



OFFICE OF
CHIEF COUNSEL

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

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BCTownsend

MAY 30 2003

MEMORANDUM FOR DIRECTOR, REFUND CRIMES

FROM:  Barry J. Finkelstein
Acting Division Counsel/Associate Chief Counsel (Criminal Tax)

SUBJECT: Request for advice – Privacy Issues Related to On-Line Filing
Enhancements

This responds to your request for advice regarding potential privacy concerns raised by a proposal to capture additional personal information (i.e., on-line filer's email address and bank account number associated with a refund anticipation loan) from on-line filers. Because your request touched upon areas within the jurisdiction of the Assistant Chief Counsel (Administrative Provisions and Judicial Practice) and the Assistant Chief Counsel (Disclosure and Privacy Law), we coordinated review of this matter with those offices. The attached memorandum provides substantive legal analysis and advice regarding the Service's ability to request the additional information from online filers and the Privacy Act implications and concludes: (1) the Service can request the email and bank account numbers from on-line filers but cannot reject noncompliant returns for failing to provide the information; and (2) the Privacy Act permits collection of the information provided there is an appropriate business determination supporting the collection of such information. The memo notes additional policy concerns and recommends consultation with appropriate IRS offices. We defer to the substantive legal advice provided and concur with the recommendation to consult with appropriate offices regarding this proposal.

If you have any questions or require further assistance, please contact Brian Townsend at 622-4470.

Attachment

PMTA: 00614

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:PA:DPL:B01:CT-118275-03
MKFisher

date: May 23, 2003

to: Barry J. Finkelstein
Acting Division Counsel / Associate Chief Counsel
(Criminal Tax)
Attn: Brian Townsend, Special Counsel

from: Charles B. Christopher 
Chief, Branch 1
(Disclosure & Privacy Law)

subject: **Privacy Issues Related to On-Line Filing Enhancements**

This memorandum responds to your request regarding potential privacy concerns and notice requirements raised by a proposal presented by Criminal Investigation (CI) to capture additional information from individuals who file their annual income tax return over the internet ("on-line filers").

ISSUES

1. Whether the Service can require the following information from on-line income tax return filers: (1) the filer's personal e-mail address, and (2) the filer's bank account number for those filers receiving a Refund Anticipation Loan (RAL).
2. Whether the Privacy Act permits the Service to collect the above information.

CONCLUSIONS

1. The Service may request the e-mail address and bank account number from the taxpayer; the Service may not reject returns missing this information.
2. The Privacy Act permits the Service to collect information regarding individuals, so long as that information is relevant and necessary to the performance of the agency's duties. The Service may collect the additional information requested by CI, in compliance with the Privacy Act if the appropriate Service officials approve a business plan justifying the need for this information.

BACKGROUND

A refund to an on-line return often is issued in less than two weeks from the date of filing.¹ Due to the speed at which the Service can electronically deposit a refund into a taxpayer's bank account, it is necessary for CI's fraud detection and investigation process to be as efficient as possible.

One way CI detects potentially fraudulent returns is by noting the destination of a refund payment. CI's Electronic Fraud Detection System (EFDS) examines incoming returns for various indicators of fraud. [REDACTED]

[REDACTED] CI would like to enhance its current fraud detection system to allow for the inclusion of two additional data items for on-line returns: (1) the bank account number of taxpayers who receive a Refund Anticipation Loan (RAL) from their tax preparation service and (2) the personal e-mail address of such taxpayers. This information is currently gathered by the return preparation service which offers the on-line tax preparation software, but is not forwarded to the Service when the on-line return is submitted. CI believes that access to this information would enhance its ability to detect fraudulent on-line returns, and speed the investigative process by removing the need to issue administrative summonses for this information.

