2d 694, 697 (9th Cir. 1969).

[62] 400 U.S. 517 (1971).

[63] *Id.* at 532. This is the argument to which the Court responded. In the district court, the taxpayer made the stronger argument that the summons was issued "for the express and sole purpose of obtaining evidence concerning any violations of the criminal statutes," *id.* at 521.

[64] *Id.* at 535.

[65] *Id.* at 533.

[66] *Id.* at 536.

[67] *See* United States v. Hodge & Zweig, 548 F.2d 1347, 1351 (9th Cir. 1977). In United States v. Billingsley, 331 F. Supp. 1091 (N.D. Okla. 1971), *rev'd and remanded*, 469 F.2d 1208 (10th Cir. 1972), the district court denied enforcement where the local special agent had in writing made a recommendation for prosecution, but the IRS regional office had taken "no action on the recommendation other than to request that the Special Agent in charge of the case make a

hierarchy.[68] On the second issue, the Second Circuit in *United States v. Morgan Guaranty Trust Co.*[69] suggested that the good faith requirement be limited to prevent abuses such as harassment,[70] and that the improper purpose inquiry therefore be restricted to an "objective test," under which a summons would generally be enforced if issued prior to referral for prosecution.[71] Most courts, however, chose to read the ambiguous *Donaldson* opinion broadly to preclude enforcement of summonses issued prior to recommendation if "the sole purpose of the summons was to obtain evidence for a criminal prosecution,"[72] or even if the investigating agent had formed a firm purpose to recommend prosecution.[73]

The "objective test" can be justified by the practicalities of summons enforcement proceedings. Most challengers lose on the merits, but the delay involved in discovery and appeal can be of great advantage — it makes it less likely that an indictment will be brought within the statutory limitations period, and in general allows time for the occurrence of events which cause abandonment of the prosecution, such as loss of interest and changes in policy or personnel on the part of the prosecution. The "objective test," in cutting off many claims without discovery procedures, largely eliminates the advantage of opposing a summons solely for the purpose of delay. Motivated by the same concern to prevent abuse of litigation, courts rejecting an objective test have

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supplemental investigation," 331 F. Supp. at 1092 n.2. The Tenth Circuit reversed, holding that "the 'recommendation' referred to in *Donaldson* occurs, at the earliest, when the Internal Revenue Service forwards a case to the Department of Justice for criminal prosecution," 469 F.2d at 1210.

[68] *But see* United States v. Oaks, 360 F. Supp. 855 (C.D. Cal. 1973), *remanded on other grounds*, 508 F.2d 1403 (9th Cir. 1974). *Oaks* held that prosecution is recommended when "the local special agent in charge of the case" recommends prosecution, "even if [the recommendation is] not final or reduced to writing." 360 F. Supp. at 858. There, a written recommendation for prosecution was not made until nine days after the defendant's arrest.

[69] 572 F.2d 36 (2d Cir.) (Friendly, J.), *cert. denied*, 99 S. Ct. 89 (1978).

[70] *See* 572 F.2d at 40–41 (discussing United States v. Powell, 379 U.S. 48, 58 (1964)).

[71] *See id.* at 41. *See also* United States v. Troupe, 438 F.2d 117 (8th Cir. 1971).

[72] United States v. Weingarden, 473 F.2d 454, 461 (6th Cir. 1973); *see, e.g.*, United States v. Zack, 521 F.2d 1366, 1368 (9th Cir. 1975); United States v. McCarthy, 514 F.2d 368, 374–75 (3d Cir. 1975).

[73] *See* United States v. Friedman, 532 F.2d 928, 932 (3d Cir. 1976); United States v. Wall Corp., 475 F.2d 893, 895 (D.C. Cir. 1972); United States v. Oaks, 360 F. Supp. 855, 858–59 (C.D. Cal. 1973), *remanded on other grounds*, 508 F.2d 1403 (9th Cir. 1974).

shortened enforcement proceedings by limiting the availability of discovery.[74]

Last Term, in *United States v. LaSalle National Bank*,[75] the Supreme Court was faced with a conflict between the "objective test" and the decision of the court below, which determined "good faith" by looking to the state of mind of the IRS agent at the time he issued the summons. Steering a middle course, the five-to-four decision by the Court laid down a test which will fail to resolve confusion in the lower courts.[76] The opinion by Justice Blackmun, the author of *Donaldson*, retained but redefined the two-part test requiring that a summons be issued in good faith and prior to recommendation for criminal prosecution.

The Court first reviewed the statutory scheme authorizing investigations and affirmed the validity of civil investigations with criminal potential: "Congress has not categorized tax fraud investigations into civil and criminal components." [77] But as a matter of statutory construction, the Court held that since the statute contained no "affirmative grant of summons authority for purely criminal investigations," [78] these were not authorized.

The Court relied on two policy concerns in restricting the availability of summonses even where seemingly authorized because of an ongoing civil investigation. Summonses were not meant "to broaden the Justice Department's right of criminal litigation discovery or to infringe on the role of the grand jury as a principal tool of criminal accusation." [79] These policy interests justified a "prophylactic" rule precluding enforcement of any summons issued after referral. The Court acknowledged that a line drawn at referral did not offer absolute protection against infringement of these interests. The potential for infringement exists earlier, when the investigating agent recommends prosecution, but the Court argued that such a possibility was "remote." [80] The point at which the prophylactic rule would apply was decided through a candid effort to balance the interest in civil IRS investi-

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[74] *See* United States v. Church of Scientology, 520 F.2d 818, 824–25 (9th Cir. 1975); United States v. Salter, 432 F.2d 697, 700–01 (1st Cir. 1970); pp. 1330–31 *infra*.

