

October 23, 2015

CC:PA:LPD:PR (REG-121542-14)
Courier's Desk
Internal Revenue Service
1111 Constitution Ave., NW
Washington, DC 20224

Dear Sir or Madam:

On June 17, 2014, the Internal Revenue Service ("IRS") published temporary regulations (T.D. 9669) and identical cross-referencing proposed regulations (REG-121542-14) under section 7602 of the Internal Revenue Code (the "Code"). The proposed regulations provide that a person authorized to receive returns or return information under section 6103(n) and Treas. Reg. § 301.6103(n)-1(a) may receive and examine books, papers, records, or other data produced in compliance with a summons and, in the presence and under the guidance of an IRS officer or employee, participate fully in the interview of the witness summoned by the IRS to provide testimony under oath. Prop. Treas. Reg. § 301.7602-1(b)(3). The proposed regulations further provide that "fully participating in an interview" includes, but is not limited to, receipt, review, and use of summoned books, papers, records, or other data; being present during summons interviews; questioning the person providing testimony under oath; and asking a summoned person's representatives to clarify an objection or assertion of privilege. *Id.*

We the undersigned organizations appreciate this opportunity to provide comments on the proposed regulations. As discussed in detail below, we are concerned that: (1) the proposed regulations are inconsistent with the plain language of section 7602 because they delegate the authority to perform certain examination functions outside of the IRS and (2) the proposed regulations place confidential taxpayer information unnecessarily at risk of unauthorized disclosure in violation of section 6103. We are also concerned that, as discussed below, the temporary regulations, under the circumstances in which they were issued, run afoul of the Administrative Procedure Act ("APA").

Background

As part of the IRS's examination function, section 7602 authorizes "the Secretary," in relevant part: (1) to examine any books, papers, records, or other data which may be relevant or material to the examination; (2) to summon persons to appear before the Secretary and to produce books, papers, record, or other data, and to give testimony under oath; and (3) to take the testimony of such persons under oath.

Section 7701(a)(11)(B) defines "Secretary" as "the Secretary of the Treasury or his delegate." The term "or his delegate" is further defined to mean "any officer, employee, or agency of the Treasury Department duly authorized by the Secretary of the Treasury directly, or indirectly by

one or more redelegations of authority, to perform the function mentioned or described in the context.” I.R.C. § 7701(a)(12)(A).

Section 6103(n) provides, “Pursuant to regulations prescribed by the Secretary, returns and return information may be disclosed to any person, including any person described in section 7513(a) [dealing with reproduction of returns], to the extent necessary in connection with the processing, storage, transmission, and reproduction of such returns and return information, the programming, maintenance, repair, testing, and procurement of equipment, and the providing of other services, for purposes of tax administration.”

Treas. Reg. § 301.6103(n)-1(a), among other things, makes clear that disclosures pursuant to section 6103(n) are permissible to the extent necessary in connection with a written contract or agreement for the acquisition of equipment, property, or certain services.

Discussion

1. The Proposed Regulations Improperly Delegate the Authority to Perform Certain Examination Functions Outside of the Agency.

As noted above, section 7602 authorizes only an officer, employee, or agency of the Treasury Department duly authorized by the Secretary of the Treasury to perform the examination functions described therein. We believe that allowing persons not employed by the government to perform the functions laid out in section 7602 conflicts with the plain language of section 7602, which purposely limits who can perform those functions. Moreover, there is no precedent or authority for allowing the Secretary to delegate his or her authority with respect to these functions to persons not employed by the government. In the past, authority related to summonses has been delegated to specific IRS employees. *See* I.R.M. 1.2.40.21 (Nov. 8, 2000) (Delegation Order 1-23). Finally, previous attempts to authorize persons not employed by the government to perform certain functions have required Congressional action. *See, e.g.*, section 6306 (added to the Code by the *American Jobs Creation Act of 2004*, authorizing the use of private debt collectors for IRS collection activities).

The preamble to the temporary regulations attempts to allay potential concerns about the delegation of these duties outside of the government by stating that “inherently governmental functions” will continue to be performed by an IRS officer or employee. The preamble provides the following examples of inherently governmental functions: deciding whether to issue a summons; deciding whom to summon, what information must be produced or who will be required to testify; and issuing the summons. By contrast, the preamble provides that contractors’ roles will be limited to functions that are not stated to be inherently governmental, such as taking testimony by asking questions, reviewing books or papers, and analyzing other data. The preamble provides no support for the conclusion that these latter functions are not “inherently governmental.” Indeed when contractors ask questions that taxpayers are compelled to answer under oath, those outside contractors are deciding what information must be produced by the taxpayer, which the preamble concedes is an inherently governmental function.

