

Disclosure Litigation BULLETIN

This bulletin is for informational purposes; it is not a directive.

Bulletin 2000-3

July 2000

With the publication of this issue of the Disclosure Litigation Bulletin, we have a new organizational name! Effective with the July 2, 2000 "stand up" of the National Office of Chief Counsel, we are the office of the Assistant Chief Counsel (Disclosure & Privacy Law). Although our name has changed, our subject matter jurisdiction remains essentially the same. Disclosure & Privacy Law attorneys provide legal advice and assistance to Internal Revenue Service and Office of Chief Counsel employees on questions involving the disclosure provisions of the Internal Revenue Code, including but not limited to I.R.C. §§ 6103, 6104, 6108, 6110, 4424, 7213, 7213A, 7431, 7513, and 7852(e), and questions involving Treas. Reg. § 301.9000-1, the Freedom of Information Act (FOIA), 5 U.S.C. § 552 and the Privacy Act of 1974, 5 U.S.C. § 552a. We coordinate the policies and programs with respect to legislation and regulations relating to disclosure matters. We assist the Justice Department in defending all litigation arising under the FOIA, the Privacy Act, and I.R.C. § 7431 (which provides civil remedies for unauthorized disclosure or inspection of tax returns and return information). We are available to assist field personnel concerning subpoenas for testimony and document production by Service personnel. We are also now responsible for handling the litigation of actions to restrain disclosure of written determinations pursuant to I.R.C. § 6110(f)(4)(A) in the United States Tax Court.

Under the new Associate Chief Counsel (Procedure & Administration), the office of the Assistant Chief Counsel (Disclosure & Privacy Law) is organized as follows:

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PRIVACY ACT SECTION (e)(2) – COLLECTING INFORMATION FROM SUBJECT

The interpretation to be given to 5 U.S.C. § 552a(e)(2) is an issue that has recently been raised by disclosure personnel. 5 U.S.C. § 552a(e)(2) provides that each agency that maintains a system of records shall “collect information to the greatest extent practicable directly from the subject individual when the information may result in adverse determinations about an individual’s rights, benefits, and privileges under Federal programs.” The OMB Guidelines (40 Fed. Reg. 28948, 28961 (July 9, 1975)) state the agencies should consider various factors in determining whether it is practicable to collect information from the subject individual. These factors include: whether information can only be obtained from a third party, the risk of obtaining inaccurate information from the third party, and the need to verify with a third party information obtained from the subject.

Inquiries into allegations of employee misconduct must be conducted consistent with section (e)(2). However, courts have approved contacting a third party prior to contacting the employee in certain circumstances. For example, in Brune v. IRS, 861 F.2d 1284, 1288 (D.C. Cir. 1988), a group manager contacted taxpayers to confirm a revenue agent’s visits prior to questioning the revenue agent about “inordinately numerous and lengthy visits.” The court held that this was acceptable where “an investigator reasonably concludes . . . that contacting the suspect first would not, in all likelihood, make it unnecessary thereafter to contact third parties but would entail some risk of compromising such further inquiry.” The court expressed concern that the revenue agent was in a position to coerce taxpayers whose returns he was examining into altering their testimony regarding the visits. Where an employee’s ability to alter evidence or coerce a witness is virtually nonexistent, a court determined the employee should be contacted prior to third parties. Waters v. Thornburgh, 888 F.2d 870, 873-74 (D.C. Cir. 1989). Nevertheless, it was held that if an employee refuses to provide information upon request, the agency may contact third parties to obtain it. Magee v. United States Postal Service, 903 F. Supp. 1022, 1028-29 (W.D. La. 1995). On the other hand, the fact that an employee might be distressed, embarrassed, or angered by questions about his conduct does not, standing alone, override the general requirement that the employee be contacted before third parties. Dong v. Smithsonian Institution, 943 F. Supp. 69, 74 (D.D.C. 1996), rev’d on other grounds, 125 F.3d 877 (D.C. Cir. 1997), cert. denied, 524 U.S. 922 (1998). Yet, reviewing the agency’s own file of documents completed and provided by the employee may be sufficient collection “from the subject individual.” Darst v. SSA, 172 F.3d 1065, 1068 (8th Cir. 1999) (SSA employee’s application for SSA benefits reviewed). It would appear that a sound practice is if an investigator determines that obtaining information from the subject individual is not practicable, the reasons for the determination should be set forth in writing and maintained for possible later use.

The (e)(2) requirement also applies to tax records. The IRS has exempted Criminal Investigation investigatory records from this requirement pursuant to 5 U.S.C. § 552a(j)(2). However, Examination and Collection records are not exempt; thus,

information for these records should be collected from third parties in a manner consistent with section (e)(2) and the factors identified by OMB. Accordingly, it is important to attain a balance between ensuring that the subject individual is contacted first whenever practicable and ensuring that an investigation is conducted in a manner most likely to obtain true and accurate information.