[75] 437 U.S. 298 (1978).

[76] *Compare* United States v. Serubo, 460 F. Supp. 689, 695–99 (E.D. Pa. 1978) (prereferral summons in course of joint civil and criminal investigation invalid because information shared with Justice Department) (dictum), *with* United States v. Chemical Bank, 43 A.F.T.R.2d 79–486 (2d Cir. 1979) (cooperation between IRS and Justice Department in a "strike force" investigation does not invalidate the IRS summons). Both cases relied on *LaSalle*.

[77] 437 U.S. at 311.

[78] *Id.* at 316 n.18.

[79] *Id.* at 312.

[80] *Id.* at 313 n.15.

gation[81] against the competing policy interests identified by the Court.

While ruling that a summons issued after referral would not be enforced, the Court declined to accept the proposition that all summonses issued before referral were valid.[82] The district court in *LaSalle* had found that the IRS agent who had issued the summons was solely interested in "unearthing evidence of criminal conduct,"[83] and had refused enforcement on this ground. The Supreme Court, however, felt that examination of the agent was insufficient to establish what it perceived to be the relevant consideration — "the institutional posture of the IRS."[84] The Court noted that an agent's recommendation to prosecute is reviewed at several layers within the IRS, and that "[a]t any of the various stages, the Service can abandon the criminal prosecution, can decide instead to assert a civil penalty, or can pursue both goals."[85] Thus, even though the agent issuing the summons intends to use it only for criminal purposes, the possibility that the Service would change its mind and decide to use the evidence for civil purposes after all allows the summons to conform to the requirement that it be issued for civil investigatory purposes.[86] In order to block enforcement, the taxpayer must show that the IRS as an institution has abandoned the determination of civil tax liability. The Court's ruling also serves to block out the boundaries of appropriate discovery. Arguing that inquiry into the agent's motives leads to fruitless delay, the Court said that discovery must be limited to "an examination of the institutional posture of the IRS."[87]

The *LaSalle* rule is an unsatisfactory solution to the problems raised by the overlap of agency summons and criminal prosecution. The Court argued that a summons is validated by the possibility of a decision at a later step in the review process to seek

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[81] In most cases, action on the civil aspects of a case will be suspended after referral "until the criminal aspects are closed," POLICIES OF THE IRS HANDBOOK, P-4-84, *reprinted in* 1 CCH INTERNAL REVENUE MANUAL 1305-10 (1978), so that the IRS's interest in immediate summons enforcement is minimal. *See also* Office of the Chief Counsel, IRS, Civil Considerations in Pending Criminal Matters, Order No. 3050.1 (March 23, 1978).

[82] *See* 437 U.S. at 316-17.

[83] *Id.* at 308.

[84] *Id.* at 316.

[85] *Id.* at 315.

[86] *But cf.* United States v. Procter & Gamble Co., 187 F. Supp. 55, 58 (D.N.J. 1960) (intent at time grand jury was called, not possibility of indictment in future, relevant factor in determining abuse of grand jury for civil purposes).

[87] 437 U.S. at 316. The Court did not make clear whether such an examination should involve inquiry into the particular agent's motives. The agent's motives may be more significant, the Court noted, in proving other sorts of lack of good faith, such as harassment, *see id.* at 316 n.17.

a civil penalty. It seems that the institutional good faith requirement can be failed only where the decision to proceed criminally has been made at the final layer of review within the agency.[88] As the Court acknowledged, only an "extraordinary departure"[89] from normal procedure could lead the IRS to fail the good faith test. Thus the practical effect of *LaSalle* is likely to be the same as if the *Morgan* rule had been accepted, in that all summonses issued before referral will be enforced, except that the investigatee will be given the chance to obtain some discovery. Such discovery, however, will be quite circumscribed,[90] since the only relevant concern is the final institutional recommendation.

As an exercise in statutory construction, *LaSalle* is unconvincing. While, as the Court noted, there is no explicit grant of authority for solely criminal investigation, there is also nothing in the legislative history to suggest that Congress intended to prohibit such use of the summons power.[91] The Court should have more closely examined the policy interests it invoked. If the articulated interest of preventing destruction of the limits on criminal discovery or infringement of the role of the grand jury is nothing more than a desire to keep things separate out of a sense of judicial propriety or concern for appearances, it is inconsistent with the Court's own observation that Congress did not intend such a compartmentalization.[92] The Court's concern to prevent infringement of the grand jury is also misplaced. Any differences between summons and subpena in substantive scope or procedural protection operate in the direction of making the subpena the more powerful tool for the government.[93] Thus, in terms of the protections provided by law, a defendant has nothing to complain of when investigated by summons rather than subpena. True, a defendant may prefer that process be issued by a United States attorney rather than an agency employee, since the latter may be motivated by prior involvement to issue a summons in order to harass. Such motivation could be entirely vindictive or could arise from the desire to press settlement of a collateral civil matter. However, the danger of such abuse can best be dealt with under

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[88] *See id.* at 315.

[89] *Id.* at 314.

[90] *See* United States v. Marine Midland Bank, 585 F.2d 36, 39 (2d Cir. 1978). *But see* 437 U.S. at 320 (Stewart, J., dissenting).

[91] I.R.C. § 7602 authorizes issuance of a summons "[f]or the purpose of ascertaining the correctness of any return." Since filing an incorrect return (with the requisite mens rea) may subject the filer to criminal sanctions, *see* I.R.C. §§ 7201–7207, the statute can fairly be read to authorize an investigation solely designed to determine criminal liability, as such a determination involves "ascertaining the correctness" of the return.

