

**Office of Chief Counsel
Internal Revenue Service
memorandum**

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to: Andrew E. Zuckerman
Director
EP Rulings and Agreements

from: Julie C. Schwartz
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(Procedure & Administration)

subject: Disclosure of Nonbank Trustee Investigation Information

This is in response to a request for advice received from Calvin Thompson regarding the captioned subject.

ISSUES

Whether information concerning the investigation of a Nonbank Trustee (NBT) for continued compliance with the requirements of Reg. 1.408-2(e) is confidential under IRC § 6103 and whether such information is disclosable under the Freedom of Information Act (FOIA).

CONCLUSIONS

Certain information generated by a NBT investigation is IRC § 6103 protected return information and therefore disclosable only as authorized by the Internal Revenue Code (the Code). This and certain other information contained in a NBT investigation file may be protected under FOIA, either under subsection (b)(3) in connection with IRC § 6103 or FOIA subsection (b)(4) depending on the facts and circumstances of each investigation.

FACTS

A Nonbank Trustee (NBT) is an entity that is not a bank but is permitted to act as a trustee or custodian for specified Individual Retirement Arrangements (IRAs) if it demonstrates, in writing, to the satisfaction of the Commissioner that the requirements specified under Reg. 1.408-2(e)(2) through (e)(6) are met. IRM 4.72.18.1; Reg. 1.408-2(e)(1). There is no standard form for the application.

PMTA 2010-19

By memo dated June 23, 2000, the Disclosure Litigation Division, a predecessor to the Office of the Associate Chief Counsel (Procedure & Administration), reaffirmed its view articulated in 1979 that the publication of the identities of approved NBTs is consistent with IRC §§ 6103, 6104 and 6110. The 2000 memo concluded that the application for NBT status under IRC § 408, and the notices of approval issued to applicants, are not received by the IRS in connection with determining a taxpayer's liability or potential liability under the Code and, as such, the information is not return information protected from disclosure under IRC § 6103. The 2000 memo noted that entities applying for NBT status are not subject to any tax or penalty under the Code and that the penalty for noncompliance with the NBT status requirements is the revocation of such status, as provided in the Treasury regulation, not a tax or penalty. The 2000 memo noted that entities apply for NBT status for business purposes, not tax related purposes. The 2000 memo addressed only the application for NBT status and publication of the name, address and approval date of approved NBTs.

The 2000 memo also concluded that NBT applications and approval notices are not subject to IRC § 6104 as an entity's NBT status has nothing to do with an entity's qualification as a tax exempt organization. Likewise, the 2000 memo noted that the notice of approval of NBT status is not a written determination within the meaning of IRC § 6110 as it does not fall within any of the categories of information made public by IRC § 6110.

As of February 28, 2010, there are 82 entities listed on the approved NBT list. Once each calendar quarter, the EP classification function selects an approved NBT from the list for each area to investigate for continued compliance with the NBT regulations. IRM 4.72.18.2(2). We understand these investigations are generally random, but IRS practice is that each NBT should be investigated once every five years. Additionally, if the Washington office receives or otherwise obtains information that a specific approved NBT does not comply with the regulations, the Washington office may request or recommend that a NBT investigation occur. IRM 4.72.18.2(3). Furthermore, approved NBTs must notify the Commissioner in writing of any change that affects the continuing accuracy of any representations made in its application. Reg. 1.408-2(e)(6)(iv). Such notification can also result in the IRS investigating a NBT for continued regulatory compliance.

IRM 4.72.18 contains NBT Investigation Procedures. The IRM procedures mirror the Regulation, setting forth the requirements for operating as a NBT (establish Fiduciary Ability, Capacity to Account, Fitness to Handle Funds and Rules of Fiduciary Conduct Reg. 1.408-2(e)(2) through (e)(5)) and detailing the information the IRS investigator should obtain, view and consider in determining continued compliance.

The IRS intranet and internet NBT sites contain numerous procedures and guidelines for NBT investigators to follow in conducting their investigations. These guidelines provide very detailed information regarding sources the IRS investigators should use in conducting the investigation. The guidelines recommend gathering certain information

from the NBT itself via interview and Information Document Requests (IDRs). The guidelines also recommend that the investigator use internal databases and specified codes on these databases to gather information about the NBT, including but not limited to IDRS, INOLES/T, PMFOLS, AMDISA, and BMFOLT. All of the information gathered by the investigators from these databases is IRC § 6103 protected return information and is placed in the NBT investigation file.

