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Privacy Implications of IRS' Proposed Tax Administration System. GGD-78-46; B-137762. March 22, 1978. Released March 27, 1978. 15 pp.

Report to Sen. Abraham Ribicoff, Chairman, Senate Committee on Governmental Affairs; by Robert F. Keller, Acting Comptroller General.

Issue Area: Tax Administration (2700); Automatic Data Processing; Social Impacts of Computer-Based Systems (109).
Contact: General Government Div.
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Organization Concerned: Department of the Treasury: Internal Revenue Service.

Congressional Relevance: House Committee on Ways and Means; Senate Committee on Governmental Affairs. Sen. Abraham Ribicoff.

Authority: Privacy Act of 1974. Tax Reform Act of 1976. Internal Revenue Code, sec. 6103.

Concerns were expressed about the collection of, access to, and use of information in the Internal Revenue Service's (IRS) proposed computerized Tax Administration System. IRS does not plan to collect and retain significant additional information not already in its files. The information would: meet relevancy requirements of the Privacy Act; not include individuals' religious, political, or other affiliations; be collected "to the greatest extent practicable directly from the subject individual;" and not be disclosed without notice to the individual. The system would improve the efficiency of performing necessary cross-references between related accounts. IRS plans to continue current security measures for control of access to data and to add an additional feature, the use of a coded identification badge. There are legislative restrictions on the use of taxpayer information both by IRS and for nontax purposes. (HTW)



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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March 22, 1978

The Honorable Abraham Ribicoff
Chairman, Committee on
Governmental Affairs
United States Senate

Dear Mr. Chairman:

Your letter of August 1, 1977, also signed by Senators Percy and Muskie, requested that we address several aspects of the Internal Revenue Service's (IRS) proposed computerized Tax Administration System (TAS); the collection and maintenance of information in TAS, access to the information, and planned uses of the information. You were concerned that more immediate access to information regarding all facets of an individual's personal life, made possible through TAS, would bring about a greater possibility for widespread abuse.

This report addresses those specific concerns and complements our overall report to the Congress, "An Analysis of IRS' Proposed Tax Administration System: Lessons for the Future", (GGD-78-43, March 1, 1978). The overall report analyzes the capability of IRS' current computer equipment to meet future needs, evaluates the benefits of the proposed system, and summarizes its privacy implications. We noted in that report that existing legislation generally circumscribes the collection and use of tax returns and return information. However, there are some aspects of existing privacy legislation which could be tailored more closely to any proposed large-scale computer system with the technical potential for internal linkage, data consolidation and derivation, and electronic linkage with other computer systems.

We recommended that the Congress pass legislation prohibiting direct electronic linkage between IRS' computer systems and other computer systems. We also recommended that, if the Congress wants to provide further protection, it could amend section 6103 of the Internal Revenue Code to expressly prohibit IRS from linking or consolidating tax returns or tax return information for non-tax administration purposes except as authorized by Federal statute.

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To respond to your concerns, we reviewed as much of the TAS documentation as was available and held numerous discussions with responsible IRS officials. Since TAS was still in the conceptual stage, much specific information with respect to its detailed design was not available. The results of our work are therefore based on the TAS design concept as it existed during much of 1977.

We found that (1) IRS did not plan to collect and retain significant additional information not already in its files, (2) restrictions were planned for accessing the information, and (3) the account linkages planned were consistent with tax administration purposes.

Potential for improper use of data, such as tax returns and return information, exists whenever information is collected. This potential is not dependent on the form in which the information is stored, but on its mere existence. Aside from passing laws, developing and enforcing internal security policies and procedures, and assigning and carrying out oversight responsibilities, there is little more that can be done to safeguard information.

COLLECTION AND MAINTENANCE OF INFORMATION IN TAS

You were concerned that the immediate availability of personal information contained in TAS could have increased the possibility for widespread abuse. Specifically, you were concerned with

- the extent to which personal information that is not currently available would have been accessible via computer terminal,
- the assurances which would exist that any "intelligence" or third-party information entered into TAS would have met the relevancy requirements set by section 3(e)(1) of the Privacy Act of 1974,
- the amount of additional information regarding First Amendment rights of religious freedom and free speech which would have been stored in TAS and whether IRS would have altered its compliance policies with respect to the maintenance of this information as restricted by section 3(e)(7) of the Privacy Act,

--the effect TAS would have had on IRS' practices in complying with the Privacy Act requirement that information be collected "to the greatest extent practicable directly from the subject individual,"

--the amount of information IRS would disclose to the individual under section 3(e)(3)(B) of the Privacy Act which requires that the individual be informed as to "the principal purpose or purposes for which the information * * * (being collected) * * * is intended to be used," and

--the extent that more personal information about each individual would be linked together in one source.

