

REPORT BY THE
Comptroller General
OF THE UNITED STATES

9388

**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.



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report

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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To the Chairman and Vice Chairman
Joint Committee on Taxation
Congress of the United States

Review of
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.

William A. Stealy
Comptroller General
of the United States



COMPTROLLER GENERAL'S REPORT
TO THE JOINT COMMITTEE ON
TAXATION

DISCLOSURE AND SUMMONS PRO-
VISIONS OF 1976 TAX REFORM
ACT--PRIVACY GAINS WITH
UNKNOWN LAW ENFORCEMENT
EFFECTS

D I G E S T

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. 96C 00004

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. 3 502

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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Internal Revenue Service

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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. 206

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 record-keepers 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.

Agency concerns

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 provisions 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 provisions 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.

<u>Fiscal year</u>	<u>Number of Strike Force cases initiated by IRS</u>
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.

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 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 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:

<u>District office</u>	<u>Time frame</u>	<u>Summonses issued</u>	<u>Summonses stayed</u>	<u>Summonses not enforced</u>
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	<u>1,417</u>	<u>a/203</u>	<u>33</u>
Total		<u>3,062</u>	<u>370</u>	<u>80</u>

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:

<u>Reason for not seeking summons enforcement</u>	<u>Number of summons</u>
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	<u>1</u>
Total	<u>24</u>

IRS attorneys in the five district offices declined to seek enforcement of 25 other summonses for the following reasons:

<u>Reason for not seeking summons enforcement</u>	<u>Number of summonses</u>
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	<u>1</u>
Total	<u><u>25</u></u>

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:

<u>Reason for returning summons to district office</u>	<u>Number of summons returned</u>
Summons enforcement declined	58
Insufficient factual information provided	25
District office withdrew summons enforcement request	<u>5</u>
Total	<u>88</u>

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:

<u>Reason for declination</u>	<u>Number of summons</u>
Improper or insufficient notice to taxpayers	31
Third-party witness asserted valid fifth amendment defense	22
Defective or unnecessary summons issued	<u>5</u>
Total	<u>58</u>

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 record-keeper 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.

	<u>Los Angeles</u>			<u>Phoenix</u>		
	<u>Reported</u>	<u>Recon- structed</u>	<u>Differ- ence</u>	<u>Reported</u>	<u>Recon- structed</u>	<u>Differ- ence</u>
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.

<u>District office</u>	<u>Sample size</u>	<u>Persons involved in illegal activities</u>	<u>Tax protesters</u>
Boston	4	1	-
Chicago	17	6	1
Dallas	7	2	4
Los Angeles	10	2	3
Milwaukee	<u>4</u>	<u>1</u>	-
Total	<u>42</u>	<u>12</u>	<u>8</u>

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.

<u>District office</u>	<u>Average number of days</u>	<u>Number of summonses stayed</u>	<u>Number of cases involved</u>
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 February 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, reissued, 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;

no intent to
~~whether~~ --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. *Special*

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.

<u>Fiscal Year</u>	<u>No. of Strike Force Cases Initiated</u>	<u>No. of SEP Cases Ini- tiated (other than Strike Force & Wagering Tax) */</u>	<u>Total</u>
	(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.

Mr. Allen R. Voss

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.

Mr. Allen R. Voss

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.

Mr. Allen R. Voss

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

Mr. Allen R. Voss

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,

A handwritten signature in black ink, appearing to read "James H. ...". The signature is written in a cursive style with a large, sweeping initial "J".



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

^{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 inculcate 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. Praetorius, 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 motion 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.

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

Mr. Robert L. Keuch
Deputy Assistant Attorney General
Criminal Division
Department of Justice
Washington, D.C. 20530

Person to Contact: Mr. A. Gordon

Telephone Number: 566-3908

Refer Reply to: CP:D

Date: **JAN 13 1978**

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 Agencies

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.

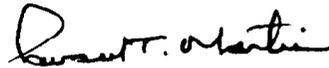
As stated previously our assessment is still incomplete and subject to change, especially when we consider that many present Strike Force cases arose previous to the new laws and sufficient information had previously been exchanged to apprise Strike Force attorneys of those taxpayers concerning whom 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

<u>Questions</u>	<u>Correct response</u>	<u>Number of correct responses</u>	<u>Number of erroneous responses</u>	<u>Percent of erroneous responses</u>
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

<u>Questions</u>	<u>Correct response</u>	<u>Number of correct responses</u>	<u>Number of erroneous responses</u>	<u>Percent of erroneous responses</u>
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



SUMMONS STATISTICS ACCUMULATED
 BY IRS' CRIMINAL INVESTIGATION DIVISION
 MARCH 1, 1977, TO MARCH 31, 1978
 (note a)

	1977												Total-- March, 1977 to March, 1978 (note c)	
	March	April	May	June	July	August	September	October	November	December	January	February		March
Summons 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 with cumulative totals derived by adding the individual monthly statistics. IRS personnel were unable to reconcile the cumulative 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.

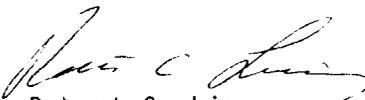
Department of the Treasury

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

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