[92] *See* 437 U.S. at 311; p. 1324 *supra*.

[93] *See* pp. 1312–13 *supra*.

the rubric of harassment, an independent ground for refusal to enforce a summons.[94]

The argument that administrative summonses should not be allowed to subvert limitations on criminal discovery, which apply after indictment, is more persuasive.[95] Discovery from the defendant is limited to items which the defendant intends to introduce in evidence.[96] Normally this excludes key evidence, since the defendant usually does not plan to introduce evidence which the government seeks in order to establish guilt. Further, discovery from the defendant is conditioned on the defendant's seeking discovery from the prosecution. As for discovery of evidence from third parties, the criminal rules provide for issuance of subpenas,[97] but these are meant specifically to provide for evidence at trial.[98] Neither are depositions general discovery devices — they can only be used under limited circumstances to preserve evidence.[99] Thus the present limits on discovery in the criminal rules provide significant protection to the defendant, protection which should not be circumvented by the fortuity of agency investigation.[100]

If the important consideration is limits on criminal discovery and not encroachment on the role of the grand jury, then the *La-Salle* rule is overinclusive, because it mandates an inquiry into good faith as to summonses issued before indictment, when the government's ability to investigate is meant to be nearly unlimited, as shown by the broad powers of the grand jury. It is under-

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[94] *See* United States v. Powell, 379 U.S. 48, 58 (1964).

[95] Any such argument assumes that an agency will in fact turn over to criminal prosecutors the fruits of its investigation.

[96] *See* FED. R. CRIM. P. 16(b)(1)(A).

[97] *See* FED. R. CRIM. P. 17.

[98] *See* United States v. Keen, 509 F.2d 1273, 1274-75 (6th Cir. 1975); United States v. Hedge, 462 F.2d 220, 222-23 (5th Cir. 1972).

[99] *See* FED. R. CRIM. P. 15, Notes of Advisory Comm. on 1974 amendment (the rule "is not to provide a method of pretrial discovery").

[100] *See* Application of Myers, 202 F. Supp. 212 (E.D. Pa. 1962) (focusing on discovery limits and not the grand jury in refusing to enforce administrative summons); Note, *Concurrent Civil and Criminal Proceedings*, 67 COLUM. L. REV. 1277, 1277-78, 1280-81 (1967).

Preventing unilateral prosecution discovery is, however, a limited concern. The practical effect of a rule preventing use of an agency summons to obtain discovery may just be to make prosecutors more careful to obtain all the evidence they need from the grand jury, and may even redound to the disadvantage of defendants if this leads to more extensive use of the grand jury.

In addition, although it should not do so, the government can evade limitations on discovery by using a grand jury to gather evidence after indictment. Under present law, based on judicial reluctance to interfere in the grand jury process, there is little a court can do to stop such abuse. *See* United States v. Doe, 455 F.2d 1270 (1st Cir. 1972); Rodis, *A Lawyer's Guide to Grand Jury Abuse*, 14 CRIM. L. BULL. 123 (1978). Thus a prophylactic rule to deter abuse in the summons area may simply shift abuses to the grand jury area.

inclusive because it does not fully protect the interest in limited discovery when an agency issues a summons before referral and in conformity with the *LaSalle* good faith test, but the person under investigation is under indictment for a separate offense.[101] Even though the material sought might be of use to the government in the criminal case, a court following *LaSalle* would presumably grant enforcement.

Even after indictment a court should exercise discretion,[102] weighing the danger that the government is employing the summons to obtain discovery for the criminal case against the legitimate government interest in the particular civil investigation. In assessing the likelihood that the information will find its way from the agency to the Justice Department, the court should inquire, for example, whether there are any statutory limits on such information sharing.[103] The government should have the burden of convincing the court to enforce the summons, since it possesses the evidence necessary to inform the court's exercise of its discretion.

It has been argued above that the criterion for automatic enforcement of a summons should be whether it was issued before indictment. Current law, which makes referral rather than indictment the cutoff point for automatic enforcement may be justified on the grounds that this decreases the chance that a summons will be returned after indictment. The defendant is in effect given a grace period between referral and indictment to challenge the summons and perhaps to appeal from a grant of enforcement. Whether indictment or referral is chosen as the cutoff point, the rights of the parties should be fixed at the time of the enforcement hearing in district court instead of issuance.[104] This is be-

[101] *See* United States v. Hodge & Zweig, 548 F.2d 1347 (9th Cir. 1977); United States v. Henry, 491 F.2d 702 (6th Cir. 1974); Venn v. United States, 400 F.2d 207 (5th Cir. 1968).

[102] This exercise of discretion is the only distinction between the test proposed here and the *Morgan* court's approach. *See* p. 1323 *supra*.

[103] *See, e.g.*, I.R.C. § 6103.

[104] The problem of when to fix the rights of the parties has arisen in the context of a postindictment appeal from a decision to enforce a preindictment summons. Courts have usually resolved the question against the defendant, holding that the rights of the parties are fixed at time of issuance, thus making the subsequent indictment legally irrelevant. *See In re* Magnus, Mabee & Reynard, Inc., 311 F.2d 12, 16 (2d Cir. 1962), *cert. denied*, 373 U.S. 902 (1963) (summons enforced where government forced to return indictment by running of statute of limitations); United States v. Moore, 485 F.2d 1165, 1168 n.4 (5th Cir. 1973); United States v. Cromer, 483 F.2d 99, 101 (9th Cir. 1973); *cf.* Couch v. United States, 409 U.S. 322, 329 n.9 (1973) (rights of parties fixed at time summons is served, so that transfer of documents after service is legally irrelevant). *But cf.* United States v. Monsey, 429 F.2d 1348 (7th Cir. 1970) (appeal taken by Government). Under an objective test (such as *Morgan* or

cause the relevant concern should not be whether the summons was issued for a proper purpose, but rather whether the effect of enforcement will be to obtain criminal discovery at a time when it would be improper.