Information Accessible With TAS

We reviewed IRS' October 1977 update of individual taxpayer master file descriptions, discussed file contents with IRS officials, and compared the data proposed for TAS with those transcribed and maintained on the current computer system or in paper files. A complete analysis was not possible because: (1) TAS documentation described the type of general information that would be collected and maintained rather than specific pieces of information, (2) a complete listing of all pieces of information contained in current files was not available, and (3) we could not verify some of the information obtained. Nevertheless, as best we could determine, IRS projected maintaining or transcribing in TAS about 470 pieces of data on individual taxpayers. This is about 170 pieces of information more than that transcribed or maintained on the current computer system. However, only 10 pieces of new data not currently maintained by IRS in either computerized or paper files were projected to be maintained on TAS.

Pieces of information about individual taxpayers planned for computerization under TAS

<u>Type of data</u>	
Currently maintained in computerized files	300
Currently maintained in paper files	160
New data not currently in computerized or paper files	<u>10</u>
Total	<u>470</u>

The types of data currently maintained either wholly or partially in paper files but planned for computerization under TAS included

- information on which IRS office is working on an account and the account status,
- cross-references between accounts,
- prior year audit results,
- sources for levies on collection cases,
- collection history and status records,
- enforcement history records,
- status of investigations,
- information to verify mathematical computations,
- results of the Taxpayer Compliance Measurement Program,
- data from information documents submitted by employers,
- identification of authorized taxpayer representatives,
- training files of simulated taxpayer data, and
- information to protect the system's security.

An example of information currently in paper files but planned for computerization in TAS was the collection history record. IRS believed that, since about 60 percent of delinquent taxpayers are repeaters, the computerization of such data as delinquent taxpayers' phone numbers, attorney identification, and personal and real property descriptions would facilitate the faster collection of tax liabilities and the securing of delinquent returns.

Another example was data such as wages, interest and dividends paid obtained from information documents submitted by employers (Forms W-2, 1099, and 1087). Currently, about 40 percent of these documents are matched against the taxpayers' returns. Under TAS, all would have been matched to assist in detecting failures to file income tax returns and underreporting of income.

The new data that was to be included in TAS, which is neither in current computerized files nor paper files, consisted of information to maintain accounting control over the account, the taxpayers' state of residence and state tax amount to administer piggybacking and an indicator showing whether a taxpayer's representative is properly authorized to represent the taxpayer.

Of the approximately 300 pieces of information currently maintained in computer files, a limited number are available in about six seconds via computer terminal for about 10 percent of the taxpayers. Of the information planned for computerization under TAS, the following would have been obtainable for all taxpayers, as appropriate, in about six seconds via a terminal

- abbreviated data to answer most inquiries about the latest tax returns filed,
- cross-reference data for spouses,
- open balance accounts selected for examination,
- delinquent return accounts,
- accounts with pending actions (claims, correspondence or adjustment, etc.), and
- accounts with high potential for inquiry - such as those with a recently issued math error notice.

IRS estimated that this data would have comprised about 8 percent of the total TAS data. The remaining data would have also been available via computer terminal from between 30 seconds to overnight, depending on the workload.

IRS indicated that external information gathered during intelligence investigations would have been retained on paper files as is currently done and would not have been computerized.

Relevancy Requirements Set by the Privacy Act

Each piece of taxpayer information which IRS collects, maintains, and uses must meet the relevancy requirements of the Privacy Act. Section 3(e)(1) of that Act, which is applicable to all systems of records except as exempted, requires that agencies may keep in their records only "relevant" and "necessary" information. Not only must the information which goes into a file be relevant to an agency need, but that need must also be a legitimate one. Agencies cannot maintain information except pursuant to an agency purpose required to be accomplished by statute or executive order. Further, if an individual is adversely affected by irrelevant or unnecessary information maintained by the agency he can file suit for damages incurred. If the court finds that the agency acted in a manner that was intentional or willful, the individual is entitled to actual damages and attorney fees.

To implement this section of the Act, IRS issued a manual supplement in January 1976 which restricts the maintenance of information about individuals. This document states that IRS will not maintain information unless it is both "relevant" and "necessary." It also provides guidelines for determining relevance and necessity.

