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Providing Income Verification Services to Mortgage Lenders Pursuant to Taxpayer/Loan Applicant Consents

This responds to your request for our comments on the disclosure implications of a proposal to charge user fees for income verification services provided by the Internal Revenue Service (Service) to mortgage lenders.

- Does I.R.C. § 6103(a) bar the Service from disclosing income verification information to mortgage lenders?

1. The Service's authority to provide income verification services is governed by the provisions of I.R.C. § 6103, given that "income verification" by the Service, necessarily entails disclosure by the Service of section 6103 protected information, i.e., Federal tax returns (or information extracted therefrom) and/or return information of taxpayer/loan applicants.[1]

[1] I.R.C. § 6103 represents a comprehensive statutory scheme governing the confidentiality and disclosure of Federal tax returns and return information. I.R.C. § 6103(a) provides that tax "returns and return information shall be confidential, and except as authorized by this title [title 26 of the United States Code] ... no officer or employee of the United States ... disclose any return or return information." Furthermore, I.R.C. § 7213 provides criminal penalties against officers and employees of the United States who disclose tax returns or return information in a manner not authorized by the Internal Revenue Code (Code), and section 7431 provides for civil damages as a result of such unauthorized disclosures. Therefore, unless specifically authorized by either I.R.C. § 6103 or some other provision of the Code, returns or return information may not be disclosed. See Church of Scientology of California v. Internal Revenue Service, 484 U.S. 9 (1987).

2. I.R.C. §§ 6103(e)(1)(A), (e)(7), permits the Service to make "income verification" disclosures directly to a taxpayer/loan applicant--not to a lender--so long as such disclosures would not seriously impair Federal tax administration.

3. I.R.C. § 6103(c) provides that the Service may, subject to requirements and conditions prescribed in implementing regulations, disclose returns and return information "to such person or persons as the taxpayer may designate in a written request for or consent to such disclosure," so long as such disclosure would not seriously impair Federal tax administration.

- Income verification disclosures to mortgage lenders pursuant to I.R.C. § 6103(c)

As a matter of strict legal interpretation, the plain language of section 6103(c) and implementing Treasury regulations authorizes the Service to provide income verification information to a lender pursuant to a valid section 6103(c) consent from the taxpayer/loan applicant.[2]

However, income verification disclosures to lenders based on section 6103(c) consents obtained from loan applicants as a routine step in the loan application process, are vulnerable to challenge on three grounds.

1. Strict compliance with the statute and regulations. The Service may not honor a purported taxpayer consent that does not meet detailed requirements and conditions specified both in the statute itself (e.g., I.R.C. § 6103(c) requires that taxpayer consents be in writing), and in the implementing Treasury regulations.

The courts, consistently and unanimously, have held that strict compliance with the terms of section 6103(c) and its implementing regulations is required, and have rejected the argument that a general waiver of confidentiality can be construed by the courts. See e.g., Tierney v. Schweiker, 718 F.2d 449, 455, 451 (D.C. Cir. 1983) (because the "notice-and-consent form" at issue did not "meet the requirements of the IRS' own regulations[,] any release of tax information based on the consent form ... would violate the confidentiality section of the

[2] The disclosure authority which a consent bestows upon the Service is discretionary, not mandatory (the Service may release tax data with the taxpayer's consent, but it is not required to do so).

Internal Revenue Code"); Olsen v. Egger, 594 F. Supp. 644, 646 (S.D.N.Y. 1984) (consent provision in marital separation agreement did not comply with the requirements set forth in Treas. Reg. § 301.6103(c)-1(a) including the clear requirement of "a written document pertaining solely to the authorized disclosure"); Huckaby v. United States' Department of the Treasury, 794 F.2d 1041, 1046-47 (5th Cir. 1986) (Fifth Circuit overruled lower court finding that taxpayer could consent to disclosure of his tax information in a manner that did not meet the requirements of section 6103(c)). See also Johnson v. Sawyer, 640 F. Supp. 1126, 1132-33 (S.D. Tex. 1986); Dowd v. Calabrese, 101 F.R.D. 427, 438-39 (D.D.C. 1984); cf. Garity v. United States, 46 A.F.T.R.2d 5146 (E.D. Mich. 1980); S. Rep. No. 938, 94th Cong., 2d Sess. 318 (1976), 1976-3 C.B. (Vol.3) 356 ("the committee felt that returns and return information should generally be treated as confidential and not subject to disclosure except in those limited situations delineated in the newly amended section 6103 where the committee decided that disclosures were warranted.")