LaSalle, like the "improper purpose" cases preceding it, was an IRS case. There is less litigation involving other agencies, probably because these issue fewer summonses,[105] and no cases could be found refusing enforcement on improper purpose grounds outside the tax area. *LaSalle*'s applicability to summonses issued by agencies other than the IRS is uncertain. An important consideration under *LaSalle* is the extent to which the legislative grant of investigative authority can be interpreted to permit solely criminal investigation. In contrast to the vague provision in the Internal Revenue Code,[106] statutes authorizing investigation by Offices of the Inspector General [107] and by the SEC [108] seem to contemplate solely criminal investigation, although *LaSalle* has been held applicable to the SEC.[109] The test proposed here applies uniformly to all agencies,[110] since it rests not on exegesis of vary-

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the test proposed here) the appellate court's dilemma is eased, since any appeal based on improper purpose grounds will almost certainly be frivolous. In such a case, therefore, the desirability of discouraging frivolous appeals outweighs the concern about the integrity of criminal discovery.

[105] In 1976 the IRS issued approximately 3000 third-party summonses per month. *See* Wilson & Matz, *supra* note 13, at 679 n.138 (1977).

[106] I.R.C. § 7602.

[107] The Inspector General Act of 1978, Pub. L. No. 95-452, 92 Stat. 1101 (1978) (to be codified at 5 U.S.C. app.) created Offices of the Inspector General in 12 executive agencies. Under §§ 4(a)(1) and 6(a)(2) of the Act, OIG's enjoy broad investigative power, and may issue subpenas in connection with these investigations under § 6(a)(4) which are enforceable by a district court. Investigations of criminal conduct—fraud and bribery—were clearly contemplated. *See* S. Rep. No. 95-1071, 95th Cong., 2d Sess. (1978), *reprinted in* [1978] U.S. Code Cong. & Ad. News 4406. As proposed by the Senate Committee, the Bill defined "investigation" as including investigation of "criminal activity," *see* 124 Cong. Rec. S15869-70 (daily ed. Sept. 22, 1978), but the entire definition was deleted prior to passage on the grounds that "'[i]nvestigation' is a term with a generally well-understood meaning," *id.* at S15873 (remarks of Sen. Eagleton).

[108] The SEC has the power to issue summonses in aid of "all investigations which, in the opinion of the Commission, are necessary and proper for the enforcement of [the Act]," 15 U.S.C. § 77s(b) (1976), and may transmit evidence of criminal violations to the Attorney General, *see* 15 U.S.C. § 77t(b) (1976).

[109] *See* SEC v. Dresser Indus., Inc., 453 F. Supp. 573, 575-76 (D.D.C. 1978). *See also* United States v. Handler, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,519, at 94,025-26 (C.D. Cal. 1978) (SEC Special Counsel investigation); United States v. Bloom, 450 F. Supp. 323, 330-31 (E.D. Pa. 1978) (informal SEC investigation).

[110] The improper purpose problem has not arisen in the antitrust area, where the Justice Department has responsibility for both civil and criminal investigation. Information obtained by Civil Investigative Demand (CID) may be used

ing statutory authority to issue a summons, but rather on the duty of courts to oversee activity which threatens to interfere with the safeguards erected around criminal trials. This duty is grounded on common agency statutes requiring a court order to enforce a summons.[111] Applying *LaSalle* to agencies which do not have a procedure for formal referral to the Justice Department [112] would require that courts search for a "recommendation" analogue. Lack of a definite point of referral poses no problems for the analysis advocated here, as the cutoff point for automatic enforcement in such cases could be indictment.[113]

2. Summons Enforcement Proceedings and Suppression at Trial. — Consideration of the procedural aspects of summons enforcement proceedings [114] must start with rule 81(a)(3) of the Federal Rules of Civil Procedure, which provides that such proceedings are summary and that applicability of the rules — including the discovery and intervention provisions — may be limited at the trial judge's discretion.[115] Under guidelines laid down by appellate courts, discovery (usually deposition of agency employees and production of investigative files) is allowed only if evidence substantiating allegations of criminal purpose has been

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before a grand jury or otherwise for criminal cases. *See* 15 U.S.C. § 1313(d) (1976). Limitation of this tool to civil purposes would prove a minimal constraint on the Department, since it would simply require moving to the grand jury at the appropriate stage in the investigation. Indeed, a litigant would be foolish to challenge a CID on improper purpose grounds before indictment, because he would simply be faced with a grand jury investigation if he won the challenge. Such a shift is much less burdensome when it takes place within the Justice Department, rather than across agency boundaries.

[111] *See* statutes cited notes 56, 58 *supra*.

[112] For example, § 4(d) of the Inspector General Act of 1978, Pub. L. No. 95-452, 92 Stat. 1101 (1978), provides that the OIG "shall report expeditiously to the Attorney General whenever the Inspector General has reasonable grounds to believe there has been a violation of Federal criminal law." This requirement of expeditious reporting suggests a model of cooperative investigation at an early stage. *See Legislation to Establish Offices of Inspector General: Hearings on H.R. 8588 Before the Subcomm. on Governmental Efficiency and the District of Columbia of the Senate Comm. on Governmental Affairs*, 95th Cong., 2d Sess. 12, 28, 48-49, 65-66 (1978).

