A PEEK BEHIND THE CURTAIN: HOW TAX RETURN INFORMATION IS DISCLOSED IN AN INVESTIGATION INVOLVING NON-TAX CRIMES

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By their nature, tax returns contain highly sensitive information. Consequently, the Internal Revenue Code makes return information, which is broadly defined, confidential. I.R.C. § 6103(a). This confidentiality provision comes with real teeth:

- If an employee of the federal government *inspects or discloses* a return or return information, either "knowingly, or by reason of negligence," in violation of section 6103, the taxpayer may sue the United States for damages. I.R.C. § 7431(a). If the taxpayer wins, she can recover statutory damages of $1,000 per violation, actual damages if greater, and, if the violation is either willful or the result of gross negligence, punitive damages. I.R.C. § 7431(c)(1). There is also the potential for an award of attorneys' fees. I.R.C. § 7431(c)(3).
- Improper disclosure is also a felony. Section 7213 of the Code provides that officers and employees of the United States (along with officers and employees of certain contractors who handle returns and return information) who willfully disclose a return or return violation in violation of section 6103 are subject to "a fine in any amount not exceeding $5,000, or imprisonment of not more than 5 years, or both" if convicted. I.R.C. § 7213(a).

By the same token, the fact that tax returns contain highly sensitive information means they can be quite useful to the government. Consequently, there are a large number of exceptions to the confidentiality requirement of section 6103(a). Obviously, officials in the Treasury Department need access to returns and the information that they contain to enforce the Code, and section 6103 contains a corresponding exception to provide that access. I.R.C. § 6103(h)(1). Similarly, when the Justice Department is investigating or litigating tax cases, its employees need access to return information; consequently, there is an applicable exception. I.R.C. § 6103(h)(2).

Section 6103 also authorizes the disclosure of return information to the general public by IRS employees as part of an audit, in connection with efforts to collect taxes, or in a civil or criminal tax investigation. *See* I.R.C. § 6103(k)(6). For example, in the course of a criminal investigation, an IRS special agent can disclose return information to a taxpayer's customers through letters that request information concerning

all transactions that each customer had with the taxpayer who is under investigation. *Diandre v. United States*, 968 F.2d 1049, 1052-53 (10th Cir. 1992).

What about other crimes? The Code provides a mechanism for federal agents and prosecutors to access return information if they are investigating other federal crimes. *See* I.R.C. § 6103(i). The operation of section 6103(i) was addressed last week by a district judge in Kentucky. *See In re Application of United States for Taxpayer Return Information*, No. 6-16-cv-00138-GFVT, 2016 U.S. Dist. LEXIS 119895 (E.D. Ky. Sept. 6, 2016).

Section 6013(i) authorizes disclosure of return information "to officers and employees of any Federal agency who are personally and directly engaged" in proceedings that involve the enforcement of a Federal criminal statute that does not involve tax administration. I.R.C. § 6103(i)(1)(A). The types of proceedings that would justify disclosure are fairly broadly defined:

(i) preparation for any judicial or administrative proceeding pertaining to the enforcement of a specifically designated Federal criminal statute (not involving tax administration) to which the United States or such agency is or may be a party, or pertaining to the case of a missing or exploited child,

(ii) any investigation which may result in such a proceeding, or

(iii) any Federal grand jury proceeding pertaining to enforcement of such a criminal statute to which the United States or such agency is or may be a party, or to such a case of a missing or exploited child . . . .

Id.[1]

To obtain the return information, the agency must apply for a court order; the court is required to address several factors under the statute:

- *First*, the court must determine whether "there is reasonable cause to believe, based upon information believed to be reliable, that a specific criminal act has been committed." I.R.C. § 6103(i)(1)(B)(i).
- *Second*, the court must determine whether "there is reasonable cause to believe that the return or return information is or may be relevant to a matter relating to the commission of such act." I.R.C. § 6103(i)(1)(B)(ii).
- *Third*, the court must determine whether "the return or return information is sought exclusively for use in a Federal criminal investigation or proceeding" and whether the information is reasonably available from another source absent disclosure. I.R.C. § 6103(i)(1)(B)(iii).