A. *RALs and Bank Account Numbers*

When a taxpayer is eligible to receive a refund, he or she will receive a paper check in the mail unless the taxpayer elects to have the refund electronically deposited into the bank account number provided on the return. The EFDS monitors these account numbers to determine whether multiple returns are deposited into the same bank account, a sign of potential fraud. [REDACTED]

Most large tax preparation services offer their clients the option for a loan equal to a portion of their anticipated refund. The RAL is sponsored by the return preparer and arranged through a bank designated by the preparer. When the taxpayer appears in person before a tax preparer, the return preparer examines the taxpayer's identification prior to granting the RAL request and filing the return. When the taxpayer prepares his or her return on-line, however, the preparer is unable to verify the identity of the filer, but may still grant the RAL request. In order to obtain a RAL, a filer will instruct the preparer to issue a paper check for the amount of the loan or, more commonly, have the loan

¹ The Service accepts returns in three electronic formats: (1) telefile, when the return is submitted over the phone; (2) e-file, when the return is prepared by the return preparer and submitted over the internet; and (3) on-line filing, when the return is prepared by the taxpayer using software provided by a return preparation service. An on-line return is submitted over the internet to the return preparation service which operates the software. The return preparation service then forwards the return to the Service. Collectively, these three submission formats are referred to as electronically filed returns (ELFs).

amount electronically transferred into the filer's bank account. As the Service is not permitted to deposit a return into an account other than one belonging to the filer, the designated bank creates individual accounts for each RAL in the name of the filer. The RAL bank account number is listed on the filed return, rather than the taxpayer's bank account number. The Service is unable to determine when one individual is filing multiple returns using the RAL process, as separate RAL bank accounts are created for each return even if all the returns are filed by the same person.

In order to enhance their fraud detection efforts, CI would like to require tax preparation services to provide the personal bank account number for those taxpayers who use the preparer's RAL option. The RAL account number would still be listed as the routing number for the electronically deposited refund, but the Service would add an additional data field to the on-line filing system that would ask for the bank account number into which the loan was electronically deposited.

B. Taxpayer E-mail Addresses

When an on-line return is filed, the Service's computers record the internet service provider (ISP) used by the filer, as well as the date and time when the return was filed. If CI believes that a fraudulent return has been filed on-line, they can issue a preservation request to the ISP, which requires the ISP to maintain a copy of its access logs for 90 days. From this log, CI can determine which ISP customer logged onto certain websites—such as a tax preparation service's website—at the time when the return was filed.²

The current system only notes the name of the ISP used by the on-line filer, not the filer's e-mail address. It is routine for CI to summons the return preparer to obtain the e-mail address provided by the filer. CI can use this e-mail address to (1) potentially identify the individual who filed the return, (2) verify that the correct ISP user's information is identified on the ISP's logs, and (3) catch additional fraudulent returns filed under the same e-mail address.

² An ISP may be indicative of the location—and eventually the identity—of the taxpayer, depending upon which ISP is used. If the filer is using a smaller ISP, such as his or her workplace's internet access, then the Service can use the ISP to narrow down significantly its search for suspects. Larger ISPs, such as AOL, have significantly more users, but may have a valid address for a particular user due to the billing arrangements set up to use that ISP's services. However, an individual using a public computer—such as one in a university or at library—and who uses a free e-mail service, such as hotmail or yahoo—would not be traceable by simply having the name of the ISP. In addition, some ISPs have firewall technology that prevents the Service from detecting the ISP.

LEGAL ANALYSIS

I. The Service may request the e-mail address and bank account number from the taxpayer; the Service may not reject returns missing this information.³

I.R.C. § 6001 requires every person liable for any tax under the Internal Revenue Code to "keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe." Further, the Service may, after serving notice upon a taxpayer or by regulations, require the taxpayer "to make such returns, render such statements, or keep such records, as the Secretary deems sufficient to show whether or not such person is liable for tax under this title." Id.