[113] Indictment is in fact the point suggested by the analysis here, and referral is used as an easily ascertainable point prior to indictment in order to protect the defendant's opportunity to challenge a summons.

[114] *See generally Symposium on Federal Civil and Criminal Income Tax Fraud Investigations*, 2 HOFSTRA L. REV. 129, 152-58 (1974); Comment, *Taxpayer Intervention at Summary Proceedings to Enforce an Internal Revenue Service Summons*, 32 MD. L. REV. 143 (1972).

[115] *See* Advisory Comm. Notes on Rule 81 (1946) (Rule 81(a)(3) "permit[s] application of any of the rules in the proceedings whenever the district court deems them helpful").

presented at an evidentiary hearing.[116] The articulated concern has been to prevent abuse of litigation through delay.[117]

Rule 81 has also been used to deny intervention to the potential defendant in proceedings to enforce summonses issued to third parties. A taxpayer who alleges that a summons is being used for an improper purpose has an interest in not being prosecuted or convicted on the basis of evidence obtained in an improper manner.[118] The question is whether this interest is substantial enough to justify giving the taxpayer the opportunity to intervene in the summons enforcement proceeding against a third party. Before *Donaldson*, several circuits allowed the taxpayer to intervene as of right under rule 24(a)(2).[119] In *Donaldson*, however, the Court qualified this reading of rule 24 with reference to rule 81, which makes the application of all the Civil Rules to summons enforcement proceedings discretionary. The Court recognized that a taxpayer had some interest in suppressing documents obtained for an improper purpose, but reasoned that such an interest was sufficiently protected by the taxpayer's ability to seek exclusion of such evidence at trial.[120]

The subsequent decision in *United States v. Miller*,[121] however, casts doubt on the availability of this protection. The defendant in *Miller* sought at trial to suppress evidence obtained from grand jury subpenas which he claimed were technically de-

[116] *See* United States v. Salter, 432 F.2d 697 (1st Cir. 1970). *Salter* has been generally followed, *see* United States v. Interstate Tool & Eng'r Corp., 526 F.2d 59, 62 (7th Cir. 1975); United States v. Church of Scientology, 520 F.2d 818, 824 (9th Cir. 1975); United States v. McCarthy, 514 F.2d 368, 373 (3d Cir. 1975). In United States v. Newman, 441 F.2d 165 (5th Cir. 1971), even an evidentiary hearing was denied the summoned party where the allegations he made were not sufficiently substantial. *See id.* at 169. The Fifth Circuit has since moved to a position similar to that of *Salter*. *See* United States v. Garrett, 571 F.2d 1323, 1327 (5th Cir. 1978); United States v. Wright Motor Co., 536 F.2d 1090, 1095 (5th Cir. 1976); *cf.* Lynn v. Biderman, 536 F.2d 820 (9th Cir. 1976) (no evidentiary hearing required in proceeding to enforce HUD subpena when investigation initiated at request of aggrieved purchaser rather than agency due to small possibility of agency oppression in such a case).

[117] *See* United States v. Church of Scientology, 520 F.2d 818, 824–25 (9th Cir. 1975); United States v. Salter, 432 F.2d 697, 700–01 (1st Cir. 1970).

[118] The third party may itself argue the improper purpose point, as was the case in *LaSalle*.

[119] *See* cases cited 400 U.S. at 530. Rule 24(a)(2) allows intervention to an applicant who

> claims an interest relating to the property or transaction which is the subject of the action and [who] is so situated that the disposition of the action may as a practical matter impair or impede his ability to protect that interest, unless the applicant's interest is adequately represented by existing parties.

[120] *See* 400 U.S. at 531. *See also* United States v. Genser, 582 F.2d 292, 303 n.18 (3d Cir. 1978).

[121] 425 U.S. 435 (1976).

fective. The Court denied standing to the defendant under the fourth amendment, reasoning that he had no expectation of privacy in the pertinent documents.[122] The Ninth Circuit has relied on *Miller* to hold that evidence obtained by a third-party summons cannot be excluded on improper purpose grounds when the defendant lacks any fourth amendment interest.[123]

The Third Circuit arrived at the opposite conclusion in *United States v. Genser*,[124] reasoning that *Miller* involved only fourth amendment objections to enforcement while civil summonses implicate the statutory limits of section 7602 of the Internal Revenue Code, and that to deny standing at trial would undermine the balance struck by *Donaldson*. *Genser*'s reasoning is persuasive because the improper purpose doctrine rests on considerations which deserve protection independent of fourth amendment grounds.

Congress partially overruled the denial of intervention in *Donaldson* — and rendered largely moot the emerging split in the circuits — in the Tax Reform Act of 1976, which granted taxpayers the right to receive notice of certain third-party summonses and to intervene in the enforcement proceedings.[125] But this right extends only to summonses issued to "third-party recordkeeper[s],"[126] a category which includes most financial institutions but not all professionals. Because of Supreme Court decisions restricting fourth and fifth amendment protection in this area,[127] however, an intervenor's only successful arguments are likely to be based not on privacy, but rather on statutory grounds such as improper purpose. There thus seems to be little principled distinction between third-party recordkeepers and others from whom evidence is sought. With a view toward evenhandedness, courts exercising discretion under *Donaldson* should generally permit intervention.

