

# Disclosure Litigation BULLETIN

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## Testimony Authorizations Inapplicability of 31 C.F.R. § 1.11 to the IRS

31 C.F.R. § 1.11 governs the testimony and/or production of records in a court or other proceeding by employees of certain Treasury Department offices defined in 31 C.F.R. § 1.1(d)(1). 31 C.F.R. § 1.11, however, does not apply to the Internal Revenue Service.

Pursuant to the authority granted under 5 U.S.C. § 301, the Secretary of the Treasury promulgated separate regulations, Treas. Reg. § 301.9000-1, to control the production of records by, and the oral testimony of, Service employees. Similar to 31 C.F.R. § 1.11, Treas. Reg. § 301.9000-1 prohibits employees from producing any records or any copies of such records to any person outside the Treasury Department or to any court, administrative agency or other authority, whether in answer to a subpoena duces tecum, or otherwise, or from testifying in their official capacities, without prior authorization from the Commissioner. Under Delegation Order 156 (Rev. 15) the Commissioner's authority granted in Treas. Reg. § 301.9000-1 is delegated to other Service officials, including, the Assistant Commissioner (Examination), the Assistant Commissioner (International), Regional Commissioners, District Directors, and Service Center Directors. General Counsel Order No. 4 delegates to the Chief Counsel the authority to determine whether to permit testimony or the production of documents in response to a request, subpoena, or other order of the U.S. Tax Court. Unlike the regulation at 31 C.F.R. § 1.11, Treas. Reg. § 301.9000-1 does not require a person seeking records pursuant to a subpoena to furnish an affidavit concerning the subject matter of the testimony sought.

## Case Developments

*Terry Jones et al. v. United States*, Civil No.4:92CV-3029 (D. Neb. Oct. 22, 1998)

In this I.R.C. § 7431 case arising from the unauthorized disclosure of tax information, the district court had ruled, after a trial on the merits of plaintiffs' claims, that a special agent's disclosure to a confidential informant that a search warrant was to be executed on the premises of plaintiffs' company, Jones Oil, was not authorized under I.R.C. § 6103, but nevertheless was the result of a good faith but erroneous interpretation of that Code section, within the meaning of I.R.C. § 7431(b)(1). *Jones v. U.S.*, 898 F.

Supp.1360 (D. Neb.1995). During the trial, the special agent who made the disclosure to the confidential informant testified that he was generally aware of I.R.C. § 6103 and its authority for making investigative disclosures, but did not consult the statute or regulations prior to making the disclosure.

Plaintiffs appealed the court's ruling and, on appeal, the Eighth Circuit in Jones v. U.S., 97 F.3d 1121 (8th Cir. 1997) held that the district court had improperly placed the burden of pleading bad faith on the plaintiffs and therefore remanded the case for further findings. On remand, the district court held that the Government failed to meet its burden of proving that the special agent met the objective standard of good faith in making the disclosure to the confidential informant. Jones v. U.S., 954 F. Supp.191 (D. Neb. 1997). After a trial on damages, the court awarded plaintiffs \$5.5 million in actual damages (including \$4.5 million for the loss of Jones Oil as a going concern and \$325,000 in damages for emotional distress suffered by Terry Jones and his spouse). The district court's award was premised on its finding that the special agent's unauthorized disclosure to the informant was the actual and proximate cause of the damages suffered by plaintiffs, Terry and Patricia Jones and Jones Oil. Specifically, the court found that the Service's informant placed an anonymous tip to a local television news station the morning of the raid, indicating that something was happening at Jones Oil, and that the resulting adverse publicity caused the ultimate demise of Jones Oil. The court found that the special agent's actions were not willful or grossly negligent, and therefore declined to award punitive damages. In determining that plaintiffs were not entitled to attorney fees and costs under I.R.C. § 7430, the court found that the Government's position was "substantially justified" within the meaning of section 7430(c)(4)(B)(i). A notice of appeal has been filed by both sides.

Schipper v. United States, Civil Action No. 94-4049 (E.D. N.Y. Sept. 15, 1998)

Plaintiff filed this action for unauthorized disclosure of return information pursuant to I.R.C. § 7431, alleging that the Service improperly issued four levies in its attempt to collect a tax refund the Service believed it had erroneously paid to her. The court had rejected the Government's argument that the exclusivity clause contained in I.R.C. § 7433 for certain unauthorized collection actions precluded plaintiff from any recovery in this case alleging unauthorized disclosure of return information in connection with collection activity undertaken by the Service. Section 7433 provides for civil damages for certain unauthorized actions taken with respect to "any collection of Federal tax. . ." The court concluded that to the extent that the wrongful disclosures alleged under section 7431 occurred during the course of a failed collection of a tax refund, and not the collection of a tax liability, the exclusivity clause of section 7433 did not foreclose plaintiff's cause of action under section 7431.

The court held, contrary to the holding of the majority of courts to consider the issue, (e.g., Venen v. U.S., 38 F.3rd 100 (3rd Cir. 1994)), that the Service's liability pursuant to section 7431 hinged on the propriety of the underlying collection levy action. The court reasoned that the Service's admission that it acted improperly with respect to its attempts to recover plaintiff's refund, coupled with plaintiff's repeated attempts to notify the Service of its error, clearly established a case of negligence. The court concluded

that since the levies should never have been issued, the disclosures of plaintiff's confidential return information in pursuit of those levies violated section 6103, and therefore, plaintiff sustained her burden of proof under section 7431.