A NBT investigation concludes several ways. The NBT can receive a No Change Closing Letter with continued NBT approval, a No Change with Deficiencies Closing letter with continued NBT approval, but with an explanation of minor deficiencies found and corrective action recommended, a Revocation Letter with explanation of the bases for revocation or a Closing Agreement settling some outstanding issues with the NBT and sometimes imposing a penalty under IRC § 4973.

LAW AND ANALYSIS

A. Section 6103 and the NBT Investigation

Subject to certain limited exceptions, IRC § 6103 protects returns and return information from disclosure. Return information is defined in IRC § 6103(b)(2) as:

a taxpayer's identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments, whether the taxpayers return was, is being or will be examined or subject to other investigation or processing, or any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence or possible existence, of liability (or the amount thereof) of any person under this Title for any tax, penalty, interest, fine, forfeiture, or other imposition or offense.

26 USC § 6103(b)(2)(A). This term return information is broad and includes any information gathered by the IRS with regard to a taxpayer's liability under the Code. See McQueen v. U.S., 264 F.Supp.2d 502, 516 (2003); LaRouche v. U.S. Dept.of Treasury, 112 F.Supp.2d 48, 54 (D.D.C. 2000) "The [Tax Reform Act of 1976] defines returns and return information in the broadest way". The Code defines returns and return information in the broadest way. United States v. Barrett, 837 F.2d 1341 (5th Cir. 1988), cert. denied, 492 U.S. 926, reh'g denied, 493 U.S. 883 (1989).

We continue to believe that applications for NBT status under IRC § 408, and the notices of approval issued to applicants, are not received in connection with determining a taxpayer's liability or potential liability under the Code. There is no Code liability at issue during an application's processing and we understand the IRS looks only at the information provided by the applicant in connection with seeking NBT status. NBT status is either approved or not approved. As there is no liability or potential liability

under the Code at issue, the information contained in the application or approval notice are not protected from disclosure under IRC § 6103.

The nature of certain information gathered in the course of a NBT investigation, however, compels a different result. The NBT investigation guidelines outlined above make clear that IRS investigators gather and consider information about the NBT from IRS databases and files, information that was collected by the IRS with respect to the NBT's tax liability, and that therefore constitutes return information. The investigator's access to the NBT's return information is authorized under IRC § 6103(h)(1) as it is accessed in connection with the IRS investigator's tax administration duties. The nature of the information gathered from other IRS systems and files retains its identity as IRC § 6103 protected return information in the NBT investigation file and must continue to be protected as such.

Furthermore, it appears that in some circumstances, the result of a NBT investigation may command the protection of IRC § 6103 as there exists the potential for some Code liability to be at issue when investigating a NBT for continued compliance. In some NBT investigations, the result is continued NBT approval, continued NBT approval with some recommended action for minor infractions, or revocation. These results do not appear to involve the NBT's liability or potential liability for anything under the Code and are not protected by IRC § 6103.¹ Some NBT investigations, however, result in the resolution of the NBT's liability or potential liability under the Code and the information concerning that Code liability is, therefore, confidential according to IRC § 6103.

Your office provided us with several sample closing agreements entered into between the IRS and a NBT in connection with NBT activities. These closing agreements resolve potential tax liabilities the NBT may have incurred while conducting its NBT duties in a manner inconsistent with the NBT regulations. For example, the closing agreement may contain a penalty under IRC § 4973 to be paid by the NBT; agreement that the NBT will not claim deductions or otherwise seek to recover for tax purposes any portion of the penalty; agreement that no portion of the penalty shall be considered income or compensation to anyone affected by the NBT's actions and an agreement that the IRS will not assert that the IRAs overseen by the NBT failed to meet IRA requirements under IRC § 408 such that a tax liability may be assessed. Section 304(a) of the "Consolidated Appropriations Act of 2001", Pub. L. No. 106-544, (effective date December 21, 2000), amended IRC § 6103(b)(2) to clarify that closing agreements, similar agreements, and background information concerning such, are confidential return information under IRC § 6103. All information in the NBT investigation file concerning these matters, including the closing agreement and all information gathered or created in connection with drafting the closing agreement is return information protected by IRC § 6103.²

¹ This statement holds true in the case of revocation only to the extent revocation is not the result of determining and/or resolving the NBT's liability or potential liability under the Code.