Complicating this situation, however, is the risk that the taxpayer will be able to exploit a permissive attitude toward intervention for purposes of delay. Where the taxpayer intervenes under

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[122] *See id.* at 440–43.

[123] *See* United States v. Sand, 541 F.2d 1370, 1374 (9th Cir. 1976).

[124] 582 F.2d 292, 299–311 (3d Cir. 1978). The Eighth Circuit, in United States v. Schutterle, 42 A.F.T.R.2d 78-6077 (8th Cir. 1978), noted the problem but did not reach the issue.

[125] *See* I.R.C. § 7609.

[126] I.R.C. § 7609(a). Third-party recordkeepers include savings and loan institutions, banks, credit unions, brokers, attorneys, accountants, and "any person extending credit through the use of credit cards or similar devices," *id.* *See generally* United States v. Exxon Co., 450 F. Supp. 472 (D. Md. 1978) (defendant not a third-party recordkeeper where business records sought were unrelated to issuance of credit cards).

[127] *See* Fisher v. United States, 425 U.S. 391 (1976); United States v. Miller, 425 U.S. 435 (1976); California Bankers Ass'n v. Shultz, 416 U.S. 21 (1974); Couch v. United States, 409 U.S. 322 (1973); p. 1289 & note 78 *supra*.

the 1976 amendment, the running of the statute of limitations for criminal tax violations is tolled.[128] Such is apparently not the case where intervention is granted under *Donaldson*, and putting such a premium on delaying tactics would be inconsistent with *Donaldson*'s emphasis on the preservation of the summary nature of summons enforcement proceedings. The potential for delay would be a less significant problem under the analysis proposed here, since in most situations an improper purpose claim could be disposed of simply by determining whether the case had been referred to the Justice Department.

BUREAU OF SOCIAL SCIENCE RESEARCH, INC.,
Washington, D.C., July 10, 1980.

Senator MAX BAUCUS,
Chairman, Subcommittee on Oversight of the Internal Revenue Service of the Committee on Finance, U.S. Senate, Washington, D.C.

DEAR SENATOR BAUCUS: I am writing to call your attention to an apparent technical oversight in the drafting of S. 2402, now pending before your subcommittee.

Currently Section 6103 of the Internal Revenue Code makes a clear distinction between return information in identifiable and in nonidentifiable form. While public disclosure of identifiable information about a taxpayer is generally prohibited, the release of nonidentifiable information is permitted. This is in keeping with the underlying purpose of Section 6103 which is to protect taxpayer privacy—not to serve as a bar to the relase of information about our tax system, and its administration by the Internal Revenue Service.

In defining return information, Section 6103(b) currently states: "but such term [return information] does not include data in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer."

This clause unfortunately is omitted from S. 2402. I believe the above quoted language should be retained. S. 2402 should be amended to make it clear that the public availability of nonidentifiable information whatever it original source as return or nonreturn information is not changed by this proposed legislation.

As a fellow taxpayer, I am sure you will agree that there is a strong public interest in ensuring the availability of information about the functioning of our tax system. Information in anonymous form from return and nonreturn sources is also valuable for many research purposes. Such information may be statistical in nature, or describe policy, procedures or decisions of the I.R.S.

I know from my own research as a social scientist the value of these types of information. For example, I recently completed a report on "White-Collar Crime Data Sources" for the U.S. Department of Justice, National Institute of Justice. The report relied heavily upon statistical and policy documents of the Internal Revenue Service containing information from returns and other sources in nonidentifiable form.

Sincerely,

SUSAN B. LONG,
Visiting Scholar.

STATEMENT OF STEPHEN K. STRONG

I am pleased to submit this statement to the subcommittee on IRS oversight, which is considering Senate bills 2402, 2403, 2404. These bills are intended to make certain tax information available to law enforcement agencies, while basically preserving the confidentiality of return information submitted by taxpayers. I am concerned only with the proposed amendment to 26 U.S.C. § 6103(b)(2), which defines "return information."

The current definition of "return information" in the statute played a decisive role in litigation in which I have been involved. *Long* v. *Internal Revenue Service,* 596 F. 2d 362 (1979), cert. denied 48 U.S.L.W. 3693 (1980). In this case, the IRS took the position that tax information it compiled in a study of its own efficiency could

not be disclosed under § 6103 because it ultimately came from taxpayers' returns, even if the data were completely severed from items which identified specific taxpayers. The Ninth Circuit rejected this argument, relying on the clause in § 6103(b)(2) which excluded from the definition of nondisclosable "return information" any data in a form which cannot be associated, directly or indirectly, with particular taxpayers. 596 F. 2d at 368. The court commented that this provision permitted the disclosure of compilations of useful data in circumstances which do not pose a risk of breaching a person's privacy, and that the information sought by the Longs "is extremely useful in formulating tax policy and in evaluating current [IRS] practices." 596 F. 2d at 368, 369.

The proposed bills might change this result by deleting the definitional exclusion for data in an anonymous form. The deletion of this important clause might severely affect the ability of the public to know much that is important about tax law and policies and the Internal Revenue Service's practices. The IRS's tax models, for instance, might no longer be disclosable. These tax models show the operation of income tax laws by containing a random statistical sample of tax returns from which all identification has been removed. A user of a tax model, which is contained on computer data tapes, can then perform analyses of the data to determine, for instance, the fiscal impact of specific changes in the tax laws. These models are currently made available for sale by the Machine-Readable Records Division of National Archives. A change in the law meaning that outsiders could not study the operation of our nation's tax laws with these models, but would have to depend solely on IRS conclusions, would be most unfortunate.