In the current proposal, CI wants the e-mail address and taxpayer's bank account number to be provided by the return preparation service, which already collects this information from the taxpayer. The return preparation service, however, is not the person liable for tax under title 26. Accordingly, I.R.C. § 6001 does not provide any authority for requiring a return preparation service to submit a taxpayer's e-mail address and bank account routing information. Administrative Provisions & Judicial Practice (APJP) is not aware of any provisions which would bypass I.R.C. § 6001 and permit the Service to collect this information from the return preparer rather than the taxpayer.

Alternatively, CI could modify the Form 1040 to request the taxpayer's e-mail address and bank account routing information. Based on the language of I.R.C. § 6011(a), the Service has broad authority regarding what information can be required on one of its forms. Whether it is appropriate for the Service to request the taxpayer's e-mail and bank account routing information is a policy decision. However, assuming that the taxpayer's failure to include the taxpayer's e-mail address and bank account routing information were the only defects in the taxpayer's tax return, it would not be possible to reject the return on that basis. The U.S. Supreme Court has allowed documents that do not conform with forms prescribed by the Secretary to be treated as valid returns. See Badaracco v. Commissioner, 464 U.S. 386 (1984); Zellerbach Paper Co. v. Helvering, 293 U.S. 172 (1934); Florsheim Bros. Drygoods Co. v. United States, 280 U.S. 453 (1930).

The Tax Court, in Beard v. Commissioner, 82 T.C. 766, 777 (1984), aff'd 793 F.2d 139 (6th Cir. 1986), presented the Supreme Court's requirements in the following four-part test:

First, there must be sufficient data to calculate [the] tax liability; second, the document must purport to be a return; third, there must be an honest and

³ On Part I of the Legal Analysis, this office received assistance from the Office of the Assistant Chief Counsel (Administrative Provisions & Judicial Practice). Questions on this part of the analysis may be directed to APJP attorney Michael Skeen at (202) 622-4910.

reasonable attempt to satisfy the requirements of the tax law; and fourth, the taxpayer must execute the return under penalties of perjury.

Form 1040 currently asks a taxpayer to provide a telephone number and the taxpayer's occupation.⁴ Similarly, the Service could ask taxpayers to voluntarily provide their e-mail address and bank account routing information. However, because there are no repercussions for not providing an e-mail address and bank account routing information, it is very unlikely that fraudulent taxpayers would comply with these requests.

II. *The Privacy Act permits the Service to collect information that is "relevant and necessary" to tax administration.*

The Privacy Act of 1974 (Privacy Act) establishes various restrictions on agency recordkeeping. 5 U.S.C. § 552a(e). One of these restrictions is that an agency "maintain in its records only such information about an individual as is relevant and necessary to accomplish a purpose of the agency required to be accomplished by statute or by Executive order of the President." 5 U.S.C. § 552a(e)(1). The Office of Management and Budget (OMB) interprets this section as requiring the following:

The authority to maintain a system of records⁵ does not give the agency the authority to maintain any information which it deems useful. Agencies shall review the nature of the information which they maintain in their systems of records to assure that it is, in fact, "relevant and necessary." Information may not be maintained merely because it is relevant; it must be both relevant and necessary.

Privacy Act Guidelines, Implementation of Section 552a of Title 5 of the United States, 40 FED REG. 28949, 28960 (July 9, 1975) (footnote and emphasis added).⁶

⁴ The Form 1040 does not inform taxpayers that providing the phone number and occupation is optional.

⁵ A system of records, generally, is a collection of information containing information on individual persons that is searchable by individual names or other unique identifiers, such as a taxpayer identification number. 5 U.S.C. § 552a(a)(5).

⁶ The OMB Privacy Act Guidelines are entitled to the deference usually accorded to interpretations of the agency that has been charged with administration of the statute. See Quinn v. Stone, 978 F.2d 126, 133 (3d Cir. 1992). See also Baker v. Dep't of the Navy, 814 F.2d 1381, 1383 (9th Cir. 1987).