The preamble to the temporary regulations states, “The conclusion that contractors may receive summoned books and papers, analyze data, and question summoned witnesses is consistent with Treas. Reg. § 301.7602-2(c)(1)(i)(B) and (c)(1)(ii) Example 2. Under those rules, which implement the provision requiring notice to the taxpayer of contacts by IRS officers or employees with third parties, contractors (in this case appraisers) are treated in the same manner as IRS officers or employees when they contact industry experts to discuss a taxpayer's business.”

These statements in the preamble minimize the fact that among the activities contractors are permitted to perform are questioning summoned persons under oath and asking a summoned person's representative to clarify an objection or assertion of privilege. The preamble begs the question why these functions are not “inherently governmental.” Indeed, it is difficult to imagine anything more “inherently governmental” than questioning a witness, under oath and with compulsion, or directing that witness's counsel clarify an objection or assertion of privilege, in an extra-judicial government investigation such as an IRS audit. The fact that an additional “safeguard” is found necessary in these circumstances (i.e., that participating in the interview of a witness can only be done in the presence and under the guidance of an IRS officer or employee) would suggest such functions are inherently governmental.

The preamble further states, “The assistance of persons from outside the IRS or Chief Counsel promotes efficient administration and enforcement of laws administered by the IRS, by providing specialized knowledge, skills, or abilities that the IRS officers or employees assigned to the case may not possess. For example, outside persons often assist the IRS in matters involving transfer pricing.” The IRS's existing guidelines for hiring experts and consultants require, among other things, that the work “cannot effectively and more appropriately be performed by a current employee.” I.R.M. 6.304.1.2 (Nov. 2009).

There is a qualitative difference between hiring an expert, such as an appraiser or economist, who may possess skills not possessed by the IRS so that the expert can *advise* the IRS in executing its summons authority, and hiring a contractor to *perform* examination activities traditionally performed by government employees and, in the case of summons activities, typically by government attorneys. The recent well-publicized hiring of a *law firm* by the IRS to perform such activities highlights this distinction. The proposed regulations' reference to asking a summoned person's representative to clarify an objection or assertion of privilege is telling in this respect. Moreover, if the IRS is permitted to subcontract these functions to persons not employed by the government, there would appear to be nothing preventing them from subcontracting out all other examination functions including drafting Notices of Proposed Adjustments and Notices of Deficiency. In short, we believe that the proposed regulations exceed current statutory authority under section 7602 by impermissibly delegating certain summons-related functions to persons not employed by the government.

2. *The Proposed Regulations Place Confidential Taxpayer Information Unnecessarily at Risk of Unauthorized Disclosure Under Section 6103.*

The proposed regulations presuppose that the functions described are to be carried out by someone already authorized to receive returns or return information that would otherwise be confidential under section 6103. We think it is debatable whether the disclosure of confidential taxpayer information to outside counsel is permissible under section 6103(n). Prior to 1990, confidential taxpayer information could not be disclosed to outside contractors of the IRS unless they were performing purely ministerial tax administration (processing) functions unrelated to the content of the taxpayer information. The phrase “or other services” was added to section 6103(n) in 1990, apparently in response to the IRS’s decision to use outside experts such as economists in litigation. Hiring outside experts was in part justified on the basis of objectivity – because internal experts might be viewed as biased toward the IRS in litigation.¹

As indicated above, there is a significant difference between using an outside expert – particularly where the expertise may not be housed in the IRS – and using an outside contractor to perform functions typically performed by a government agency, such as conducting examinations. Moreover, the use specifically of a *law firm* to perform such functions reflects the appearance, if not the reality, that the IRS has hired an outside *advocate* rather than an objective expert.

Protecting the confidentiality of taxpayer information has long been recognized as fundamental to our system of voluntary compliance.² Placing taxpayer information in the hands of outside contractors increases the risk of misuse and unlawful disclosure because outside contractors are not subject to the same rules of conduct as IRS employees and may have loyalties to other clients besides the IRS and the public fisc. In addition, the IRS has failed to demonstrate that government employees cannot effectively and more appropriately perform the functions contemplated by the temporary regulations.

