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United States General Accounting Office

**Report to the Commissioner of Internal
Revenue
Department of the Treasury**

November 1986

**TAX
ADMINISTRATION**

**How IRS Ensures That
Others Adequately
Safeguard Tax Data**



037371



General Government Division

B-223802

November 14, 1986

The Honorable Lawrence B. Gibbs
Commissioner of Internal Revenue
Department of the Treasury

Dear Mr. Gibbs:

We analyzed the Internal Revenue Service's (IRS) policies and procedures on safeguarding federal tax information IRS discloses to federal, state¹, and local government agencies. We have concluded that IRS' guidance and its procedures to assess agency implementation of that guidance provide a reasonable framework for ensuring that agencies receiving tax data maintain adequate safeguards.

Background

Section 6103 of the Internal Revenue Code prescribes specific circumstances under which tax information may be disclosed. For example, disclosures to various federal, state, and local agencies are authorized for administering the tax laws, preparing statistical studies, locating parents owing child support, and verifying eligibility for benefits under certain entitlement programs. Federal tax information so disclosed may be used solely for the purposes described in section 6103.

Each year IRS makes numerous disclosures under section 6103. In calendar year 1985, for example, IRS reported about 263 million disclosures in its annual disclosure report to the Congress. Included among those disclosures were about 154 million to other federal agencies, such as the Bureau of the Census for statistical studies, 106 million to states for tax administration, and 1.4 million to local child support enforcement agencies.

In the past few years, the Administration and the Congress have taken steps to expand the use of tax data for nontax purposes. For example, the Internal Revenue Code, as amended by the Debt Collection Act of 1982, allows IRS to disclose to the heads of federal agencies that administer loan programs (1) information on whether an applicant for a federal loan has a tax delinquent account and (2) the mailing address of a taxpayer who owes money to the government but cannot be located. Also, the Code, as amended by the Deficit Reduction Act of 1984, authorizes the use of tax information by federal, state, and local agencies

¹As used in this report, the word "state" includes the District of Columbia.

administering certain benefit programs—such as Medicaid and unemployment compensation. The use of tax data is intended to help those agencies more accurately determine an individual's eligibility for benefits and the proper amount of the benefit entitlement. The Administration has indicated that it intends to propose legislation that would authorize the use of tax information for other benefit programs, such as veterans benefits.

The Tax Reform Act of 1976 prescribed specific rules for safeguarding federal tax information and made IRS responsible for ensuring that agencies receiving tax data maintain adequate safeguards. Generally, IRS requires that recipients of tax information (1) maintain records to account for the receipt and control of tax data, (2) provide for safe storage of the information, (3) restrict access to those employees whose duties or responsibilities require access, and (4) ensure the return or proper disposal of the information when it is no longer needed for official use. IRS may refuse to disclose tax information to any agency that has not implemented or maintained proper safeguard procedures. Also, the Internal Revenue Code prescribes civil damages and criminal penalties for unauthorized disclosures.

Objective, Scope, and Methodology

Our objective was to assess IRS' policies and procedures on safeguarding federal tax information IRS discloses to federal, state, and local government agencies.

We performed our work at IRS' National Office and its Philadelphia and Richmond district offices; the Pension Benefit Guaranty Corporation; the Tax and Criminal Divisions within the Department of Justice; the Office of Child Support Enforcement in the Department of Health and Human Services; tax agencies in Pennsylvania, Virginia, and the District of Columbia; and the child support enforcement agencies for Pennsylvania and the District of Columbia. The agency locations were chosen judgmentally to provide a mixture of agencies which receive varying types and amounts of tax data from IRS. Our primary considerations in selecting states to visit were short travel time and low cost. We did our work from March 1985 to December 1985 in accordance with generally accepted government audit standards.

In doing our work we (1) analyzed IRS policies, procedures, and guidance on safeguarding tax information; (2) interviewed IRS officials and reviewed IRS documentation to determine what IRS does to monitor the safeguard practices of other agencies; (3) interviewed federal, state tax,

and child support enforcement agency officials on their use and control of federal tax data; (4) analyzed the agencies' policies and procedures for handling federal tax information and observed and documented their physical security and administrative controls; (5) tracked a small, nonstatistical sample of IRS disclosures through the state tax agencies' systems; (6) reviewed information made available by IRS on safeguard reviews conducted before October 1984 revisions to its Safeguard Review Program; and (7) reviewed quarterly safeguard review activity reports submitted by IRS' regional offices in 1985.

