

Department  
of the  
Treasury

Internal  
Revenue  
Service

Office of  
Chief Counsel

**N o t i c e**

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November 8, 1999

Discovery of Unrelated  
**Subject:** Third Party Information

Upon Incorporation  
**Cancel Date:** Into the CCDM

These procedures, which apply to all field and national office Chief Counsel attorneys, provide coordination instructions whenever the tax returns and return information of unrelated third parties are the subject of a discovery request or demand in connection with a disparate treatment claim raised by an unrelated taxpayer in a judicial tax administration proceeding.

## Background

Occasionally in tax litigation, taxpayers will raise disparate treatment claims which are accompanied by discovery requests seeking tax returns and return information of similarly situated, but unrelated, taxpayers.

I.R.C. § 6103(a) prohibits the Internal Revenue Service from disclosing returns or return information, as those terms are defined in I.R.C. § 6103(b)(1) and (b)(2), unless disclosure is authorized under a specific provision of Title 26. *Church of Scientology of California v. IRS*, 484 U.S. 9 (1987).

I.R.C. § 6103(h)(4) is a narrowly tailored exception to the confidentiality requirements of section 6103(a), which specifically authorizes disclosure of certain tax return and return information in judicial or administrative tax proceedings. Subparagraphs (B) and (C) of section 6103(h)(4) establish “item” and “transaction” tests under which returns and return information of taxpayers who are not parties to such proceedings may nevertheless be disclosed in the proceedings. Under section 6103(h)(4)(B), a third party taxpayer’s statutorily protected information may be disclosed in judicial tax proceedings only “if the treatment of an item reflected on such [third party’s] return is **directly related** to the resolution of an issue in the proceeding.” (Emphasis added.) Under section 6103(h)(4)(C), such information may be disclosed if it “**directly relates** to a transactional relationship between a person who is a party to the proceeding and the taxpayer which **directly affects** the resolution of an issue in the proceeding.” (Emphasis added.)

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It is the IRS's position that disclosure of similarly situated, but unrelated, taxpayers' tax returns and return information is not authorized by the "item" or "transaction" tests of section 6103(h)(4)(B) and (C). The legislative history of section 6103(h)(4)(B) explains the intended scope and application of the "item" test and makes clear that mere relevance to an issue in a tax proceeding was not the standard adopted by Congress in enacting this particular exception to the general nondisclosure rule in section 6103(a). See S. Rep. No. 938, 94<sup>th</sup> Cong., 2d Sess. at 326 (1976). Nowhere in the legislative history of the "item" and "transaction" tests is there any suggestion that section 6103(h)(4)(B) or (C) would permit disclosure of unrelated third party taxpayers' returns and return information if the unrelated third parties and the taxpayer, who is the party to the proceeding, were similarly situated. To the contrary, Congress provided two clear examples illustrating its intention that disclosure of similarly situated, but unrelated, third party taxpayers' tax information in tax proceedings, was not authorized:

The return reflecting the compensation paid to an individual by an employer other than the taxpayer whose liability is at issue would **not** meet either the item or transaction tests described above in a reasonable compensation case. Thus, for example, the reflection on a corporate return of the compensation paid its president would not represent an item the treatment of which was relevant to the liability on an unrelated corporation with respect to the deduction it claims for the salary it paid its president.

In section 482 cases (involving the reallocation of profits and losses among related companies), where it is sometimes necessary to determine the prices paid for certain services and products at arms-length between unrelated companies, the return or return information of a company which was unrelated to the taxpayer company would **not** be disclosable under either the item or transaction tests described above.

*Id.* at 325-26 (emphasis added).

Case law interpreting sections 6103(h)(4)(B) and (C) is generally consistent with the legislative history's explanation of these provisions. See *Tavery v. United States*, 32 F.3d 1423 (10<sup>th</sup> Cir. 1994), *aff'g*, 1991 U.S. Dist. LEXIS 15592 (D. Colo. Oct. 18, 1991) (court determined that the third party wife's income and tax refunds were directly related to the issue of eligibility of taxpayer husband to court appointed counsel, such that the disclosure was authorized under section 6103(h)(4)(B)); *Christoph v. United States*, 1995 U.S. Dist. LEXIS 19977 (S.D. Ga. Dec. 12, 1995) (court ordered disclosure, pursuant to section 6103(h)(4)(B), of third party ex-wife's tax information, showing her tax treatment of the payment in question, to the taxpayer ex-husband, since it was directly related to the resolution of the deductibility issue in ex-husband's tax proceeding); *Lebaron v. United States*, 794 F. Supp. 947 (C.D. Cal. 1992) (court determined that disclosure of third party parishioner's tax treatment of her payments to the taxpayer church as business expense deductions was directly related to the

resolution of a discovery issue in the summons enforcement proceeding to which the church was a party, and thus authorized under section 6103(h)(4)(B)); *Estate of Stein v. United States*, 81-1 U.S. Tax Case (CCH) ¶ 13405 (D. Neb. 1981) (disclosure was authorized by section 6103(h)(4)(C) to establish whether a donor's gift to the taxpayer donee was in contemplation of death); *Guarantee Mutual Life Ins. Co. v. United States*, 78-2 U.S. Tax Case. (CCH) ¶ 9728 (D. Neb. 1978) (disclosure of third party taxpayers' returns, in order to determine whether they viewed themselves as employees or contractors, was authorized by section 6103(h)(4)(C) since the information was transactionally related to the resolution of the issue of the employer's withholding obligations); *cf.*, *Beresford v. United States*, 123 F.R.D. 232 (E.D. Mich. 1988) (where the IRS relied upon the value of third party taxpayers' sales of stock in calculating the value of decedent taxpayer's stock, where valuation was squarely at issue in the tax refund suit, the court ordered disclosure under section 6103(h)(4)(B)).

### **Procedures**

Attorneys should resist party litigants' attempts to discover tax returns and return information of unrelated third parties that are based on claims of disparate treatment, relying on I.R.C. § 6103 and any other privileges or objections that may be appropriate.

If a court orders the production of third party returns or return information, such order should be brought to the immediate attention of the Procedural Branch, Field Service, who will coordinate the appropriate response to the court order with the Offices of the Associate Chief Counsel (International) or (Employee Benefits and Exempt Organizations), as appropriate, and the Office of the Assistant Chief Counsel (Disclosure Litigation).

Any questions concerning these procedures should be directed to the Procedural Branch, Field Service, 202-622-7940.

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MARLENE GROSS  
Deputy Chief Counsel (Operations)