There are many other types of tax data that are now routinely made available to the public in anonymous form. For instance, President Carter, in a message to Congress advocating tax reform, cited several specific (but anonymous) cases to illustrate actual abuses under the current law. Similarly, the IRS frequently cites specific unnamed cases to illustrate problems in filing tax returns or administering the tax laws. In addition, General Counsel Memoranda of the IRS which reflect agency interpretation of the law in specific cases are now made available under the Freedom of Information Act without the identifying details. Thus, if the definition is amended to perhaps preclude disclosure of such types of anonymous tax data, we would all be lacking much important information about the income tax laws and IRS practices. Accordingly, the bill should not eliminate the provision that information from taxpayers' returns can be made available to the public when it is disclosed in completely anonymous form.

Statement of the International Association of Trade Exchanges

This is in response to a request for written comments on S. 2403 which proposes to amend provisions of 26 U.S.C. 7609 dealing with the administrative summons provisions of the Internal Revenue Code.

The International Association of Trade Exchanges (IATE) wishes to express its opposition to S. 2403. We believe the bill goes too far in the direction of revising third-party summons procedures at the expense of taxpayers rights.

Although S. 2403 leaves intact the notice provisions of section 7609, the bill proposes to (a) eliminate the automatic stay of compliance enjoyed by the noticee, and (b) remove the burden of enforcing summonses from the IRS. The effect of S. 2403 would be to place the burden of proof on the taxpayer by having the noticee initiate a challenge to the summons through a motion to quash procedure. It is this proposed revision of section 7609 which we consider unfair.

Our interest in section 7609 provisions stems from IRS' selection of our industry for a special examination project wherein section 7609 issues have been prominently raised. This special examination project, directed by Internal Revenue Manual Supplement 45G-324, dated March 11, 1980, is underway at the present time and has as its object obtaining records of financial transactions of every taxpayer who does business with a barrier exchange.

The IATE represents the leading members of the over 200 organized trade or barter exchanges in the United States. The exchanges serve around 40,000–50,000 business owners and professionals who trade their products and services through the facility of organized barter exchanges. Our member exchanges record all transactions and modern accounting techniques and equipment are employed in the recordkeeping functions. A unit of account, commonly called a trade credit, is used to facilitate barter transactions. The gross annual volume of the barter exchange industry is estimated to be in the range of $250 million.

Last year, as an outgrowth of interest in the underground economy, the IRS initiated an unreported income program. One of the projects, indeed the first project undertaken in this program, was the Barter Exchange Project. Procedural guide-

lines and instructions for carrying out the project are contained in the above referenced Manual Supplement. The instructions state that "during each examination of a barter or trade exchange, members of the exchange should be identified along with the amount of transactions for each member." As this excerpt indicates, it is IRS' stated objective that members of barter exchanges are targets for examination along with the exchanges themselves. In other words, it is possible that a universe of approximately 40,000-50,000 individuals are subject to having their records examined simply because they barter goods and services through barter exchanges.

In carrying out this project, IRS has authorized the use of both administrative and John Doe summonses as investigative tools. As an example of the use of both types of summonses, we have enclosed as attachments 1 and 2 copies of two summonses served on one of our members. The first attachment is a copy of an administrative summons served on the Pittsburgh Trade Exchange in December 1979 and the second attachment is a copy of a John Doe summons served in April 1980 on the same Exchange in the tax liabilities of "John Does, Members of the Pittsburgh Trade Exchange". What these summonses demonstrate is that large numbers of taxpayers are being singled out for special examination. These summonses are being resisted in the courts with respect to their use to obtain the records of financial transactions of members of a barter exchange, and this matter is currently in process of litigation.

In addition, it is our belief that barter exchanges are third-party recordkeepers within the meaning and legislative history of section 7609. The IRS does not at the present time share this view, and we believe this point requires clarification. The fact is that barter exchanges do act as third-party recordkeepers.

Our concerns about S. 2403 are real. If S. 2403 becomes law, there is a strong likelihood that taxpaying small businessmen and women who belong to a barter exchange, and who have been notified that their records are being sought by the IRS from the exchange, will be effectively precluded from defending against such intrusion and requiring the IRS to demonstrate a proper grounds for requesting the records.

In the final analysis, when faced with the choice of retaining counsel, the inconvenience of the time expended, and the money spent and time involved in mounting a successful motion to quash proceeding against a summons, the choice not to resist becomes an inevitable one for this small business person.

Based upon our experience with the IRS' barter exchange project, the small businessman who barters and whose records are held by an exchange would not only be exposed to an enforcement effort of questionable legality, but would be required also, according to S. 2403, to shoulder the burden to quash the summons for his records in order to block IRS access to them.

The IATE is concerned about reports of abuses and tactics of delay on the part of taxpayers in the summons enforcement process. But abuses, mistakes, and misjudgments are not limited and attributable solely to taxpayers. There must also be protections against these same manifestations on the part of tax compliance, collection and enforcement agencies of government. Our concerns, stemming from our direct experience with IRS' nationwide examination project, are for the majority of law-abiding taxpayers who would no longer be effectively safeguarded from misguided IRS summons requests. The protections of section 7609, we believe, are needed. Furthermore, as long as the burden of proof remains on the IRS to initiate a motion to enforce proceeding there is the likelihood that the IRS would more carefully consider the wisdom of going forward with a summons action. Being relieved of this burden opens the door to the IRS' becoming lax in reviewing the merits of particular summonses.