To obtain a first-hand perspective of the reasonableness and practicality of IRS' guidance for safeguarding tax information, we reviewed the application of that guidance by the federal and state agencies cited above. Our work did not include an assessment of the adequacy of IRS' safeguard reviews. We did not, for example, accompany IRS personnel during their safeguard reviews or evaluate their workpapers to see if the reviews were conducted in accordance with IRS' prescribed procedures.

Because we did not assess the adequacy of IRS' safeguard reviews and because the agencies we visited were selected on a limited, nonscientific basis, our conclusion about the adequacy of IRS' guidance and procedures should not be construed to mean that all federal tax information in the hands of federal, state, and local agencies is being adequately protected. Our conclusion means only that IRS' guidance and procedures provide a reasonable basis for assuring adequate protection.

IRS' Security Guidelines and Safeguard Review Program

Any agency authorized to receive tax information from IRS must, as a condition for receiving it, meet the safeguard requirements of Section 6103(p)(4) of the Internal Revenue Code. Agencies are required to

- establish and maintain a permanent system of standardized records to account for federal tax data disclosed to them or by them;
- establish and maintain a secure area or place in which returns or return information will be stored;
- restrict access to the returns or return information to those persons whose duties or responsibilities require access;
- provide such other safeguards that may be required by IRS to protect the confidentiality of information; and
- return the information to IRS when it is no longer needed or make the information undisclosable, such as by shredding or burning.

IRS has issued guidelines to help agencies meet these safeguard requirements and has established a Safeguard Review Program to monitor agencies' safeguards.

Security Guidelines

IRS' security guidance, contained in Publication 1075 (Tax Information Security Guidelines), sets out the security measures IRS believes are necessary if recipients of federal tax information are to protect adequately that information from unauthorized disclosures. The guidance discusses such things as employee awareness activities, recordkeeping requirements, controls over the processing of tax information on magnetic media, security over storage areas, controls over access to tax information, controls over the transmission and disposal of tax information, IRS' minimum protection standards for different categories of data, use of locking devices and automatic detection equipment, procedures to be followed in controlling and safeguarding keys and combinations, and minimum requirements for locking systems.

Safeguard Review Program

Besides providing agencies with guidance on how to safeguard tax information, IRS reviews the safeguards established by those agencies. Overall responsibility for the Safeguard Review Program, during the time we performed our work, rested with the Operations Branch of IRS' Disclosure and Security Division (DSD). As part of a restructuring of administrative support activities at IRS' National Office, DSD will be abolished and its functions transferred to other components within the National Office.

Review Activity Between 1982 and 1984

Before 1982, IRS required that its disclosure personnel conduct safeguard reviews at federal and state tax agencies annually and at child support enforcement agencies once every 4 years. In late 1981, IRS changed that requirement to allow agencies to self-certify that their safeguards met IRS' security requirements. Under that change, IRS would conduct a review only when an agency reported uncorrected deficiencies or when IRS, for whatever reason, considered a review necessary. According to DSD staff, this change was necessitated by reductions in the number of personnel available to perform safeguard reviews.

IRS' National Office did not maintain records on the safeguard activity of its regional and district offices while its self-certification program was in effect. At our request, DSD staff obtained information from IRS field offices on the number of safeguard reviews conducted in calendar years

1982, 1983, and 1984. According to that information, reviews were conducted at 35 state tax agencies, 4 child support enforcement offices, 2 other state level offices, and 2 U.S. territories. A DSD official noted that the scope of these reviews probably varied from full on-site evaluations to examinations of only one aspect of an agency's safeguard practices. During this same period, according to IRS' quarterly reports to the Congress, National Office staff conducted a limited review of the Bureau of the Census' County Business Patterns publication to determine if it met IRS' confidentiality standards for statistical reports and visited the Office of Child Support Enforcement in the Department of Health and Human Services to inspect that agency's computer processing procedures to determine if they provided for the adequate safeguarding of tax information.

Changes to Safeguard Review Program Since 1984

Several legislative initiatives, such as the Deficit Reduction Act of 1984, have authorized new uses of federal tax data and increased the number of agencies permitted access to tax information. Because of these changes and proposals that would further expand the number of parties authorized access to tax data, IRS, in October 1984, revised its Safeguard Review Program to provide for increased monitoring of agencies' safeguards over tax data. IRS re-established a requirement for periodic on-site reviews of agencies' safeguards. Reviews are to be conducted at least once every 5 years, with more frequent reviews if warranted.