Although CI's EFDS itself is exempt from the "relevant and necessary" requirement,⁷ the system of records that EFDS scans to detect fraud is not. When a new return is accepted by the Service, it is considered to be part of the taxpayer's Individual Master File (IMF), even though the return's information has not yet been input into the Service's databases. Therefore, the relevant system of records notice for on-line filed returns is Treasury/IRS 24.030, 66 Fed. Reg. 63800 (December 10, 2001). This notice does not exempt the collected information from the "relevant and necessary" requirement imposed by 5 U.S.C. § 552a(e)(1).

Although there is a lack of case law interpreting this section, as a general matter, Privacy Act subsection-(e)(1) is not violated so long as the maintenance of the information at issue is relevant and necessary to accomplish a legal purpose of the agency. See e.g., National Fed'n of Fed. Employees v. Greenberg, 789 F. Supp. 430, 433-34 (D.D.C. 1992) (requiring more than a vague justification to demonstrate agency relevance and necessity to the agency's operations), vacated and remanded on other grounds, 983 F.2d 286 (D.C. Cir. 1993); Rueber v. United States, 829 F.2d 133, 139-40 (D.C. Cir. 1987). See also Felsen v. HHS, No. CCB-95-975, slip op. at 59-61 (D. Md. Sept. 30, 1998) (subsection (e)(1) "refers to the types of information maintained and whether they are germane to the agency's statutory mission," and does not incorporate [an] accuracy standard").

Courts evaluating Privacy Act claims involving this issue have been extremely conclusory, with little explanation of what documents are relevant and necessary. See e.g., Rueber, 829 F.2d at 139-40 (permitting an agency to maintain reprimand information about a contractor's employee because an agency should be able to ensure its contractors are operating appropriately); Barlow v. Veteran's Admin., No. 92-16744, 1993 U.S. App. LEXIS 23511 (9th Cir. September 13, 1993) (authorizing the VA's collection of the appellant's medical records in order to evaluate his benefits request).

Although one of the purposes of the Privacy Act is to reduce the amount of personal information collected by federal agencies, the Act recognizes that such information may be needed in order for the agency to perform its duties. See generally Freedom of Information Act Guide and Privacy Act Overview 779-80 (U.S. Dep't of Justice, May 2002). In determining what is relevant and necessary under the Privacy Act, we must determine the agency's primary purpose and authority to operate. Agencies are given the authority to collect and maintain information either by a legal authority (i.e., the

⁷ The Service republishes biennially a listing of all its systems of records in the Federal Register. A system of records, including paper records that correspond to computer records, that is investigatory material compiled for law enforcement purposes may be exempt from 5 U.S.C. § 552(e)(1), providing that the system is published in the Federal Register and the exemption is claimed. 5 U.S.C. § 552a(k)(2). It is the understanding of this office that CI's EFDS is a law enforcement system and that the exemption for this system was claimed in Treasury/IRS 46.050, 66 Fed. Reg. 63801 (December 10, 2001).

Constitution, a statute or executive order) which explicitly requires the maintenance of such records, or, by the legal authority to perform a function that cannot be carried out without the maintenance of such records. See Privacy Act Guidelines, 40 Fed. Reg. at 28960. The Service has been tasked with enforcing the internal revenue laws (i.e., tax administration).⁸ The Service has the authority to solicit and maintain any data relevant and necessary to accomplish that task. I.R.C. §§ 7601 and 7602 contain broad grants of authority to the Commissioner, which require the maintenance of systems of records to perform the Commissioner's duties. Taken together, I.R.C. §§ 7601 and 7602 are interpreted as conferring on the Service an affirmative statutory obligation to inquire about all persons who may be liable for taxes and to enforce and administer the internal revenue laws. United States v. Bisceglia, 420 U.S. 141 (1974). The information that is collected by the Service should not be too remote from the Service's tax administration duties.⁹