Investigative files are generally exempt from this provision of the law. However, IRS' policy on investigatory files such as Intelligence Division tax fraud case files, states:

"Although it may have been necessary to exempt some systems of records from subsection 3(e)(1), the principles of relevance and necessity nevertheless remain applicable to all records to the extent that we are able to apply them Employees are specifically cautioned not to collect, maintain, use or disseminate non-tax related

information concerning taxpayers, except as necessary for the enforcement and administration of the internal revenue laws."

Information on First Amendment
Rights Was Not Projected For
Storage in TAS

Our review of the TAS documentation showed that IRS had no plans to computerize information on a person's religious, political, and other affiliations, such as union membership. Such information may appear on an individual's income tax return or may be requested from the taxpayer for purposes such as substantiating a deduction when the return is audited. Similarly, IRS had no plans to computerize an individual's medical information except the amounts deducted for medical and dental expenses which are already computerized for such purposes as mathematical verification and audit selection.

Current IRS policy restricts the maintenance of records describing how an individual exercises his First Amendment rights to one or more of three conditions

- if a statute specifically authorizes it,
- if an individual expressly authorizes it,
and/or
- if the record is required by the agency for
an authorized law enforcement function.

IRS is permitted to collect information about a person's affiliations if pertinent to and within the scope of an authorized law enforcement activity. Therefore, we reviewed a statistical sample of closed tax fraud cases to determine whether such information was routinely collected and would be available for computerization from these sources, if desired. Of the 40 cases we examined, we found one instance where an individual's affiliation with an organization had been recorded in an Intelligence case file. The individual had volunteered this information to the IRS special agent as a reason for his tax account being investigated. In fact, the case was initiated because the individual had allegedly filed false withholding certificates and failed to file his individual income tax return.

We were told that medical information is routinely requested of the taxpayer upon initiation of a tax fraud case.

If the taxpayer agrees, the information is gathered. Of the 40 closed tax fraud cases sampled, we noted that medical information was maintained in six. The information was used to assist the Government in deciding whether to prosecute the taxpayer. Because it is difficult to gain a conviction on tax fraud cases, IRS does not want to increase this difficulty by attempting to prosecute a taxpayer suffering from chronic or severe illness.

Even though the medical information used in IRS' law enforcement activity is volunteered by the taxpayer, such information should be purged from the file upon case closure. Once purged from IRS' file, the information would no longer be available for possible misuse.

TAS Would Not Affect Collection of Data From Individual Taxpayers

The Privacy Act requires agencies to "collect information to the greatest extent practicable directly from the subject individual when the information may result in adverse determinations about an individual's rights, benefits and privileges under Federal programs." This provision establishes the requirement that decisions under Federal programs affecting an individual should be made on the basis of information supplied by that individual, but recognizes the practical limitations of this by qualifying the requirement with the words "to the greatest extent practicable."

The Office of Management and Budget, in its Privacy Act Implementation Guidelines, stated that, before contacting a third-party source, an agency should consider the nature of the program, cost, risk of inaccuracy resulting from third-party sources, and the need for use of a third party to verify the information. Such a determination may require the balancing of interests, and in the final analysis, agency judgment.

In compliance with the Act, current IRS policy states that the Service will "collect information to the greatest extent practicable directly from the subject individual," i.e., from returns and documents filed with the Service. Further, in analyzing each situation in which personal information is collected from a third-party source, each functional activity has been instructed to consider the factors outlined by the Office of Management and Budget. According to IRS officials, this policy would have remained the same with TAS.

Disclosure to an Individual
of Intended Information
Uses Not Affected by TAS

When an agency requests information it is required by the Privacy Act to inform the individual to whom it makes the request of

"(A) the authority (whether granted by statute, or by executive order of the President) which authorizes the solicitation of the information and whether disclosure of such information is mandatory or voluntary;

"(B) the principal purpose or purposes for which the information is intended to be used; and

"(C) the routine uses which may be made of the information. . . "

To comply with the Privacy Act, IRS issued a manual supplement in October 1975 which states that

"the Service will include in the Form 1040/1040A Tax Package a universal notice which will apply to the U.S. Individual Income Tax Returns, to declarations of estimated tax, to U.S. Quarterly Gift Tax Returns, and to any other tax return required to be filed by an individual, and to schedules, statements, or other documents related to the returns, and any subsequent inquiries. . ."

