DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

AUG 17 1999

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MEMORANDUM FOR ASSISTANT COMMISSIONER (INTERNATIONAL)
Attn: Ms. DeGrosky OP:IN:I:T:3

FROM: Michael Danilack MD
Associate Chief Counsel (International)

SUBJECT: RRA Section 3417 Interpretations

This responds to your memorandum dated March 22, 1999 requesting our views on the extent to which the third-party notice requirements in I.R.C. § 7602(c) apply to exchanges of information under tax treaties and tax information exchange agreements. You asked for our views to assist your office in preparing answers to questions that will be forwarded to treaty partners and later posted on the section 7602(c) website.

The recommendations contained in this memorandum are made in the absence of regulations under section 7602(c). Since there is an open project to draft regulations under this Code section, we encourage you to identify any administrative difficulties that may arise as a consequence of the advice contained in this memorandum as soon as possible. This will enable our offices to coordinate with the attorneys assigned to draft the regulations to address your concerns. We also recommend that the Office of the Assistant Chief Counsel (General Litigation) review your answers before they are forwarded to treaty partners. If you forward a copy of your answers to this office, we will coordinate General Litigation's review.

I.R.C. § 7602(c)

Section 7602(c) was enacted by section 3417(a) of the Internal Revenue Service Restructuring and Reform Act of 1998, P.L. 105-206 (July 22, 1998), effective for contacts made after 180 days after July 22, 1998. Section 7602(c)(1) imposes the following requirement on IRS officers and employees:

> An officer or employee of the Internal Revenue Service may not contact any person other than the taxpayer with respect to the determination or collection of the tax liability of such taxpayer without providing reasonable notice in

advance to the taxpayer that contacts with persons other than the taxpayer may be made.

Paragraph (2) of subsection (c) requires the IRS to provide periodically, or upon a taxpayer's request, a list of third-party contacts. The requirements in paragraphs (1) and (2) do not apply:

(a) to a contact authorized by the taxpayer;

(b) if the IRS determines for good cause that notice to the taxpayer "would jeopardize collection of any tax or such notice may involve reprisal against any person"; or

(c) with respect to a pending criminal investigation.

See I.R.C. § 7602(c)(3).

Application of I.R.C. § 7602(c) to exchanges of information under tax treaties and tax information exchange agreements

Our comments are provided after a recitation (in bold type) of the questions and interpretations contained in your memorandum.

1. Routine Exchange of Information - **Would a routine exchange of information between two competent authorities, either outbound or inbound, be considered a third-party contact for purposes of section 3417?**

   Routine exchanges of information (automatically exchanged) occur between competent authorities in an electronic format with no personal contact. The information exchanged routinely would include a taxpayer's name, address, and an amount earned, e.g., interest. We have determined, based on the section 3417 procedures, that routine exchanges between competent authorities are not considered third-party contacts, since the actions leading to routine exchanges of information are not connected with an IRS examination or collection activity of the taxpayer(s) about whom the information pertains. The section 3417 procedures issued 12/23/98 support this interpretation.

Comments: We concur with your view that a routine exchange of information, whether outbound or inbound, does not involve a third-party contact for purposes of section 3417. An outbound routine exchange:

(a) is unrelated to the determination or collection of a U.S. tax liability;

(b) is not made by the IRS for the purpose of obtaining information;

(c) is made automatically and requires little or no involvement by an IRS officer or employee;

(d) is not the type of contact that Congress intended to be covered by the third-party notice requirement in section 7602(c). In this regard, section 3417 was added to the Bill in the Finance Committee. The Finance Committee Report includes the following with respect to the provision:

> The Committee believes that taxpayers should be notified before the IRS contacts third parties regarding examination or collection activities with respect to the taxpayer. Such contacts may have a chilling effect on the taxpayer's business and could damage the taxpayer's reputation in the community.

S. Rep. No. 105-174, 105th Cong., 2d Sess. 77 (April 22, 1998). An outbound routine exchange with a foreign country of information that is already in the possession of the IRS cannot have an adverse effect on a taxpayer's business or reputation. Even where the taxpayer may have business transactions with the foreign government, the information exchange provisions in our treaties prohibit the sharing of information received with anyone not involved in the assessment, collection, or administration of the treaty or a covered tax. Thus, the information will not be shared with other offices or agencies within the foreign government that may have business transactions with the taxpayer that are not directly related to the substantive issues covered by the treaty (e.g., the procurement of equipment or services from the taxpayer).