As part of its revision of the Safeguard Review Program, IRS provided its personnel with more detailed guidance for determining whether a safeguard review is needed and for conducting such a review. The guidance provides, for example, that decisions on whether to conduct a safeguard review at a particular agency should be based on such factors as (1) the length of time since the last review; (2) past history of problems; (3) information reported by outside sources, such as us; (4) an analysis of congressional records and news items relating to the agency; and (5) significant changes in the nature or volume of disclosures to the agency. IRS' guidance includes information on various review techniques, including test checks and after-hours inspections, and a review guide listing topics and questions that the reviewer should consider during his or her visit to the agency.

Other changes to the Safeguard Review Program included

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- a requirement that all safeguard reviews include an assessment of the agency's use of tax data to determine if it is only receiving data it needs and can use,
 - the development of formal procedures for denying tax information in situations where serious safeguard deficiencies exist, and
 - a requirement for quarterly reporting by regional offices on their safeguard review activity.

As an indication of IRS' increased emphasis on monitoring agencies' safeguards, IRS' records indicate that its field offices completed safeguard reviews of 37 state and local agencies in calendar year 1985—almost as many agencies as had been reviewed in the prior 3 years combined. According to quarterly safeguard activity reports submitted by IRS' regional offices, most of the reviewed agencies were in overall compliance with IRS' tax security requirements. A listing of the reviews conducted by IRS field offices in 1985 is included in appendix I.

Since the review program was revised in 1984, National Office staff have initiated two safeguard reviews involving other federal agencies. One review, which has been completed, involved an assessment of the Department of Education's use of contractors to process educational institutions' requests for addresses of people who defaulted on loans. The second review, which is ongoing, involves the Social Security Administration's procedures in response to taxpayers' requests that tax information be forwarded to third parties designated by the taxpayer.

IRS has received requests from several state and local government agencies for tax information under provisions of the Deficit Reduction Act of 1984, which permit access for purposes of administering certain needs-based programs. Some of those agencies had not previously had access to tax information. IRS anticipates that several more state and local agencies that have not had access to tax data may eventually request such data. Because IRS was concerned, according to DSD officials, that limited resources would preclude it from adequately monitoring the safeguards of all those state and local agencies, it implemented procedures whereby the agencies' safeguards are to be reviewed periodically by the federal agencies having oversight over the various benefit programs—the Departments of Agriculture, Labor, and Health and Human Services. Those reviews are to be conducted on a schedule established by the responsible federal agency and approved by IRS. In addition, IRS may conduct its own safeguard reviews, at any time, if it has reason to believe that tax information is not being properly safeguarded or to insure that the federal oversight agencies are properly monitoring the

safeguards employed by requesting agencies. The requirement for IRS on-site reviews at least once every 5 years remains in place for other agencies.

Change in Organizational Responsibility for Safeguard Review Program

In April 1986, IRS adopted a series of recommendations by an internal study group to restructure its headquarters administrative support activities. As recommended by the study group, DSD will be abolished and the disclosure group, which is responsible for the Safeguard Review Program, will be transferred to the Assistant Commissioner for Examination. As noted in your September 29, 1986, letter commenting on a draft of this report (see app. II), that transfer was scheduled to take place sometime in October 1986.

Given the growing number of agencies authorized access to tax data and the need to protect that data from unauthorized disclosure, we were concerned that the reorganization might lead to a de-emphasis of the Safeguard Review Program. But, officials from IRS' Disclosure and Security Division and from the Office of the Associate Commissioner for Operations assured us that transfer of the safeguard review function will not result in less emphasis on the program. Rather, it was their opinion that the transfer to Operations, which includes IRS' Examination, Collection, and Criminal Investigation functions, would enhance the disclosure group's ability to compete for additional resources and would provide a broader base from which to draw staff.

Safeguard Practices of Selected Federal and State Agencies

To obtain a first-hand perspective on the application of IRS' guidance for safeguarding tax information, we reviewed the safeguards established by three federal agencies, three state tax agencies, and two state level child support enforcement agencies. Our reviews indicated that IRS' guidelines were reasonable and practical.

Table I summarizes the major types of safeguard procedures employed by the agencies pursuant to IRS' security guidelines. Because IRS' guidelines provide alternatives to achieve a specific security objective (different techniques, for example, that an agency can use to dispose of tax data), not every procedure was used by every agency. In some cases, an agency might use a combination of methods to accomplish a security objective. For example, in providing physical security, an agency may employ guards, install an intrusion alarm system, and require identification for entry to a facility.