Based on the evidence produced at trial, the court determined that plaintiff was entitled to a total of \$4,800 in actual damages under section 7431(c)(1)(B)(i) for disclosures made in the four levies encompassed within her complaint. All of the damages awarded in this case were awarded for emotional distress, with the exception of damages granted for one of the levies which also included an award for physical ailments suffered by plaintiff. The court further held that plaintiff was not entitled to an award of punitive damages under section 7431(c)(1)(B)(ii) since she did not sustain her burden of proving that the Service employees acted wantonly, recklessly, or with a careless disregard for her rights. Instead, the court specifically noted that the employees who disclosed plaintiff's return information did so in the belief that they were pursuing valid levies.

Salter v. United States, Civil Action No. 96-0820 (W.D. Louisiana, October 16, 1998)

In this case the plaintiff, a former Service employee, sought damages under I.R.C. § 7431 for unauthorized disclosures of his return information. Plaintiff alleged that Service employees openly discussed his confidential tax information in a break room, and that one of the employees further disclosed such information to another Service office where he was scheduled to begin his employment. Plaintiff sought actual damages, contending, among other things, that the unauthorized disclosures and related actions of the Service caused him to be fired and induced heart trauma. In addition, plaintiff sought punitive damages.

Before trial the Government stipulated that there were six unauthorized disclosures of plaintiff's return information by Service employees. After a bench trial, the court awarded statutory damages under section 7431 (c)(1)(A) of \$6,000, finding that the plaintiff did not prove that he sustained actual damages under section 7431 (c)(1)(B)(i) as a result of the disclosures, and that the conduct of the Service employees was not so egregious as to support the award of punitive damages under section 7431(c)(1)(B)(ii). In addition, the court determined that attorney's fees and costs were awardable. Plaintiff has submitted his application for attorney's fees and costs and the Government has filed its opposition thereto. Plaintiff has filed a notice of appeal on the damages issue.

This case makes clear that even disclosures of returns or return information made by Service employees to other employees are actionable under I.R.C. § 7431 unless the disclosure is authorized under I.R.C. § 6103(h)(1). I.R.C. § 6103(h)(1) allows disclosures of returns and return information to other employees "where official duties require ... disclosure for tax administration purposes." Clearly, Service employees may discuss taxpayer cases in the course of official business and disclose tax return information on a "need to know" basis. In Salter, the employees made the unauthorized disclosures in the midst of a group of employees only some of whom had any official need to know. Accordingly, employees should be aware of the circumstances under

which taxpayer cases are discussed, such as when others not having a need to know are nearby or when carrying on discussions in public places, so that I.R.C. § 6103(h)(1) is not violated. Gratuitous discussions that include tax return information in the context of war stories or "water cooler" type gossip fall outside of the reasonable scope of an employee's official tax administration duties, and could result in administrative disciplinary action, possible criminal penalties and/or civil damages against the United States.

Abraham & Rose. P.L.C. v. U.S., No. 96-CV-72337 (E.D. Mich., Nov.16,1998)

At issue in this Freedom of Information Act (FOIA) case was the information contained in the Automated Lien System (ALS) in two Service district offices that had already been made public through the filing of Federal tax liens in local county offices where delinquent taxpayers resided. The information in the ALS that was a matter of public record included taxpayer identity information and the amount of tax liability.

This case was remanded from the Sixth Circuit in Abraham & Rose. P.L.C. v. U.S., 138 F.3d 1075 (6th Cir.1998). The circuit court reversed the earlier district court decision concluding that the information could not be withheld from plaintiff just because it was already public and available through a search of county records; rather, the applicability of specific FOIA exemptions needed to be examined. On remand, the district court upheld the Government's assertion of FOIA exemption (b)(7)(C) which permits the withholding of "records or information compiled for law enforcement purposes, but only to the extent that the production of ... such records or information could reasonably be expected to constitute an unwarranted invasion of personal privacy." The court agreed with the Service that the lien database was information compiled for law enforcement purposes. Citing the U.S. Supreme Court in Dept. of Justice v. Reporters Committee for Freedom of the Press, 489 U.S. 749, (1989), the district court rejected the notion that there was little privacy interest in the information sought because it had already been made public in myriad local county offices. The court concluded that even though the information may be publicly available an individual still has an interest in limiting the disclosure or dissemination of that information.

Having found a clear privacy interest on the part of the individual taxpayers in the information sought, the court next turned to the public interest in disclosure as part of the balancing process of weighing privacy interests against the public interest in disclosure, required by FOIA exemption (b)(7)(C). Relying again on Reporters Committee, the district court said that when considering the disclosure of information under FOIA exemption (b)(7)(C), the nature of the requested information must be examined in relation to the basic purpose of the FOIA to open agency action to the light of public scrutiny. The court did not see how disclosure of the ALS information furthered the public interest, *i.e.*, it would not appear to shed any light on Service collection procedures, and that was particularly true given that the plaintiff sought information that was already in publicly filed liens. Accordingly, because the court determined there was a privacy interest in the ALS information and no countervailing public interest, the information was exempt from disclosure.

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Your suggestions for inclusion of topics in future Bulletins are invited.