Similarly, the third-party notice requirements in section 7602(c) are not applicable to an inbound routine exchange. Such an exchange:

(a) is not initiated or made by an officer or employee of the IRS;

(b) is not made with respect to a U.S. taxpayer that has been identified by the IRS and for which a determination or collection of a U.S. tax liability is known to be in process.

2. Spontaneous Exchange of Information - **Would a spontaneous exchange of information between two competent authorities, either inbound or outbound, be considered a third-party contact?**

A. Outbound spontaneous exchange of information - This is information sent by the United States (unsolicited) to a treaty or TIEA partner. The information is obtained during an examination of a specified U.S. taxpayer. The information exchanged may include information about a U.S. taxpayer, but the information exchanged with the treaty or TIEA partner is about a foreign person that is not the subject of an examination or collection action by the IRS.

We have determined that this type of exchange of information should not be considered a third-party contact as the information provided to a treaty or TIEA partner is about a taxpayer in their taxing jurisdiction. The section 3417 procedures issued 12/23/98, the table of changes issued 1/15/99 nor version 3/10/99, do not address this type of exchange, but should because this type of exchange is not determinative of a tax liability.

Comments: We concur with your view that an outbound spontaneous exchange of information does not involve a third-party contact for purposes of section 3417. An outbound spontaneous exchange:

(a) is unrelated to the determination or collection of a U.S. tax liability;

(b) is not made for the purpose of obtaining information;

(c) is not the type of contact that Congress was concerned about (i.e., a contact that could have "a chilling effect on the taxpayer's business and could damage the taxpayer's reputation in the community.")

B. Inbound spontaneous exchange of information - This is information received from a treaty or TIEA partner (unsolicited) about a taxpayer (U.S.) and is not the subject of an examination or collection action by the foreign country. The 3417 procedures issued 12/23/98 support the interpretation that this type of exchange of information would not be considered a third-party contact.

However, an outbound spontaneous exchange of information (from the United States to a treaty or TIEA partner) should be no different than unsolicited information received (inbound) from a foreign country. The very nature of this type of activity is to exchange information between competent authorities because either the United States or the foreign country has uncovered a potential tax compliance problem that is not determinative of a tax liability at the time the information is exchanged.

Comments: We concur with your view that an inbound spontaneous exchange of information does not involve a third-party contact for purposes of section 3417. An inbound spontaneous exchange:

(a) is not initiated or made by an officer of employee of the IRS;

(b) is not made with respect to a U.S. taxpayer that has been identified by the IRS and for which a determination or collection of a U.S. tax liability is known to be in process;

(c) is not the type of contact that Congress was concerned about (i.e., a contact that could have "a chilling effect on the taxpayer's business and could damage the taxpayer's reputation in the community.")

3. **Specific Requests to Exchange Information - Would a specific outbound request (request made by the United States to a treaty or TIEA partner) to exchange information be considered a third-party contact for purposes of section 3417?**

This exchange of information activity has been interpreted as a third-party contact if the information requested from the treaty or TIEA partner is more than verification of a taxpayer's address or location of assets. However, some of the information obtained from a treaty partner is not considered determinative of a tax liability, rather the information so requested is more appropriately defined as background information, e.g., worldwide organization chart structures of a U.S. multinational taxpayer that may have affiliates (CFCs) located in the foreign country, financials, location of assets, documentation of business transactions, etc. In our opinion, the outbound specific request to the foreign country is during an open examination before any determination as to the taxpayer's liability has been made. The information exchanged may lead to a determination of a tax liability, but at the time the specific request may be made to the foreign country (treaty or TIEA partner) the examination would be in more of a fact finding stage.

We are of the opinion that a distinction should be made with respect to the outbound specific requests made by the United States to a treaty or TIEA partner, either through the Competent Authority's office or through the Revenue Service Representative's (RSR) office located in a foreign post. These requests are currently considered third-party contacts related to an open examination - 1) request made to the Competent Authority or RSR to secure public information that is foreign sourced

information with no contact with the treaty or TIEA partner, and 2) request made to Competent Authority or RSR where the Competent Authority or RSR must contact the treaty or TIEA partner to obtain the information. We feel that an outbound request made for the purpose of obtaining public information should not be considered a third-party contact.

Comments: While we think there is some doubt that Congress intended contacts with foreign governments to be within the purview of section 7602(c), in the absence of regulations excepting contacts with foreign governments, it is our view that an outbound specific request, relating to an identified taxpayer, is a third-party contact for purposes of section 7602(c).