Table I: Type of Safeguards Used by Agencies

Type of safeguard	Number of agencies using safeguard
Physical Security:	
Security Guards	8
Receptionist at Entrance	6
Alarm System	4
Office Door Locks	6
Entry by Badge or Other ID	5
Closed Circuit TV Monitoring	2
Storage and Access to Data:	
Locking File Cabinets	8
Safes	2
Secured Rooms	5
Controls Over Keys and Lock Combinations	8
Systems of Records for Tax Data	8
Employee Security Awareness:	
Annual Training Program	2
New Employee Orientation	8
Periodic Memos/Reminders	3
Use of Nondisclosure Oaths/Statements	4
Copies of Internal Procedures Given to All Employees	4
Disposition of Data:	
Burning	2
Shredding	6
Return to IRS	3
Tape Erasure	3

In reviewing the agencies' safeguards, we noted isolated instances in which established procedures were not always followed. For example, one agency uses a sign-out/sign-in card system for controlling access to tax data. When a file containing tax information is charged out or returned, an employee of the Control Branch (where the data are stored) is supposed to witness each transaction and sign and date the file card. We found three file cards, however, that contained no signature to indicate that a Control Branch employee had witnessed the transaction. After being notified of our finding, the agency reminded its Control Branch employees of the need to attest, in writing, to each file transaction they witness.

A more serious problem existed in another agency. Contrary to IRS requirements and the agency's own procedures, data in two of the agency's units were stored on open shelving and in nonlockable filing cabinets, which increased the opportunity for unauthorized access to the data. Agency officials agreed that these storage methods were not appropriate and subsequently informed us that secure storage containers have been provided for the federal tax data in the two units.

Conclusion

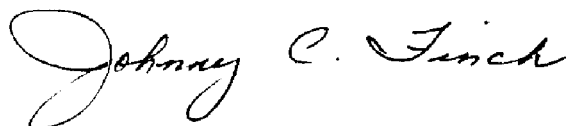
The Tax Reform Act of 1976 required that those receiving tax information from IRS establish appropriate safeguards to protect the confidentiality of the information. The act also authorized IRS to approve and periodically review those safeguards. IRS has developed security guidelines and has implemented a Safeguard Review Program to monitor and evaluate the application of those guidelines by agencies having federal tax data in their possession. We believe that the guidelines and review program, taken together, provide a reasonable framework for ensuring that agencies receiving tax data maintain adequate safeguards.

Agency Comments

As noted in your September 29, 1986, letter, IRS, in conjunction with the disclosure function's transfer to the Assistant Commissioner for Examination, will be re-evaluating its efforts to safeguard tax information "with a view toward further strengthening the [Safeguard Review] Program to prevent unauthorized disclosures and invasions of taxpayers' rights to privacy."

We are sending copies of this report to the Joint Committee on Taxation, the House Committee on Ways and Means, the Senate Committee on Finance, other appropriate congressional committees, and officials in the agencies we visited during the survey. Copies will also be made available to other interested parties.

Sincerely yours,



Johnny C. Finch
Senior Associate Director

IRS Safeguard Reviews Calendar Year 1985

First Quarter

Kansas Department of Revenue
Delaware Division of Revenue

Second Quarter

Durham County, North Carolina, Child Support Enforcement Agency
Florida Child Support Enforcement Agency
Florida Department of Revenue
Tennessee Child Support Enforcement Agency
Illinois Bureau of Child Support
Illinois Department of Revenue
Santa Clara County, California, Child Support Division
Maryland Department of Human Resources
Massachusetts Department of Revenue

Third Quarter

Alabama Department of Revenue
Arkansas Employment Security Division
Arkansas Department of Finance and Administration
Connecticut Bureau of Child Support
Hawaii Department of Taxation
Idaho State Tax Commission
Kentucky Cabinet for Human Resources, Division of Unemployment Insurance
Missouri Division of Family Resources
New Hampshire Office of Child Support and Enforcement
New York, New York, Bureau of Child Support Enforcement and 5 county agencies
Wyoming State Board of Equalization

Fourth Quarter

Colorado Department of Revenue
South Carolina State Tax Commission
North Carolina Department of Revenue
Tennessee Department of Revenue
Minnesota Office of Child Support Enforcement
Wisconsin Department of Industry, Labor, and Human Relations-Job Service Division
California Board of Equalization
Washington Department of Fisheries
Ohio Department of Revenue
Oregon Public Utility Commission

Comments From the Internal Revenue Service

COMMISSIONER OF INTERNAL REVENUE

Washington, DC 20224

SEP 29 1986

Mr. William J. Anderson
Assistant Comptroller General
General Government Division
United States General Accounting Office
Washington, DC 20548

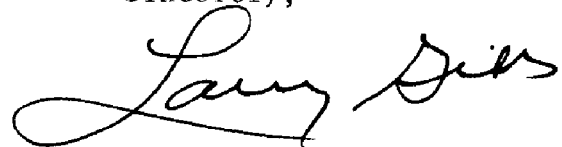
Bill
Dear Mr. Anderson:

We have reviewed your draft report on the Service's policies and procedures for safeguarding Federal tax information which we disclose to Federal, state and local agencies. We are pleased that you find our security guidelines and Safeguard Review Program to be adequate for ensuring that the safeguards required by the Tax Reform Act of 1976 are maintained.