Due to the general lack of clear explanation by the courts of the relevant and necessary requirement, we may look to other statutes in which the word "necessary" has been interpreted. In determining when legal expenses were "ordinary and necessary," the United States Supreme Court equated the phrase to those expenses that were "appropriate and helpful." See Commissioner v. Heininger, 320 U.S. 467, 471 (1943) (using the "commonly accepted meaning" of the phrase). The necessity requirement in I.R.C. § 6103(k)(6), which authorizes disclosures of return information in the course of an investigation, was defined using the Supreme Court's definition of "appropriate and helpful"—not "strictly essential." Payne v. United States, 289 F.3d 377, 389 (Garza, J., concurring in part, dissenting in part). Given the above, this office has previously concluded that the information gathered by the Service must be gathered under I.R.C. §§ 7601 and 7602 on a legitimate tax administration purpose that justifies the burden borne by the taxpayers. Therefore, if the Service can articulate a business purpose for the administration of the tax laws which justifies the collection of the information, then the Service will meet the requirements of Privacy Act subsection (e)(1).¹⁰

⁸ Tax administration is defined very broadly in I.R.C. § 6103(b)(4) and "includes assessment, collection, enforcement, litigation, publication and statistical gathering functions under such laws. . . ."

⁹ Cf. United States v. Humble Oil and Refining Company, 518 F.2d 747 (5th Cir. 1975) (refusing to enforce a John Doe summons to gather information for research on a policy issue, which the court determined was not sufficiently related to tax administration). But see United States v. Flagg, 634 F.2d 1087 (8th Cir. 1980) (enforced a summons issued for the primary purpose of conducting compliance research and for the secondary purpose of determining the correctness of the summoned taxpayer's return).

¹⁰ In addition to meeting the "relevant and necessary" requirement, information collected by the Service must also comply with 5 U.S.C. § 552a(e)(5). That provision requires each agency that maintains systems of records to "maintain all records which are used by the agency in making any determination about any individual with such accuracy, relevance, timeliness, and completeness as is reasonably necessary to assure fairness to the individual in the determination." If the Service approves CI's business proposal for the collection of the requested information, subsection (e)(5) would apply to the system of record's operations applicable, and reasonable efforts to ensure the accuracy, completeness, and timeliness of the information should be undertaken.—

[REDACTED]

DP

If the proper authorities in the Service approve CI's business proposal for the collection of the bank account number and the e-mail addresses, then this office has no Privacy Act objections to the data collection.

DP

[REDACTED]. This office has communicated with the Office of the Privacy Advocate, and they share these concerns.¹¹

[REDACTED]

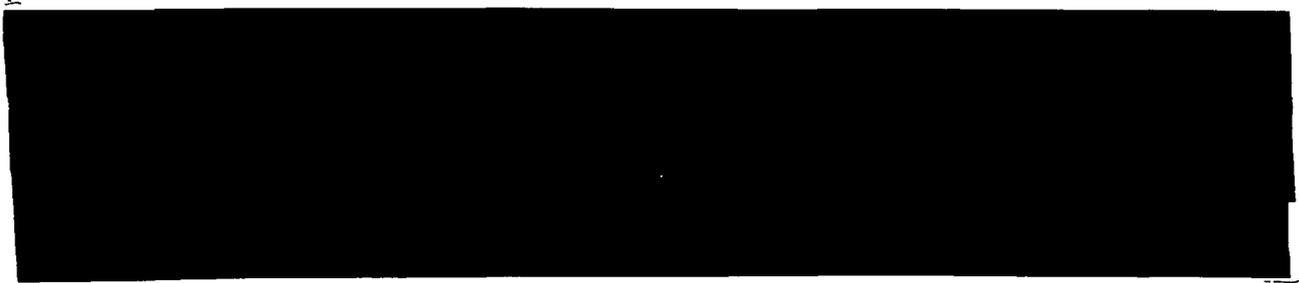
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[REDACTED]

¹¹

[REDACTED]

DP



If you have any questions or require further assistance, please contact Melinda Fisher at (202) 622-4580.

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