For obvious reasons, this is an *ex parte* process; the court makes its determination "on the basis of the facts submitted by the applicant." I.R.C. § 6103(i)(1)(B). There is one applicable exception: If representatives of the Treasury Department certify to the court that "that such disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation," then disclosure is not authorized. *See* I.R.C. § 6103(i)(6) (providing for certification); *see also* I.R.C. § 6103(i)(1)(A) (creating exception to authorization of disclosure).

Since disclosure is obtained through an *ex parte* proceeding, published opinions are rare. *In re Application of United States for Taxpayer Return Information* arose through some unusual circumstances.

The case involved a public corruption investigation by the FBI. 2016 U.S. Dist. LEXIS 119895 at *2. The magistrate judge assigned to rule on an *ex parte* application under section 6103(i) requested that the government brief whether the reasonable cause standard under the statute was a lower standard than

the probable cause standard for a search warrant under the Fourth Amendment. *Id.* at *2-*3. Unpersuaded by the government's position, the magistrate judge applied a probable cause standard and rejected the application. *Id.* at *3. The government then appealed, and the presiding district judge appointed counsel to file a brief in opposition to the government's appeal.

The district court commenced its analysis with the plain language of the statute, which it considered "inescapably ambiguous." *Id.* at *5 (citations omitted). While the court initially observed that the phrase "reasonable cause" seemed to involve a lower standard of proof than probable cause, it also noted that Black's Law Dictionary equated the two terms. *Id.* at *5-*6 (citations omitted).

Next, the court considered relevant authority construing the phrase "reasonable cause," starting with the Supreme Court's decision in *United States v. Watson*, 423 U.S. 411 (1976), a case that had used the terms "reasonable cause" and "probable cause" as synonyms. *Id.* at *7 (citations omitted). While *Watson* suggested the terms might be synonyms, the district court noted that there was contrary authority from the Supreme Court. Specifically, in a case construing the phrase "reasonable cause to suspect" under 19 U.S.C. § 482, the Supreme Court applied a standard that differed from probable cause. *Id.* at *7 (citing *United States v. Ramsey*, 431 U.S. 606, 612-14 (1977)). The court also observed that the Sixth Circuit had recently concluded that "reasonable cause to believe" under the Stored Communications Act called for less protection than "probable cause." *Id.* (citing *United States v. Carpenter*, 819 F.3d 880, 889 (6th Cir. 2016)).

In the absence of controlling authority and given inconsistent judicial treatment of the term "reasonable cause," the district court then turned to the legislative history of section 6103(i). The relevant Senate Report explicitly indicated that the reasonable cause standard was intended to provide a standard that was not as strict as the probable cause requirement for issuance of a search warrant. *Id.* at *8-*9 (citing S. Rep. No. 94-938, pt. 1 at 328 (1976)). The court also considered the government's rationale for applying a lower standard persuasive: "This information, already disclosed to one division of the federal government, is sensibly subject to a lower threshold of protection than that given to an individual's house or computer pursuant to the Fourth Amendment 'probable cause' standard." *Id.* at *10.

In addressing what a lower standard might entail, the court observed that a lower standard than probable cause applied in the context of a *Terry* stop, where a reasonable suspicion standard applies. *Id.* at *10-*11 (citing *Terry v. Ohio*, 392 U.S. 1, 21 (1968)). The court also observed that the Sixth Circuit applied a similar intermediate standard under the Stored Communications Act. *Id.* at * 11 (citations omitted).

Accordingly, the court articulated a governing standard, indicating that "the Government need only make some rational showing, supported by reliable evidence, that a criminal act has been committed and that the tax return information may be relevant to that crime." *Id.* at *13-*14 (citing I.R.C. § 6103(i)(1)(B)(i)-(ii)). It then remanded the case for further proceedings.

In re Application of United States for Taxpayer Return Information provides an interesting view of the operation of section 6103(i) in a concrete context. The court's rationale for applying a lower standard than probable cause seems appropriate under the circumstances. And the case also serves as a reminder that magistrate judges and district judges take their obligations in disclosure proceedings quite seriously.

[1] Section 6103(i) also authorizes disclosure in a variety of other contexts, including matters involving terrorism, or an effort to locate fugitives. *See* I.R.C. § 6103(i)(a)(3), (a)(5).

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