Office of Chief Counsel
Internal Revenue Service
Memorandum

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to: Area Counsel
(Tax Exempt & Government Entities CC:TEGE:FS:MSDEN)

from: Senior Technical Reviewer, Branch 6
(Procedure & Administration CC:PA:Br6)

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subject: Tax Exempt Organization; Inclusion of information relating to a disqualified person in an advisory to the Organization's "no change" letter

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Exempt Organization =
Disqualified Person =

ISSUE

Whether including in an advisory to a “no change” letter issued to the Exempt Organization information about possible excess benefit transactions between Exempt Organization and Disqualified Person violates I.R.C. § 6103.

CONCLUSION

I.R.C. § 6103 is not violated when the IRS includes in an advisory to a “no change” letter information concerning possible excess benefit transactions between the Exempt Organization and Disqualified Person, which was developed during the course of the examination of Exempt Organization.

FACTS

The IRS conducted an examination of Exempt Organization. The examination included investigating Exempt Organization's transactions with Disqualified Person and whether any of these transactions constituted excess benefit transactions resulting in prohibited private inurement under I.R.C. § 501(c)(3) and Treas. Reg. § 1.501(c)(3)-1(c)(2).[1] The IRS has concluded its examination of Exempt Organization and is planning to issue a "no change" letter with an advisory. The IRS intends to include in the advisory concerns identified during the examination about transactions between the Exempt Organization and the Disqualified Person that potentially resulted in excess benefit transactions that also constitute private inurement. The advisory discusses the implications of these transactions for the Exempt Organization's continued retention of its tax exempt status. The Exempt Organization's representative has written to the IRS stating the Exempt Organization may wish to release publicly the "no change" letter (which would include the advisory).

LAW AND ANALYSIS

I.R.C. § 6103 protects returns and return information from disclosure except as authorized by the Internal Revenue Code. I.R.C. § 6103(a). Returns are defined in I.R.C. § 6103(b)(1) as

> any tax or information return, declaration of estimated tax, or claim for refund required by, or provided for, or permitted under, the provisions of this title which is filed with the Secretary by, on behalf of, or with respect to any person…

Return information is defined, in pertinent part, in I.R.C. § 6103(b)(2) as

> a taxpayer's identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments, whether the taxpayer's return was, is being, or will be examined or subject to other investigation or processing, or any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense, …

[1] Concurrent with the examination of the Exempt Organization the IRS also conducted an examination of the Disqualified Person in which it considered whether any of the Disqualified Person's dealings with the Exempt Organization constituted excess benefit transactions taxable under I.R.C. § 4958. At times information was gathered for both exams simultaneously.

I.R.C. § 6103(b)(2)(A). The term 'return information' is broad and includes any information gathered by the IRS with regard to a taxpayer's liability under the Internal Revenue Code. *See* McQueen v. U.S., 264 F.Supp.2d 502, 516 (2003); LaRouche v. U.S. Dept. of Treasury, 112 F.Supp.2d 48, 54 (D.D.C. 2000) "The [Tax Reform Act of 1976] defines returns and return information in the broadest way"). Information gathered by or created by the IRS during the course of the examination of Exempt Organization is return information protected from disclosure under I.R.C. § 6103(a). Belisle v. Commissioner, 462 F. Supp. 460 (W.D. Ok. 1978).

The question of whether specific return information can be disclosed in a particular context is determined in part by whose return information it is. This factor, in turn, is determined by the context in which the information was collected or generated. In general, information collected or generated with respect to a determination as to the taxpayer's liability under the Code is the return information of that taxpayer. In other words, it is the return information of the taxpayer in whose investigation it was collected or generated.

In Martin v. IRS, 857 F. 2d 722 (10th Cir. 1988), the court agreed with the IRS that, with respect to data collected or generated by the IRS, the key factor in determining whose return information such data would be is whose tax liability is under investigation. The court cited to the illustration used by government counsel to help explain this concept:

> Suppose the IRS has a basket for each taxpayer and corporate entity. When the IRS makes a determination about an entity's return, the report is placed in the entity's basket. Under the authority of section 6103(e), it is also placed in the baskets of the entity's partners/shareholders. Individual reactions [i.e., protests] to the report are placed only in the basket of that taxpayer. If the IRS then reacts to the protests and [makes adjustments to] the entity's return, that information is again placed both in the entity's basket and in those of its partners/ shareholders."