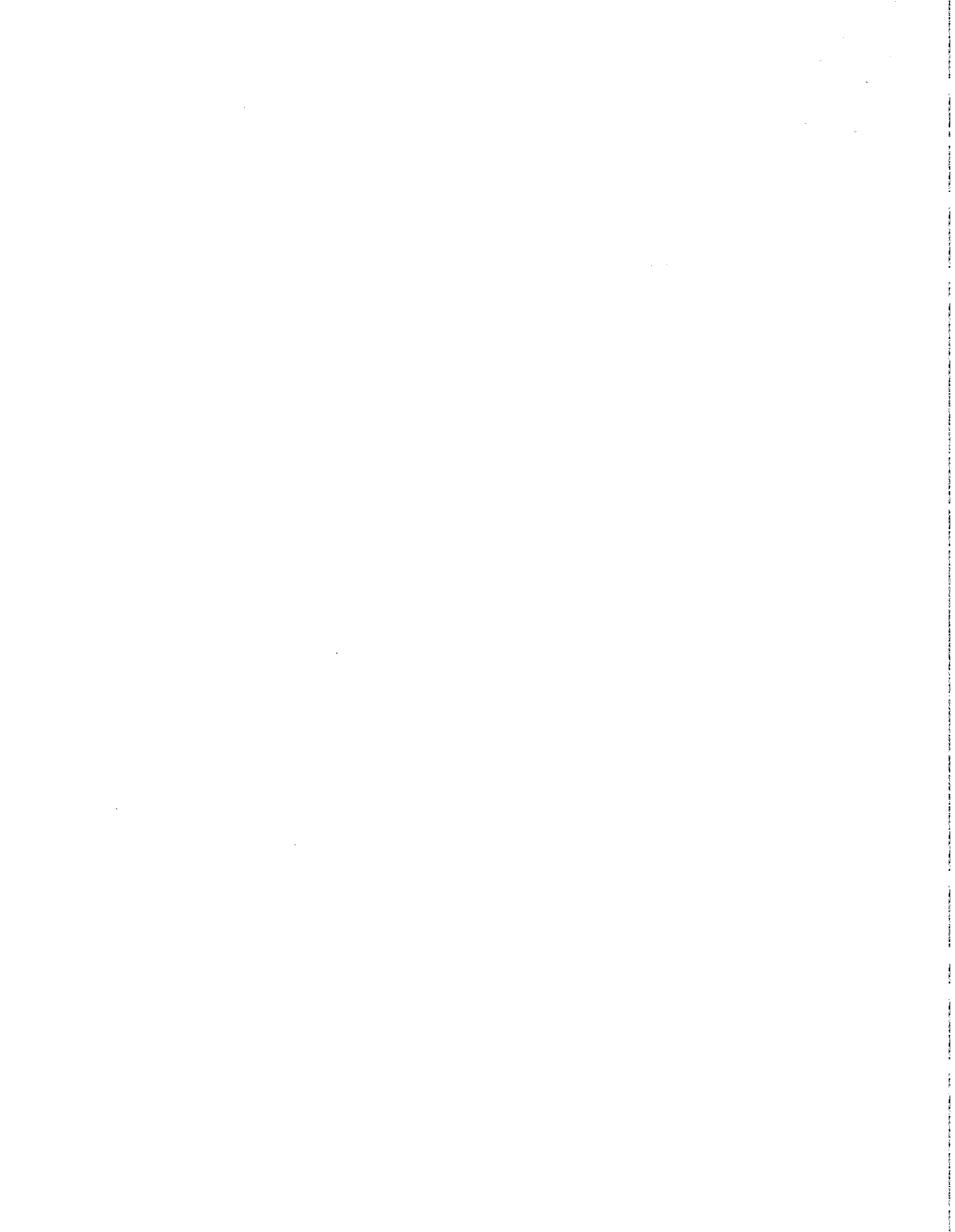
With the transfer of the Disclosure function to the Assistant Commissioner (Examination) in October 1986, our efforts in safeguarding tax information will be re-evaluated with a view toward further strengthening the Program to prevent unauthorized disclosures and invasions of taxpayers' rights to privacy.

With best regards,

Sincerely,



Department of the Treasury Internal Revenue Service



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