This notice states that the principal purpose for soliciting tax return information is to administer the Internal Revenue laws of the United States. Further, the notice states that the routine uses which may be made of the tax return information include disclosure

". . .to the Department of Justice if they need it for a lawsuitto other Federal agencies as provided by lawto States, the District of Columbia, and U.S. commonwealths or possessions to carry out their tax lawsAnd . . . to foreign governments because of tax treaties they have with the U.S."

IRS policy also requires that the notice be sent or given to all individual taxpayers whose returns are examined after September 26, 1975, and to all individual

taxpayers who are otherwise requested to furnish information concerning themselves after that date. IRS officials maintain that this notice would not have changed with TAS implementation.

Cross-References Between Related
Accounts Were the Only Planned TAS
Linkages

With TAS, IRS planned to cross-reference (link) related accounts for use in taxpayer audits, tax fraud investigations and collection cases. Our review of the TAS documentation showed that some of the cross-references considered by IRS included

- taxpayer's individual return with the spouse's return,
- taxpayer's individual return with the ex-spouse's return,
- partner's individual return with the other partners' returns and the partnership return,
- principal officer's individual return with the corporate return,
- beneficiary's individual return with the estate return,
- taxpayer's individual return with the tax preparer,
- taxpayer's sole proprietorship return with the related employment and excise returns,
- principal shareholder's individual return with the controlled corporation's return, and
- taxpayer's individual return with the return of a trust or joint return.

According to IRS, these linkages could have been used to offset credits in one account against tax due in another, provide Audit and Intelligence personnel with a complete examination package showing the taxpayer's relationships to other taxpayers and sources of income, provide an additional source for detecting nonfiling of required returns, identify multiple claiming of dependents, and provide another source for identification and correction of multiple, invalid, or inactive accounts on file.

Our review of the planned Audit uses to be made of these account linkages (discussed in chapter 3 of our March 1, 1978, report) indicated that, depending on access and retrieval time, they offered a potential for improving the efficiency with which IRS carries out its tax administration responsibilities. For example, alimony and dependents are common issues examined when auditing the returns of divorced taxpayers. We concluded that access to information on the former spouse's return could avoid some contacts with the former spouse and, in some instances, speed up the audit process. The linkage between the returns of sole proprietors and their related business returns could assist in determining whether all taxes have been paid. Linkage between taxpayers' returns and tax return preparers could assist IRS in administering its return preparer program, which is directed against unscrupulous tax return preparers.

In the Intelligence area, linkages might have had some marginal value in the course of an investigation. For example, in cases where an allegation has been made that a taxpayer has underreported his income, linkages might identify related accounts which, in turn, might affect the course of the investigation.

ACCESS TO TAX INFORMATION IN TAS

In this area, you were concerned whether information entered into TAS would have been available without restriction to IRS intelligence investigators, what procedures had been proposed to govern the entry and retrieval of intelligence information, and whether access to investigative information would have been appreciably faster with TAS.

Access and Retrieval of Information in TAS Would Have Been Restricted and Governed by Procedures

IRS' principal objective for TAS was to provide more responsive service to taxpayers and IRS' functional activities by accelerating return processing and providing increased information for responding to taxpayer inquiries and meeting operational needs. An essential element of TAS was quicker access to more current information by employees of more IRS offices. However, the proposed security features for the system, similar to those in the current Integrated Data Retrieval System (IDRS),

were designed to control this access and to provide safeguards for protecting taxpayer information confidentiality.

Access to data in the current system is controlled through a security program with the following automated features:

1. Employee Password - a unique secret password assigned by the Security Administrator and delivered to authorized employees in a sealed envelope. The employee memorizes his password and destroys the written record of its assignment. This password is used to activate the terminal.
2. Terminal Profile - an internal file which defines the functions and restricts the use of a terminal.
3. Employee Profile - an internal file which contains the functions each authorized employee can perform. It also identifies the specific files, accounts, and account sections and access codes to which the employees are authorized to perform their official duties.
4. Access Codes - used to activate computer routines for real-time input requests. They are used in conjunction with the terminal and employee profiles described above and define what inputs and inquiries can be made.
5. Computer Monitored Access - automatic monitoring by the computer of unsuccessful attempts to access the system. After three such attempts, the terminal locks, requiring supervisory intervention.

Administrative safeguards are also used. These include; prospective employee background checks, programs to develop employee awareness of security requirements, clearances for separating employees, a Security Administrator responsible for directing and coordinating security matters in each service center, and supervisory review controls.

