

Office of Chief Counsel
Internal Revenue Service
memorandum

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to: Janet Miner, Director
Office of Safeguards (Government Liaison and Disclosure)

from: Charles B. Christopher 
Chief, Branch 7 (Procedure & Administration)

subject: Disclosure of Federal Tax Information in a State Tax Proceeding

This legal advice responds to your request for assistance. This advice may not be used or cited as precedent. California and Ohio both have appeals boards to which a taxpayer can appeal the respective revenue department's tax liability determination. These appeals boards are quasi-judicial administrative bodies separate from an appeal function in the state's revenue agency. Based on state law, any proceeding before the appeals body is open to the public, including all filings. You have asked us to opine on disclosure issues arising from this statutory framework.

FACTS

In California, the Franchise Tax Board (FTB) is charged under state statute with administering the business and individual income tax laws. The FTB receives more than a dozen Governmental Liaison Data Exchange Program (GLDEP) extracts from the Service that are used as the basis for proposed audit assessments arising from the FTB. The audit work papers and proposed assessment documents for all underreported income or nonfiler cases based on the use of federal tax information will include this information as part of the document explaining the proposed assessment. FTB has an appeals function, similar to the IRS Appeals function, that serves as the first level of appeals for the taxpayer. If the taxpayer does not agree with the FTB appeals level determination, the determination may be appealed to the California Board of Equalization (BOE).

Under California law, the BOE is an independent state agency charged with administering certain taxes and it serves as the external appeals body for many different taxes, including taxes involving a proposed assessment based on federal tax information. To appear before the BOE, the taxpayer must submit an appeals package containing information relevant to the appeal. For cases involving a proposed assessment, the FTB must also submit an appeals package, which may include federal tax information that was used as a basis for the proposed assessment. Under California law, the FTB appeals package becomes public information as soon as the

request for appeals is submitted to the BOE, regardless of whether the appeal is actually heard by the BOE, and the information is not safeguarded. The general public, in advance of the hearing, may request a copy of the FTB appeals package.

Similarly, in Ohio the Department of Taxation (DOT) receives GLDEP extracts and is charged with administering the state tax laws. Much of the proposed assessment for underreported income is based upon comparing federal tax information and state tax information. The DOT agent's work papers often contain federal tax information as the basis of the proposed assessment. If the taxpayer does not agree with the DOT determination, the determination may be appealed to the DOT Commissioner. The Commissioner's determination can then be appealed to the Ohio Board of Tax Appeals. The DOT files an answer to the appeal with the Ohio Tax Appeals Board with supporting documents that may contain federal tax information. Once the DOT submits its answer, the information is made available to the public upon request, regardless of whether there is a hearing.

LAW AND ANALYSIS

The IRS 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 administration of State tax laws. I.R.C. § 6103(d)(1). Disclosure by the IRS 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. The state taxing agencies at issue, like those of all other states, have entered into an agreement with the Service for sharing return information pursuant section 6103(d).

In addition to section 6103(d)(1), section 6103(h)(4) authorizes disclosure of federal tax information in a state judicial or administrative proceeding pertaining to tax administration, provided that one of the requirements of subsections 6103(h)(4)(A), (B), (C), or (D) have been met. Thus, section 6103(h)(4)(A) authorizes disclosure of returns and return information in a tax proceeding if the taxpayer is a party to the tax proceeding or if the tax proceeding arose out of or in connection with determining the taxpayer's liability or the assessment and collection of taxes owed by the taxpayer. See, United States v. Mangan, 575 F.2d 32, 40 (2d Cir. 1978). The issue here is whether disclosure of federal tax information by the state taxing agencies to an external appeal agency or board is a permitted disclosure in an "administrative proceeding" within the meaning of section 6103(h)(4).

Under section 6103, a "proceeding" is not limited to a hearing and it includes any procedural steps that are a part of a larger action or procedure, including administrative appeals. See, e.g., First W. Gov't Sec., Inc. v. United States, 578 F. Supp. 212, 217 (D. Colo. 1984) ("There is little doubt that an audit, with its numerous procedural steps and protections and its appeal process, constitutes an administrative proceeding relating to tax administration"). For example, an audit is an administrative tax proceeding under section 6103(h)(4). Abelein v. United States, 323 F.3d 1210, 1214-15 (9th Cir. 2003).

The facts here demonstrate that either state's revenue department is authorized to disclose federal tax information to the appeals body because that body is tasked with an integral part of the many steps encompassed in state tax administration: the administrative appeal through which the taxpayer challenges the state taxing agency's determination of liability for a tax. All the steps of the process, from the audit through the hearings, are part of the state's tax administration proceedings. Moreover, because the taxpayer is a party to the proceeding, disclosure is authorized pursuant section 6103(h)(4)(A).

You have expressed a concern that both states provide for a public hearing, as well as public access to the records, once the taxpayer initiates its appeal. This practice is different from the IRS Appeals procedure, which is not open to the public. We note that the appeal is initiated by the taxpayer, not the state. Every man is presumed to know the law or at least acquaint themselves with the laws likely to affect their normal activities. State v. Pinkney, 36 Ohio St.3d 190, 198 (1988). Therefore, a taxpayer is presumed to know that filing an appeal means its tax information is open to the public.

When otherwise confidential return information becomes a matter of public record in a judicial or administrative proceeding pertaining to tax administration, taxpayers no longer have a legitimate claim of privacy in the information. See Nixon v. Warner Commc'ns, Inc., 435 U.S. 589, 597 (1978) (court proceedings are public record). Accordingly, the information is no longer afforded the protections of section 6103. Lampert v. United States, 854 F.2d 335, 336-37 (9th Cir. 1988) (press releases by the government during different stages of a judicial proceeding are not unauthorized disclosures because they are part of the public record). Here, the states' appeals boards serve as quasi-judicial administrative agencies that, like other judicial proceedings, are public forums. The appeals boards are more analogous to the United States Tax Court than the IRS Appeals Office. For example, in California the BOE serves as an independent neutral appeal board that reviews the taxpayer's first level appeal determination by the FTB. Similar to the requirements to petition the Tax Court, the taxpayer cannot file an appeal with the BOE until all administrative appeal rights with the FTB are exhausted and the taxpayer receives a Notice of Action. Unlike the IRS Appeals process, the BOE is an independent third party and its determinations are final unless the taxpayer pays the tax due and files an action against the FTB in superior court. Similarly, in Ohio the Tax Appeals Board is independent and organized as an administrative court containing rules of procedure with presiding members that are appointed by the governor of Ohio. Like the Tax Court, its decisions are appealed to an appellate level court. Because the states' appeals boards are quasi-judicial public forums, the information is no longer protected under section 6103.¹

¹ We also note that both states have procedures in place for protecting Personally Identifiable Information (PII) that appears on filings open to the public. See Publication 81, Franchise and Personal Income Tax Appeals, (December 2010) available at www.boe.ca.gov; Ohio Board of Tax Appeals Rules of Practice and Procedure, Rule 5717-1-05(D).

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.