With regard to regulations implementing section 6103(c), these originally were issued in temporary form, effective January 1, 1977. See T.D. 7479, 1977-1 C.B. 376. Proposed T.D. 7479 was accompanied by a memorandum dated April 1, 1977, from the Commissioner of Internal Revenue to the Assistant Secretary of the Treasury, that recommended approval of the proposed temporary regulations on procedure and administration under subsection 6103(c). The Commissioner's memorandum specifically addressed and explained the proposed regulation's "separate written document" requirement--a requirement that is preserved in the current regulations--as follows:

> [W]e do not believe that Congress intended to permit a taxpayer to designate a person to obtain any and all ... tax data concerning the taxpayer as that person might find relevant to his own activity. We think that Congress intended that taxpayers be aware of -- and specify -- exactly what tax data is to be furnished to their designee under section 6103(c).
>
> These proposed regulations, which are specifically authorized by section 6103(c), require that the taxpayer's disclosure authorization be contained in a separate written document. This requirement would prevent a disclosure authorization from being buried in a lengthy benefit application to go unnoticed or unread. The regulation would also require the taxpayer to describe the type or kind of tax involved (and, in

> the case of return information, the specific data to be disclosed) and the taxable years involved. It should be noted that the regulations require the taxpayer to provide this detail. This is intended to prevent a taxpayer from signing a blank form which could later be completed by the designee to authorize disclosure of whatever the designee might later decide was necessary.

Commissioner's memorandum accompanying Proposed T.D. 7479 at 2 (emphasis in original).

Section 6103(c) and implementing regulations therefore contemplate a separate writing by which the taxpayer describes, with particularity, the tax information that may be disclosed, and to whom it may be disclosed.

The possibility that income verification requests and accompanying taxpayer/loan applicant consents may be forwarded to the Service in a non-paper form, e.g., electronically or using transcription technologies that tend to blur the oral/written distinction, raises the issue of whether such forms of consent constitute a "writing" or "written document" for section 6103(c) purposes.

However, the Service has not, for disclosure purposes, interpreted the requirement for a written consent to limit written requests to traditional writing media, i.e., pen-to-paper. For example, the Service currently accepts photocopies and facsimile copies of section 6103(c) disclosure consents.

Moreover, Counsel has opined that since the crux of section 6103's "written" and "writing" requirements are to ensure that disclosures are fully documented, as opposed to purely oral, the Service has the authority to administratively develop alternatives to the traditional pen-to-paper writing media subject to one caveat--an oral statement cannot be used to satisfy the writing requirement.

While Counsel therefore recognizes that broad authority exists to administratively define writing for section 6103 purposes, it is also clear that in evaluating alternative forms of writing, the Service, no doubt, will carefully consider the ultimate issues of identification, reliability, and retrievability (for evidentiary purposes) of requests or consents that are transmitted in a non-paper form, e.g., electronically utilizing transcription technology or coding and identification number technology.[3]

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[3] There have been legislative proposals to eliminate the

In sum, while taxpayer/loan applicant consents are a vehicle by which taxpayer/loan applicants may authorize the Service to provide income verification services to lenders, the taxpayer's purported consent will be wholly ineffective unless it is carefully crafted to conform to the strict conditions and requirements specified in section 6103(c) and regulations implementing that statutory provision. See I.R.C. § 6103(c) and Treas. Reg. § 301.6103(c)(1)(a).