Speed and efficiency in summons enforcement actions are goals everyone shares, but certainly not at the expense of the rights of individual taxpayers whose records are held by third parties. We believe the provisions of S. 2403 go too far. It is essential that the basic protections and procedures contained in section 7609 be retained. We are therefore opposed to S. 2403.

Form 2039-A
(Rev. 3-77)

Summons

Attachment 1

In the matter of the tax liability of
Pittsburgh Trade Exchange, Inc.
1105 Washington Boulevard
Pittsburgh, PA 15205

Internal Revenue District of Pittsburgh

Periods for the year ended June 30, 1978

The Commissioner of Internal Revenue

To Mr. Vincent E. Mannelli as President of Pittsburgh Trade Exchange, Inc. and the Pittsburgh Trade Exchange, Inc.
At 1105 Washington Boulevard, Pittsburgh, PA 15206

You are hereby summoned and required to appear before Me, an officer of the Internal Revenue Service, to give testimony relating to the tax liability or the collection of the tax liability of the person identified above for the periods shown and to bring with you and produce for examination the following books, records, papers, and other data:

SEE ATTACHMENT.

Business address and telephone number of Internal Revenue Service officer named above:

1000 Liberty Avenue, Pittsburgh, PA 15222 (412) 644-5630

Place and time for appearance:

at 1105 Washington Boulevard, Pittsburgh, PA 15206

on the 3rd day of January 19 80 at 9:00 o'clock A. M.

Issued under authority of the Internal Revenue Code

this 17th day of December, 19 79

[signature] — Signature of Issuing Officer — Internal Revenue Agent — Title

[signature] Ronald Karpuszka — Signature of Approving Officer (if applicable) — Group Supervisor — Title

Part A—To be given to person summoned

Form 2039-A (Rev. 3-77)

ATTACHMENT

Pittsburgh Trade Exchange, Inc.

All Books, Records, Invoices, Statements, or other records or data in your possession or control reflecting income, expenses, assets and liabilities for the above year, including, but not limited to the following:

1) All contracts entered into.
2) All Accounts Receivable and detailed listings for subsidiary ledger and or cards to reconcile such Accounts Receivable.
3) All Accounts Payable and detailed listings for subsidiary ledger and or cards to reconcile such Accounts Payable.
4) Credits due customers and or clients with each customer and or client identified and respective amount identified.
5) Date of each barter transaction arranged or completed, amount involved in each such transaction, and names of the person, corporation or other entities involved in each such transaction.
6) Names of all persons, corporations, or other entities from whom you received or accrued income or otherwise have done business with.

Form 2039-A
(Rev. 3-77)

Summons

In the matter of the tax liability of
Members of the Pittsburgh Trade Exchange Inc.,
during the calendar years ending December 31,
1978 or December 31, 1979.

Attachment 2

Internal Revenue District of Pittsburgh, Pennsylvania

Periods for the years ended December 31, 1978 & December 31, 1979

The Commissioner of Internal Revenue

To Pittsburgh Trade Exchange, Inc.
1105 Washington Boulevard
At Pittsburgh, Pennsylvania 15206

You are hereby summoned and required to appear before Gerald R. Potoonak, an officer of the Internal Revenue Service, to give testimony relating to the tax liability or the collection of the tax liability of the person identified above for the periods shown and to bring with you and produce for examination the following books, records, papers, and other data:

A) Rosters, membership lists, or other records which reflect the names and addresses of all persons who were members of the Pittsburgh Trade Exchange during the calendar years ending December 31, 1978 or December 31, 1979.

B) Corporate books of account, ledgers, or other records of the Pittsburgh Trade Exchange which identify for each member every bartering transaction, the date, the participants, and the amount during the calendar years ending December 31, 1978 or December 31, 1979.

Business address and telephone number of Internal Revenue Service officer named above:

I.R.S., Federal Office Building, Room 1001, Pittsburgh, PA 412-644-5630

Place and time for appearance:

at I.R.S., Room 1001, 1000 Liberty Avenue, Pittsburgh, Pennsylvania 15222

on the 18th day of April, 19 80 at 9:30 o'clock A.M.

Issued under authority of the Internal Revenue Code

this 2nd day of April, 19 80

James [signature] — Chief, Examination Div.

Signature of Issuing Officer — Title

Signature of Approving Officer (if applicable) — Title

Part A—To be given to person summoned

Form 2039-A (Rev. 3-77)

IN THE U.S. DISTRICT COURT FOR THE WESTERN DISTRICT OF PENNSYLVANIA

[MISC. NO. 7824]

In the matter of the tax liabilities of: John Does, members of the Pittsburgh Trade Exchange, Inc., during the years 1978 or 1979

ORDER

Upon the petition, the exhibits attached thereto, and the motion of the United States Attorney for the Western District of Pennsylvnia, for leave to serve a John Doe summons, the Court has determined that the summons relates to the investigation of an ascertainable group or class of persons, that is, the members of the Pittsburgh Trade Exchange, Inc., during the years 1978 and 1979, that there is a reasonable basis for believing that such group or class of persons may fail or may have failed to comply with various provisions of the Internal Revenue Code of 1954 (26 U.S.C.); and that the information sought to be obtained from the examination of the records (and the identity of the persons with respect to whose liability the summons relates) is not readily available from other sources. It is therefore

Ordered, adjudged and decreed that the Internal Revenue Service, through an authorized officer or agent, may serve the summons, attached to the petition, upon the Pittsburgh Trade Exchange, Inc. And it is further

Ordered, adjudged and decreed that a copy of this order be served with the summons.

Dated this 27th day of March, 1980, at Pittsburgh, Pennsylvania.

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U.S. District Judge.

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