CASE DEVELOPMENTS

TAX ANALYSTS v. IRS, 2000 U.S. Dist. LEXIS 5066 (D.D.C. March 31, 2000)

The court issued an opinion on cross-motions for summary judgment in this Freedom of Information Act (FOIA) case in which Tax Analysts is seeking access to six work products issued by the Office of Chief Counsel. With respect to Pending Issues Reports (PIRs) and Field Service Advice Monthly Reports (FSA Reports), the court agreed with the Service's approach in redacting certain information from these documents, specifically the redaction of return information that is either not part of the public record in docketed court cases or cannot readily be identified as part of the public record. However, because the parties had entered into a stipulation with respect to these documents prior to the court's order, there is currently a motion to strike this favorable portion of the decision.

The court also agreed with the Service's redaction of the portions of Legal Memoranda (LMs) that reflect the opinions and analysis which do not ultimately form the basis of the final revenue ruling. The court found that this approach to segregability is consistent with the mandate of the U.S. Court of Appeals for the D.C. Circuit that the deliberative process privilege be applied as narrowly as possible. The court disagreed with Tax Analysts' contention that LMs are analogous to General Counsel Memoranda and Field Service Advice, holding that unlike those documents, LMs are not used to promote uniformity in Service policy, are not updated to reflect the current status of an issue, are not widely distributed and do not necessarily reflect the official position of the Office of Chief Counsel on a given issue. In upholding the Service's claim of deliberative process with respect to LMs, the court further noted that the flow of the documents was from subordinate to superior, and therefore, "reflect the agency 'give and take' leading up to a decision that is characteristic of the deliberative process."

With respect to post December 31, 1985, Tax Litigation Bulletins (TLBs), Litigation Guideline Memoranda (LGMs) and Technical Assistance Memoranda (TAs) issued to the field, the court held that the Restructuring and Reform Act of 1998, which makes these documents subject to public disclosure pursuant to I.R.C. § 6110, divests the court of jurisdiction to hear FOIA claims with respect to them. The court further held that Tax Analysts is not entitled to recover any attorneys' fees with respect to its efforts to obtain disclosure of these documents.

Finally, the court ruled that it did not have enough information to make a ruling with respect to the various exemption claims for intra-National Office of Chief Counsel TAs and TAs written to Service program executives in the National Office. The court did

uphold the Service's redaction of factual, taxpayer specific information, but has requested additional information from the Service regarding its exemption claims based on the attorney work product privilege, attorney client privilege, deliberative process privilege, tax treaty secrecy clauses and investigative guidelines or settlement criteria with respect to these TAs.

TERRY L. JONES, et ux., et al. v. U.S., 207 F.3d 508 (8th Cir. 2000)

In 1991, the plaintiffs filed an I.R.C. § 7431 lawsuit seeking damages for unauthorized disclosure in violation of I.R.C. § 6103(a) in excess of \$112 million. Plaintiffs alleged that one or more IRS employees wrongfully disclosed plaintiffs' tax return information to a confidential informant, who, in turn, notified the local media that the IRS was conducting a search of plaintiffs' company, Jones Oil, pursuant to a search warrant. During the liability phase of the trial, the court determined that I.R.C. § 6103 did not authorize the special agent's disclosure to the informant of the search warrant's impending execution, but that the United States was not liable for damages because the taxpayers failed to prove the disclosure was based on a bad faith misinterpretation of section 6103. Jones v. U.S., 898 F. Supp. 1360 (D. Neb. 1995). The Eighth Circuit remanded the case, holding that the United States bears the burden of proving good faith under I.R.C. § 7431(b)(1). Jones v. U.S., 97 F.3d 1121 (8th Cir. 1996). On remand, the trial court found that the special agent did not make the unauthorized disclosure based upon a "good faith, but erroneous interpretation" of I.R.C. § 6103. Jones v. U.S., 954 F. Supp. 191 (D. Neb. 1997). Consequently, the Government was liable for damages and on June 19, 1998, the court awarded actual damages to Terry and Patricia Jones in the amount of \$5.4 million. Jones v. U.S., 9 F. Supp. 2d 1119 (D. Neb. 1998) (see Disclosure Litigation Bulletin No. 99-1).

On appeal, the Eighth Circuit concluded that disclosure of information under the specific circumstances of the case was not authorized by regulations pursuant to I.R.C. § 6103(k)(6) (investigative disclosures), but that the district court erroneously included pre-judgment interest of \$2.5 million in its damages award. The court also upheld the district court's refusal to award punitive damages and attorneys' fees.