2. Possible "end-run" on the statute. Courts may construe an "express written consent by mortgage applicants program" as an attempt to employ section 6103(c) as a broad, new, de facto, exception to the explicit, statutory protection afforded returns and return information under section 6103(a). See e.g., Tierney v. Schweiker, 718 F.2d 449, 456 (D.C. Cir. 1983) ("the IRS cannot use the consent exception of subsection 6103(c) as a "catch-all"

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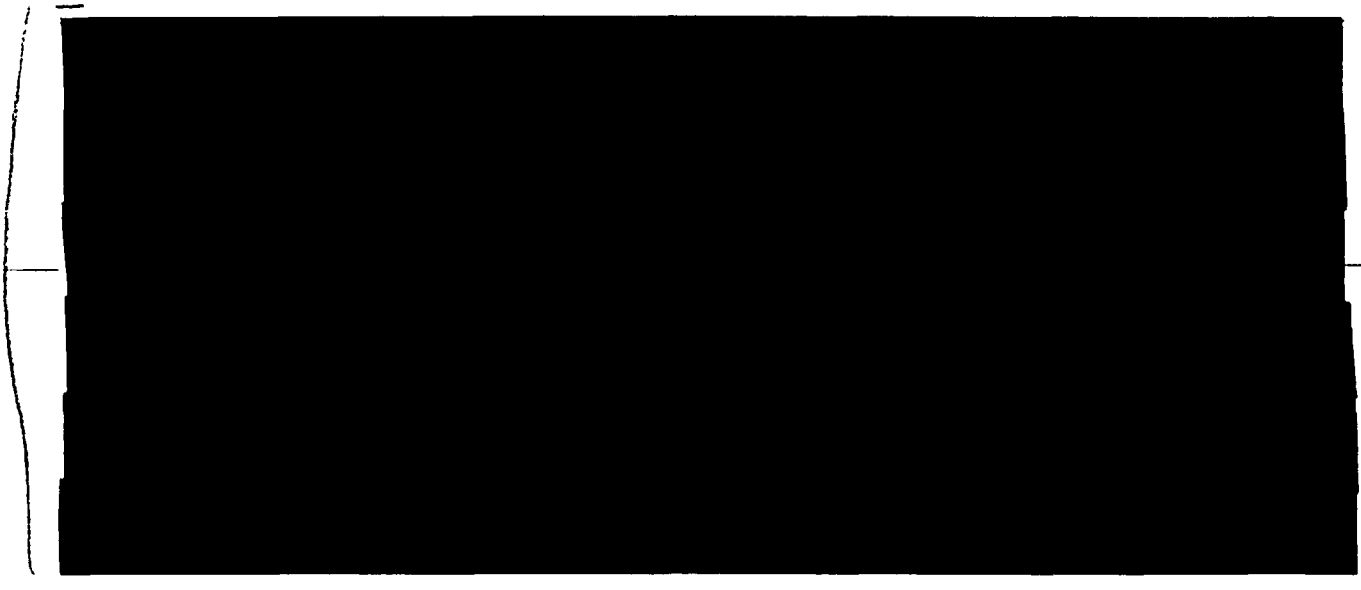
requirement that section 6103(c) taxpayer authorizations be "written." If such a proposal were enacted, presumably, new regulations could be promulgated specifying requirements and conditions governing "non-written" consensual disclosures of tax data. While taxpayers still would have to comply with applicable regulations, dispensing with the requirement that consents be "written" would facilitate consent-based disclosures by electronic and non-paper medium.

provision to circumvent the general rule of confidentiality established by Congress.")

In 1976, Congress put in place a statutory framework that established a broad, general rule of non-disclosure (section 6103(a)) and identified specific, limited exceptions to the general rule. In particular, Congress was concerned to strictly limit access to tax data for non-tax purposes, thus ensuring that the Service does not operate as a lending library for other government agencies that might find tax data useful in carrying out their functions.

In enacting specific statutory exceptions to the non-disclosure rule of section 6103(a), Congress carefully weighed taxpayer privacy and confidentiality concerns against competing claims for access to tax data for non-tax purposes, and crafted narrowly drawn exceptions that precisely identified the tax information that could be disclosed, to whom it could be disclosed, and for what purposes.

Thus, in holding that consents submitted by taxpayers for disclosure of information to the Social Security Administration (SSA) were not valid under section 6103(c), the Court of Appeals for the D.C. Circuit noted, in Tierney, 718 F.2d at 456, that Congress had specifically provided for limited access to certain tax information by SSA i.e., Congress had considered the needs of SSA and decided what tax information would be disclosed to that agency. Accordingly, although not the basis for its holding, the court saw the use of consents as an attempt to circumvent the narrow access already granted to SSA under section 6103.