According to IRS officials, the above security features restricting access to taxpayer information and protecting taxpayer confidentiality were planned to continue with TAS. In addition, IRS planned to use an identification badge

coded with access identifiers. The badge was to be inserted into an electronic terminal reader as one step in activating the access terminal and identifying the terminal user.

In our January 17, 1977, report ("Safeguarding Taxpayer Information--An Evaluation of the Proposed Computerized Tax Administration System," LCD-76-115), we found that the TAS concept, through proper design and implementation, would be able to provide a high degree of protection for taxpayer information. We found, however, a number of weaknesses which required correction within the framework of existing security procedures, methods, and controls.

A second report ("IRS' Security Program Requires Improvements to Protect Confidentiality of Income Tax Information," GGD-77-44, July 11, 1977), discussed in greater detail the weaknesses in the existing system. This evaluation indicated that IRS' security program did not assure confidentiality in the existing system because security safeguards could easily be penetrated--especially by IRS employees and others having access to the facilities. Although the security program was sound in concept, IRS did not strictly enforce prescribed security measures.

In both reports we made a number of recommendations designed to correct weaknesses in the areas of computer operations, data retrieval, employee access to printed data, employee background investigations and physical security. The Commissioner of Internal Revenue, in commenting on both reports, promised corrective action. In commenting on our second report the Commissioner replied that, although IRS had not been as aggressive in the past as it might have been in correcting situations that potentially weakened its overall security posture, he was committing IRS to a vigorous course of improvement. If IRS had implemented and enforced its planned TAS security controls, tax return information would have been adequately protected.

USES OF INFORMATION IN TAS

Once personal information has been obtained by IRS, the important issue becomes one of confidentiality--who is allowed to use the information and for what purposes? In this regard, your concern was whether access to the additional TAS information would have made it available for more and varied internal uses considered "compatible with the purpose for which [the information] was collected." You also questioned whether IRS' internal policies would allow information to be used for nontax investigations and whether assurances exist that government officials outside IRS would not abuse information obtained from IRS.

Internal Uses of Information
Are Restricted

The uses IRS can make of the information which it collects are governed by statute. One of the primary objectives of the Privacy Act of 1974 is to restrict the use of information to the purposes for which it was collected. Specifically, the Act requires an agency to maintain and use only that information which is considered to be "compatible with the purpose for which it was collected." This requirement is true whether the information is maintained in paper files, magnetic tapes, computer files or in any other form.

Use of Tax Information for Nontax
Investigations and by Government
Officials Regulated by Law

Both the Privacy Act of 1974 and section 6103 of the Internal Revenue Code as amended by the Tax Reform Act of 1976 define conditions of disclosure and access entitlements to taxpayer information. The Privacy Act limits disclosure of personal information to authorized persons and agencies.

Section 6103 of the Internal Revenue Code, as amended, is more specific and stringent about disclosure of records by IRS than either the Privacy Act or the former confidentiality provisions of the Internal Revenue Code. Under it, IRS has no discretion to make disclosures of individually identifiable tax information under conditions not specifically authorized by Federal statute.

Section 1202(d) of the Tax Reform Act of 1976 amends section 7213 of the Internal Revenue Code to further prohibit unauthorized disclosure and provides that more severe criminal penalties be imposed on persons with legitimate access who subsequently disclose the information to an unauthorized recipient. The penalties provide that:

"Any violation . . . shall be a felony punishable upon conviction by a fine in any amount not exceeding \$5,000, or imprisonment of not more than 5 years, or both, together with the costs of prosecution, and if such offense is committed by any officer or employee of the United States, he shall, in addition to any other punishment, be dismissed from office or discharged from employment upon conviction for such offense."

The same penalties, together with the costs of prosecution, apply to persons receiving returns and return information who willfully print or publish it in any manner not provided by law.


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Although we did not obtain IRS' formal comments on this report, based on discussions with IRS officials, our review of official IRS statements and testimony, and the Commissioner's responses to our previous reports concerning the proposed Tax Administration System, we believe we have fairly taken into account IRS' views on the privacy issues.

Although the Administration is no longer proceeding with TAS, the information provided in this report and our March 1, 1978, report on TAS should provide the Congress a good perspective from which to assess future IRS requests for improvements to its computer system.

We are providing a copy of this report to Senators Percy and Muskie. As arranged with your committee, unless you publicly announce its contents earlier, we plan no further distribution of this report until five days from the date of the report. At that time, we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,


ACTING Comptroller General
of the United States