3. *Procedural Concerns with the Issuance of the Temporary Regulations*

We are similarly concerned about the process by which the temporary regulations were promulgated. In most cases, Treasury and the IRS issue proposed regulations with an effective date tied to the date final regulations are published in the Federal Register. Temporary regulations, with an immediate effective date, are generally reserved for cases where immediate guidance is of urgent necessity – for example, to shut down perceived abuses. In recognition of the importance of allowing the proposed rulemaking process to proceed, section 7805(e) requires that temporary regulations be issued as proposed regulations as well, and such temporary regulations expire in three years.

¹ Cosgrove, *IRS Turning to Outside Experts at Examination Level, Monaco Says* (3 BNA Transfer Pricing Report 903, April 26, 1995); Sapirie, *News Analysis: The Trouble with Outside Contractors at Summons Interviews* (Tax Notes Today, March 9, 2015).

² Office of Tax Policy, Department of the Treasury, *Report to the Congress on Scope and Use of Taxpayer Confidentiality and Disclosure Provisions* (Oct. 2000), at 33.

The temporary regulations were not included on the 2014-2015 Treasury Priority Guidance Plan, and the preamble to the temporary regulations is devoid of any explanation of the urgency requiring the issuance of temporary regulations. Although IRS officials have stated the timing was coincidental, the IRS had, for the first time, hired a law firm to assist with summons activity in a high-profile case just the previous month. Certainly the timing of the issuance of the temporary regulations is cause for concern.

In addition to the lack of notice, we think it is unlikely the temporary regulations would pass muster under the APA.³ Under the APA, agency actions must be set aside if, among other things, they are “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.” 5 U.S.C. § 706(2)(A). The IRS has in the past argued that many of its regulations are not subject to the APA either because (1) the regulations are interpretative and thus exempt from notice and comment under 5 U.S.C. § 553(b) or (2) in the case of temporary regulations, that the specific provisions in section 7805(e) applicable to temporary regulations override the APA. *See, e.g., Intermountain Ins. Serv. of Vail v. Comm’r*, 134 TC 211 (2010) (Halpern and Holmes, JJ., concurring in the result), *rev’d on other grounds*, 650 F3d 691 (DC Cir. 2011), *vacated and remanded*, 112 S.Ct. 2120 (2012). To the contrary, in *Altera Corp. v. Comm’r*, 145 T.C. No. 3 (2015), the Tax Court recently held in a reviewed opinion that regulations issued pursuant to Treasury’s general grant of rulemaking authority under section 7805(a) are legislative rules subject to 5 U.S.C. § 553(b) notice and comment, and that the regulations at issue failed the reasoned decision-making standard applicable under the APA. *See also Mayo Foundation v. U.S.*, 562 U.S. 44 (2011) (Supreme Court declined “to carve out an approach to administrative review good for tax law only” and clarified that Treasury regulations, whether so-called “specific authority” or “general authority” regulations, are entitled to deference in accordance with the principles announced in *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984)).⁴

We have explained above why the temporary regulations conflict with the plain language of section 7602. Accordingly, we think the temporary regulations would be found to be arbitrary and capricious under the APA or otherwise not in accordance with law and similarly would fail both steps of the *Chevron* analysis. In order to avoid protracted litigation that may create extended uncertainty for taxpayers and the IRS, we believe the IRS should reconsider its approach in the temporary and proposed regulations.

³ Although the preamble to the temporary regulations summarily states that the IRS has determined that 5 U.S.C. §§ 553(b) [notice and comment] and (d) [effective date 30 days after publication] do not apply, no reason is given. The APA provides exceptions to notice and comment only for (1) interpretative rules or (2) good cause stated in the rules. 5 U.S.C. § 553(b).

⁴ *Chevron* established a two-step analysis in determining whether an agency interpretation of a statute is valid: (1) did Congress address the precise question at issue in the statute and (2) if not, is the agency interpretation a permissible construction of the statute. Under step two, the agency rule is to be set aside if the rule is “arbitrary or capricious in substance, or manifestly contrary to the statute.” *Mayo* at 52-53.

For the reasons set forth above, we respectfully request that the proposed and temporary regulations be withdrawn.

Thank you for your consideration of our views. For questions regarding these comments, please contact Karen Lapsevic, Director, Government Affairs, Financial Executives International, at 202-626-7809 or klapsevic@financialexecutives.org.

Very truly yours,

ACT | The App Association
Americans for Tax Reform
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National Association of Manufacturers
National Foreign Trade Council
Retail Industry Leaders Association
Small Business & Entrepreneurship Council
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TechNet
U.S. Chamber of Commerce

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