

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

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to: Mahlon Blagg
Disclosure Technical Advisor
(Office of Disclosure)

from: A. M. Gulas
Senior Counsel, Branch 7
(Procedure & Administration)

subject: Disclosure of Extract Data to State Department of Revenue

This legal advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUE

Whether the Tennessee Department of Revenue may use extract data obtained pursuant to section 6103(d) for the purpose of comparing the number of businesses that have a filing record with the Service with the number of business tax filers in the state for use in administering its business tax.

CONCLUSION

The Tennessee Department of Revenue may use extract data obtained pursuant to section 6103(d) for the purpose of comparing the number of businesses that have a filing record with the Service with the number of business tax filers in the state for use in administering the state's business tax.

FACTS

The State of Tennessee makes it a taxable privilege to engage in business, business activities, vocations or occupations that are enumerated in its Business Tax Act. TENN. CODE ANN. § 67-4-705 (West 2010). Although individual counties and incorporated municipalities may also levy a privilege tax on business, see TENN. CODE ANN. § 67-4-704 (West 2010), such levies are collected and administered by the Tennessee Department of Revenue rather than the individual counties and incorporated

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municipalities. TENN. CODE ANN. § 67-4-703 (West 2010).¹ The amount of tax varies based on how the business is classified, but is generally calculated as a percentage of the business' sales, defined as the transfer of title, possession or both of tangible personal property for consideration. TENN. CODE ANN. § 67-4-702(a)(17)(A)(i); 67-4-709 (West 2010). For two classifications of businesses, the Tennessee code calculates the tax as a percentage of the compensation granted under a contract and the gross income of the business respectively. TENN. CODE ANN. § 67-4-709(4), (5).

The State of Tennessee would like to use extract data it currently receives pursuant to section 6103(d) to compare the number of businesses that have filed a return with the Service to the number of known business filers in Tennessee. Tennessee would use this comparison to help identify non-filing and under-reporting businesses. The Government Liaison office has expressed concern that the business tax set out in the Tennessee Business Tax Act may not be a covered tax under section 6103(d)(1).

LAW AND ANALYSIS

The Service must protect the confidentiality of returns and return information unless disclosure is authorized by Title 26 of the United States Code. I.R.C. § 6103(a). One exception to this rule allows disclosure of returns and return information to a State for purposes of State tax administration. I.R.C. § 6103(d)(1). Disclosure by the Service is limited to returns and return information with respect to certain enumerated chapters and may only be disclosed to the extent necessary for State tax administration. Id.

While section 6103(d)(1) specifically enumerates the tax classes of federal returns and return information to be disclosed, nothing in the statutory language limits the State's use to corresponding tax classes. In other words, the State of Tennessee is not limited to using federal income tax returns solely to match against State income tax returns. The limitation on a State's use is that the information is needed for and used in the administration of State tax law. Nonetheless, the State must explain its need for and its use of federal tax information.

The State of Tennessee intends to compare the number of businesses that filed with the Service to the number of businesses that filed in Tennessee. This aids State tax administration by allowing the State to identify non-filers of the business tax, or those who did not properly file in order to promote business tax compliance. We view this as a valid tax administration purpose and conclude that Tennessee has explained its need to use the information for its matching program to advance State tax administration.²

¹ The statutory language giving the state, rather than counties and incorporated municipalities, the power to administer the business tax was added by the state legislature in 2009 and became effective starting July 1, 2009. See 2009 Tennessee Laws Pub. Ch. 530 (S.B. 2318).

² The Internal Revenue Manual at 11.3.32.4 provides in relevant part:

(1) Disclosure of Federal returns and return information to a State tax agency under IRC § 6103(d)(1) will be restricted to the agency's justified State tax administration need for and use of such information.

Even if this use was not initially contemplated in the agreement with Tennessee, because the use it proposes falls within the “any State tax administration purpose” language of IRM 11.3.32.4(5), Tennessee may match the extract information it already receives to its own business tax records and an addendum can be made to the agreement to reflect the additional use.

We note that under the current Tennessee business scheme, the State of Tennessee cannot disclose federal tax information to a county or incorporated municipality because, for purposes of section 6103(d)(1), return and return information may be disclosed to a municipality only if it meets three criteria. First, the municipality must have a population greater than 250,000 based on the most recent census data available. I.R.C. § 6103(b)(5)(A)(ii)(I). Second, the municipality must impose a tax on income or wages. I.R.C. § 6103(b)(5)(A)(ii)(II). Finally, the municipality must enter into an agreement regarding disclosure with the Service. I.R.C. § 6103(b)(5)(A)(ii)(III). In this case, it is unlikely that any county or incorporated municipality in Tennessee can meet the second criteria. Section 67-2-103 of the Tennessee Code states that the income tax is “for state purposes only, and no county or municipality shall have the power to levy the tax.” TENN. CODE ANN. § 67-2-103 (West 2010) (emphasis added). As the counties and municipalities lack the authority to impose a tax on income or wages, they do not qualify as “states” for purposes of section 6103(d)(1) and neither the Service nor the State of Tennessee may disclose the extract information to these entities.

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) 622-4570 if you have any further questions.

(5) In discussions and documentation of the particular State tax agency's need for and use of specific information, it is understood that the State tax agency may subsequently use the Federal returns and return information for any State tax administration purpose authorized by the basic agreement even though such subsequent uses were not discussed or noted in the Disclosure office's documentation records.