Martin, 857 F.2d at 725.

Both the Exempt Organization and the Disqualified Person were examined and information, sometimes the same information, was collected, sometimes at the same time, in connection with both examinations. The “no change” letter, including the advisory, concludes the examination of the Exempt Organization. Everything in the “no change” letter consists of “data . . . generated by . . . the Secretary . . . with respect to the determination of the existence, or possible existence, of liability . . . under [Title 26] for any tax . . . ” of the Exempt Organization. This includes any language in the advisory regarding the potential tax liability of, and tax consequences to, Exempt Organization resulting from its transactions with Disqualified Person. While I.R.C. § 4958 imposes an independent tax liability for an excess benefit on a disqualified person or an organization manager knowingly participating in the transaction, there is also

potential liability to the exempt organization participating in the transaction. If an exempt organization engages in transactions that violate I.R.C. § 501(c)(3)'s prohibition against private inurement (which may be evidenced by excess benefits received by a disqualified person), it can result in the loss of the organization's tax exempt status.[2] Using the illustration adopted by the Martin court, the information concerning the excess benefit transaction(s) may be placed in either Exempt Organization's basket or Disqualified Person's basket, or both of their baskets, depending on which taxpayer is being investigated when the information is collected. We understand that this matter initially arose in the investigation of Exempt Organization and thus is, in the first instance, the return information of Exempt Organization, the disclosure of which is authorized by I.R.C. § 6103(e).

I.R.C. § 6103(e) authorizes the disclosure of returns and return information to persons with a material interest in the returns and is the primary basis for the disclosure here. This subsection generally permits disclosure of I.R.C. § 6103 protected information to the taxpayer to whom it relates. I.R.C. § 6103(e)(1)(D), which requires disclosure of the returns of a corporation or subsidiary thereof as provided in the subsection, and I.R.C. § 6103(e)(7), which permits disclosure of return information with respect to any taxpayer authorized to receive returns under this section (absent an impairment of Federal tax administration determination), authorizes the IRS to disclose Exempt Organization's return information to Exempt Organization. Underlying section 6103(e) is the principle that a taxpayer is entitled to its returns and return information so that it has full knowledge and understanding of the basis for the IRS's determination as to its liability or potential liability under the Internal Revenue Code.

To the extent the same information was collected or generated in connection with an investigation of Disqualified Person, then the information would also be the return information of Disqualified Person. In Solargistic Corp. v. United States, 921 F.2d 729 (7th Cir. 1991), the IRS sent letters to investors of plaintiff's company, telling them that because plaintiff was under audit, adjustments made to plaintiff's return would necessarily affect the investors' tax liability. Plaintiff sued, claiming that its return information was wrongfully disclosed to the recipients of the letters. The court, in rejecting that view, held that the fact of the Solargistic audit, in addition to being the return information of Solargistic, was also the return information of the investors since it constituted " 'data . . . prepared by . . . the Secretary . . . with respect to the determination of the . . . possible existence' of any tax liability of the investors." 921 F.2d at 731. Accordingly, the court found the disclosure to the investors authorized under IRC § 6103(e)(1)(A). The fact that certain of a taxpayer's return information may also constitute the return information of another taxpayer does not mean that the IRS is prohibited from disclosing to the first taxpayer its own return information. *See also,* Mid-South Music Corp. v. IRS, 818 F.2d 536, 539 (6th Cir. 1987); First Western Gov't Sec. v. United States, 796 F.2d 356, 359-360 (10th Cir. 1986)

[2] With respect to excess benefit transactions occurring after March 28, 2008, Treas. Reg. § 1.501(c)(3)-1(f) et seq., lists a number of factors that will be taken into account in determining whether to revoke the exemption of an organization that engaged in one or more such transactions.