The Court of Appeals also held that the Government failed to carry its burden of showing that the special agent's actions were within the "good faith" safe harbor of I.R.C. § 7431, noting that none of the regulations that implement I.R.C. § 6103(k)(6) allows for the disclosure of return information under the circumstances of this case.

Both parties requested a petition for rehearing. The Government petitioned for rehearing on the circuit court's award of post-judgment interest, and also sought rehearing en banc on the court's holding that the special agent's actions were not the result of a good faith but erroneous interpretation of I.R.C. § 6103(k)(6). Plaintiff sought a petition on the grounds that pre-judgment interest was properly awarded by the district court, and that the district court erred in not awarding punitive damages and attorneys' fees. The Court of Appeals denied the Government's petitions for rehearing and rehearing en banc. Jones v. U.S., 2000 U.S. App. LEXIS 12195 (8th Cir. June 1, 2000). Plaintiff's petition is currently pending.

"TAX ADMINISTRATION" DISCLOSURES: HOBBS v. U.S., 209 F.3d 408 (5th Cir. 2000); GARDNER v. U.S., 2000 U.S. App. LEXIS 12829 (D.C. Cir. June 9, 2000)

In Hobbs, a case brought under I.R.C. § 7431 for damages for unauthorized disclosure of return information in violation of I.R.C. § 6103(a), the 5th Circuit upheld the decision of the U.S. District Court for the Southern District of Texas (see Disclosure Litigation Bulletin No. 98-2) that I.R.C. § 6103(h)(4)(A) allowed the disclosures of a terminated employee's return information in the course of a Merit Systems Protection Board (MSPB) proceeding and a Title VII lawsuit. I.R.C. § 6103(h)(4)(A) provides that a taxpayer's returns and return information "may be disclosed in a Federal or State judicial or administrative proceeding pertaining to tax administration . . . if the taxpayer . . . is a party to the proceeding . . ." The circuit court cited to Rueckert v. IRS, 775 F.2d 208 (7th Cir. 1985) and U.S. v. Mangan, 575 F.2d 32 (2nd Cir. 1978), which held the term "tax administration," defined in I.R.C. § 6103(b)(4) as relating "to the administration, management, conduct, direction, and supervision of the . . . internal revenue laws," is to be interpreted broadly. In short, the circuit court reasoned that the IRS was required to defend its action in the MSPB proceeding and Title VII lawsuit to terminate plaintiff's employment by disclosing the ground for his dismissal, i.e., plaintiff's improper filing of past tax returns.

The 5th Circuit also held that I.R.C. § 7431 is the exclusive remedy for unauthorized disclosures of return information. Plaintiff had also sought damages for unauthorized disclosures under the Privacy Act. However, the court stated that "I.R.C. § 6103 is a more detailed statute that should preempt the more general remedies of the Privacy Act."

In Gardner, another I.R.C. § 7431 case, a former Chief Counsel employee was dismissed from employment for failure to comply with both Federal and state tax laws. In connection with his dismissal plaintiff's relevant tax return information was examined by his supervisors. After his dismissal, plaintiff applied to the State of California for unemployment benefits which were denied. He then appealed. In proceedings before the California Unemployment Insurance Appeals Board and the Merit Systems Protection Board, evidence was submitted concerning the basis upon which plaintiff was dismissed, including testimony from plaintiff's supervisors. The U.S. Circuit Court for the District of Columbia affirmed the decision of the district court (see Disclosure Litigation Bulletin No. 99-2). The D.C. Circuit addressed the scope of "tax administration" (as defined in I.R.C. § 6103(b)(4)) within I.R.C. §§ 6103(h)(1) and (h)(4). I.R.C. § 6103(h)(1) allows disclosures of returns and return information to other Treasury employees "whose official duties require such disclosure for tax administration purposes." I.R.C. § 6103(h)(4) allows disclosures of returns and return information "in a Federal or State judicial or administrative proceeding pertaining to tax administration . . . if the taxpayer . . . is a party to the proceeding . . ." The circuit court held that the disclosures to his supervisors were authorized under I.R.C. § 6103(h)(1), and citing Hobbs v. U.S., 209 F.3d 408 (5th Cir. 2000), held that the disclosures in the administrative proceedings were likewise authorized (under I.R.C. § 6103(h)(4)). The D.C. Circuit stated that these were proper tax administration disclosures "for purposes of enabling the IRS to conduct its internal investigation of [plaintiff's] tax history, and to

explain the basis for the termination of his employment in the subsequent administrative proceedings."

As in Hobbs, supra, the circuit court determined that I.R.C. § 6103 preempted plaintiff's Privacy Act claims for unauthorized disclosure of tax return and return information.