² We note that the closing agreements provided to us were not the result of random investigations of NBTs, but instead were the result of NBTs bringing a change of status to the IRS' attention. While this (footnote continued)

We are not certain whether closing agreements are always used when a NBT is found to be in violation of the NBT regulatory requirements. Whether a closing agreement is used or not, IRC § 6103 confidentiality will attach to the results, and information on which the results are based, of any NBT investigation that resolve a NBT's liability or potential liability under the Code. Likewise, any information in the NBT investigation file that is return information obtained from an internal source and added to the NBT file continues to be protected from disclosure by IRC § 6103.

B. FOIA and the NBT Investigation

The FOIA provides that all Federal executive agency records in the possession and control of these entities must be released upon request unless the information falls within one of the Act's nine specific exemptions or three special law enforcement exclusions. 5 USC 552(a).

FOIA Exemption 3, 5 USC 552(b)(3), requires agencies to withhold information "specifically exempted from disclosure by statute (other than the FOIA), provided that such statute (A) requires that the matters be withheld from the public in such a manner as to leave no discretion on the issue, or (B) establishes particular criteria for withholding or refers to particular types of matters to be withheld." 5 U.S.C. § 552(b)(3). IRC § 6103 is the type of statute to which subsection 3 of the FOIA applies. Church of Scientology of California v. IRS, 484 U.S. 9, 12 (1987); Chamberlain v. Kurtz, 589 F.2d 827, 843 (5th Cir.), cert. denied, 444 U.S.842 (1979). Thus, any of the information in a NBT investigation identified as confidential under IRC § 6103 would also be exempt from FOIA disclosure under FOIA subsection (b)(3).

FOIA Exemption 4, 5 USC 552(b)(4) , as noted in the 1979 and the 2000 memoranda, protects from disclosure "trade secrets and commercial or financial information obtained from a person and privileged or confidential." This exemption applies to trade secrets such as processes, formulas, manufacturing plans, and chemical compositions. See Yamamoto v. IRS, Civ. No. 83-2160, slip op. at 2 (D.D.C. November 16, 1983) (exemption 4 protects as a trade secret a report on the computation of the "standard mileage rate" prepared by a private company for IRS use). The exemption also applies to commercial or financial information such as corporate sales data, salaries and bonuses of industry personnel, and bids received by corporations in the course of their acquisitions. Commercial and financial information other than trade secrets can be withheld from disclosure *only* if it is privileged or confidential and it must be obtained by the government from a "person." Be aware that simply because the information concerns matters occurring during a commercial operation does not alone make the information commercial information. See, e.g., Chicago Tribune Co. v. FAA, 1998 WL

does not alter the analysis under IRC § 6103, we do not know the instances of closing agreements resulting from random investigations.

242611 (N.D. Ill. May 7, 1998) (information on nature and frequency of in-flight emergencies not commercial information for purposes of exemption 4).

Courts have defined "confidential" information as that which, if disclosed, would be likely to (1) harm the competitive position of the person who supplied it, or (2) impair the government's ability to obtain similar information in the future. National Parks and Conservation Association v. Morton, 498 F.2d 765, 770 (D.C. Cir. 1974). Information obtained from a "person" includes data supplied by corporations and partnerships as well as individual citizens. In Critical Mass Energy Project v. NRC, 975 F.2d 871, 878 (D.C. Cir. 1992) (en banc), cert. denied, 507 U.S. 984 (1993), the D.C. Circuit limited the National Parks submitter's "harm" test to those situations wherein the submitter was required to submit the information to the agency. Where the purported proprietary information is voluntarily submitted, the test is less stringent: whether the submitter ordinarily places the information into the marketplace. See AGS Computers v. IRS, Civ. No. 92-2714 (D.N.J. Sept. 16, 1993) (applying Critical Mass, confidential information voluntarily submitted by a company suspended by the IRS from serving as an electronic filer, as part of its appeal of the suspension, was protected by exemption 4). If the submitter does not ordinarily publicize the information, then it is exempt. In these cases, the submitter need not demonstrate to the agency the competitive harm likely to befall the submitter if the information is disclosed. Thus, some information in a NBT investigation file, such as net worth, liquidity, corporate or other governing instruments and established operating procedures, may be protected from disclosure under FOIA exemption (b)(4) depending on whether this type of information is routinely publicized or kept confidential. The applicability of FOIA exemption (b)(4) will depend on the facts and circumstances of each case.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 622-7950 if you have any further questions.