Alternatively, IRC § 6103(h)(4), which provides for disclosures in administrative and judicial tax proceedings, offers another basis of authority for the disclosure here. Not only does this section provide for the disclosure of a taxpayer's own return information in an examination (I.R.C. § 6103(h)(4)(A))[3], which has been held to be an administrative tax proceeding (*see* First Western Gov't Sec. v. United States, 578 F. Supp. 212, 217-218(D. Colo. 1984), *aff'd*, 796 F.2d 356 (10th Cir. 1986), Nevins v. United States, 1987 WL 47316 at *3 (D. Kan Aug 26, 1987), Abelein v. United States, 323 F. 3d 1210, 1214-15 (9th Cir. 2003); *but see* Mallas v. United States, 993 F.2d 1111, 1122 (4th Cir. 1993)), but subsection (h)(4)(C) authorizes the tax administration proceeding disclosures of a third party's return information, *i.e.* information developed in the third party's investigation, if the return information directly relates to a transactional relationship between the taxpayer and third party and directly affects the resolution of an issue in the taxpayer's proceeding. Thus, even if the information about the transactions between Disqualified Person and Exempt Organization had been developed solely in the investigation of Disqualified Person, it nonetheless could be disclosed to Exempt Organization during the course of its examination (including the "no change" letter) since the provisions of section 6103(h)(4)(C) are clearly met here.

Not only do I.R.C. §§ 6103(e) and (h)(4) permit the IRS to disclose this return information to the Exempt Organization, but the IRS has an affirmative obligation to fully and completely explain to Exempt Organization all of the issues and potential difficulties that are a part of the "no change" determination. As stated in IRM 4.75.15.5, the IRS issues a "no change" letter along with an advisory when the examiner encounters minor issues which, if enlarged, could jeopardize the exempt status of the organization. This would include the fact that the IRS had concerns with Exempt Organization's transactions with Disqualified Person and the potential impact similar future transactions could have on the organization's continued retention of its tax exempt status. After the IRS shares the examination results with Exempt Organization, the IRS is not responsible or liable for what Exempt Organization does with the return information. *See* Rev. Rul. 2004-53, 2004-23 I.R.B.1026 (With the exception of disclosures to certain shareholders under subsection 6103(e)(1)(D), section 6103(e) contains no limitation or restriction on the redisclosure of returns or return information received by other persons with material interest).

Finally, we note that there may be the argument that the inclusion of the information about the Disqualified Person in the advisory doesn't give rise to a "disclosure" at all. Disclosure is defined in I.R.C. § 6103(b)(8) as [t]he making known to any person in any manner whatever a return or return information. There is some support that there is no "making known" of return information if the recipient already has knowledge of the information. *See* Brown v. United States, 755 F. Supp. 285,287 (N.D. Cal. 1990);

[3] Much as section 6103(e) authorizes disclosure of return information to the taxpayer to whom it pertains, section 6103(h)(4)(A) authorizes the disclosure of a taxpayer's own return information, where the taxpayer is a party to an administrative tax proceeding. The Exempt Organization is a party to its examination and is accordingly authorized to receive its own information.

Haywood v. United States, 642 F. Supp. 188, 190-91 (D. Kan. 1986). To the extent the IRS has, in the course of the examination, already discussed or otherwise disclosed to Exempt Organization its findings, concerns and issues with regard to the possible excess benefit transactions with Disqualified Person, it would be hard to argue that the reiteration of this information in the advisory is a disclosure as it is not a "making known" of any information to the Exempt Organization.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

We understand that Exempt Organization's counsel (not Disqualified Person's counsel) has warned that the inclusion of an advisory that discusses transactions with the Disqualified Person in the no-change letter would constitute a violation of I.R.C. § 6103. For the reasons stated above, we see little, if any, possibility of liability resulting from the proposed inclusion of the advisory. First, any action for wrongful disclosure would have to be brought by the taxpayer, Disqualified Person, whose information was disclosed. In this case, since Exempt Organization cannot bring suit to complain about the disclosure to itself of its own information, the case would have be brought by Disqualified Person under the theory that the return information was his alone. As outlined above, this would not support the elements of a wrongful disclosure suit under I.R.C. § 7431.

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Please call (202) 622-7950 if you have any further questions.