We disagree with your conclusion that a distinction may be made between a request for "background information" and information that is determinative of a U.S. tax liability. You suggest that a request for background information relating to an identified taxpayer would not be a third-party contact for section 7602(c) purposes. Under bilateral tax treaties, the U.S. competent authority may request information relevant to the administration of the treaty or to the administration of a domestic tax that is covered by the treaty. With respect to tax information exchange agreements, information may be requested to administer and enforce the domestic tax laws of the contracting States concerning taxes covered by the TIEA. When information is requested by the United States for a specific, named taxpayer, the purpose is the determination or collection of a U.S. tax liability in accordance with the treaty or the domestic laws of the United States whether or not the IRS ultimately decides to pursue a particular issue or examination. Thus, we think it would be difficult to defend a position that a specific request for background information in connection with a named taxpayer is not in connection with the determination or collection of a federal tax.

You also distinguish requests made to a Revenue Service Representative to obtain public information that does not require contact with a foreign competent authority from requests that require a contact with the competent authority of a treaty or TIEA country. You conclude that the former is not a third-party contact for purposes of section 7602(c). It is our view that the former is not a treaty request at all and, thus, should not be included in the answer to the question posed above.[1/]

[1/] For your information, the multifunction section 7602(c) working group has concluded that an IRS employee does not make a third-party contact under section 7602(c) where that employee seeks information from a publicly available source, provided that the employee does not identify himself or herself as an IRS employee and the employee cannot be directly or indirectly identified as an IRS employee by the third-

more than 1 month, with an additional 0.5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate.

Section 6651(a)(3) of the Code imposes for a penalty for failure to pay any amount in respect of any tax required by be shown on a return, which is not so shown, within 21 calendar days from the date of notice and demand therefor (10 business days if the amount for which such notice and demand is made equals or exceeds $100,000), unless it is shown that such failure is due to reasonable cause and not due to willful neglect. The amount of the penalty is 0.5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 0.5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate.

Section 3303 of RRA 98 added § 6651(h) to the Code to provide that the penalty for failure to pay taxes under § 6651(a)(2) and (a)(3) is reduced with respect to the tax liability of an individual for any month in which an installment payment agreement under § 6159 is in effect, provided the individual filed the tax return that generated the liability in a timely manner (including extensions), and the individual has not received a notice as provided by § 6331(d). The reduction in the amount of the penalty during the installment agreement period is from 0.5 percent to 0.25 percent per month.

Since there are no regulations for § 6651(h) of the Code and because § 6651(h) does not directly state that the reduction of the failure to pay penalty applies to an individual's business liability, it is necessary to look at the congressional intent behind the enactment of § 6651(h). The direct legislative history for § 6651(h) does not reveal any insight into whether an individual's business liability is included under § 6651(h). However, section 3467(b) of RRA 98 added § 6159(c) to the Code to provide that in the case of an individual's liability for tax under subtitle A, the Service must, at the option of the taxpayer, enter into an agreement to accept the payment of such tax in installments, when certain requirements are met.

We conclude that based on the plain language of the statute, § 6651(h) applies to any tax, including taxes under subtitle C. This argument is supported by the fact that § 6159(c) specifically states that it is limited to an individual's liability under subtitle A. If Congress wanted § 6651(h) to be limited in the same manner as § 6159(c), it would have provided the same language in § 6651(h).

It could be argued that since both § 6651(h) and § 6159(c) of the Code were added by RRA 98 to encourage the use of installment agreements for individuals, by easing the burden on taxpayers who cannot afford to pay their entire tax bill at one time, they should both be limited to taxes under subtitle A. The omission of language referring to subtitle A in § 6651(h) was merely an oversight by Congress.

In addition, employment taxes include trust fund taxes. Thus it is unlikely that Congress intended for employment taxes, which are collected from employee wages and paid on behalf of employees, to be included under § 6651(h).

However, we believe the argument that § 6651(h) of the Code does apply to all of an individual's tax liabilities, including an individual's business liabilities and trust fund liabilities under subtitle C, reaches the better conclusion. The decision of Congress not to provide a limitation to an individual's liability under § 6651(h) is evident by the fact that Congress specifically limited §6159(c) to only an individual's liability under subtitle A, relating to income tax. Thus, taken in context of other provisions enacted by RRA 98, such as § 6159(c), § 6651(h) is not limited to an individual's liability under subtitle A.

If you have any questions or concerns regarding this response, please contact Brad Taylor at (202)622-4940.

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