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[4] Taxpayers have a right to request and obtain copies of their own returns under section 6103(e)(1). They also may request and obtain their return information, so long as its disclosure would not seriously impair Federal tax administration, under section 6103(e)(7).

3. Coercion. As the Court of Appeals for the District of Columbia Circuit has held, section 6103(c) and implementing regulations contemplate "knowing and voluntary," consent by the taxpayer. See Tierney v. Schweiker, 718 F.2d 449, 456 (D.C. Cir. 1983).

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In Tierney, the Court of Appeals for the D.C. Circuit held invalid consents submitted by taxpayers for disclosure of information to the Social Security Administration (SSA) under circumstances facially similar to those presented in a loan application context. However, for the reasons explained below, we believe that Tierney is distinguishable from the typical loan application scenario.

Tierney involved an attempt by SSA to verify with the Service the financial eligibility status of Supplemental Security Income (SSI) recipients. To this end, SSA sent notice and consent forms to all SSI recipients asking them to execute written consents allowing the Service to disclose tax information about them to SSA. SSA made it clear that SSI recipients could lose their benefits if they refused to execute the consents.

Important to the court's decision in Tierney, was the fact that the affected individuals were, in the court's view, elderly, blind and disabled persons who were being threatened with termination of their life sustaining benefits if they did not consent to disclosure of their tax information. Furthermore, because the SSA consent form did not notify recipients of their procedural rights concerning their SSI benefits in the event that they refused to consent to the disclosures, the court held that the consents were thus not "knowing and voluntary" as contemplated by the statute.

Thus, consent-based income verification disclosures to potential lenders can be distinguished from the consent-based disclosures at issue in Tierney. In particular, the nature of the "benefit" potentially jeopardized by a taxpayer's refusal to execute an income verification consent in the context of arms-length business dealings transacted in a commercial or market setting, (e.g., between a loan applicant and a bank, mortgage broker, credit card or insurance company, or a government or government-backed lender such as SBA), does not rise to the level of a life sustaining "entitlement" similar to social security benefits; nor is the potential "benefit" at stake for loan applicants accompanied by comparable procedural rights in the event of denial, cessation or reduction of the "benefit," as is the case with SSI "entitlements."

Loan applicants also might argue that, like benefit applicants in Tierney, they have no choice but to consent to the release of their tax data if they want their particular "benefit" applications (i.e., their loan applications) processed by potential lenders. In other words, a loan applicant's need or strong desire for the loan, and possibly also, the absence of an alternative source of credit that does not require income verification by consent, induces the applicant's consent.

However, unlike the SSI beneficiaries in Tierney, loan applicants are not "compelled" to waive a statutory right or protection in order to secure another benefit to which they are entitled by statute. Whereas loan applicants might be required by lenders to relinquish their right to confidentiality under section 6103(a), voluntarily, as the cost of pursuing a private, commercial or business opportunity (i.e., requesting a loan), Tierney involved a class of people who were not merely at risk of foregoing a privilege; they were aged, blind or disabled SSI beneficiaries whose life sustaining benefits were placed in jeopardy.

In sum, although waiver of section 6103 protection by loan applicants potentially could be challenged as coercive if the practice were installed as compulsory, standard operating procedure throughout the credit/lending community, we are of the view that it would be possible to design a consent-based program for providing income verification information to lenders that could be distinguished, technically, in terms of the three problem areas highlighted above.

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For an explanation of the tax administration and compliance related issues at stake, we recommend soliciting the views of the Service's Office of Disclosure (CP:EX:GLD:D:O) and Office of Taxpayer Services (T). For privacy policy issues, we suggest that you solicit the views of the Privacy Advocate (IS:PA). In particular, however, we would highlight the following items as warranting focused consideration.

- To what extent is the Service's interest in furnishing income verification services to lenders, albeit at a fee, dependent upon or driven by the perception that Federal tax compliance and enforcement objectives will be advanced in the process? To what extent has such perception or assumption been tested, and if tested, validated?

1. To the extent that the Service would be unwilling or less willing to provide income verification services to lenders if in fact current law prohibits lenders from giving the Service information about possible tax fraud by loan applicants, and/or

if the Service is prohibited by law from receiving such information from lenders, Service participation in programs to supply income verification services to lenders should await legal interpretation from the appropriate Counsel function regarding the applicability of laws such as the Right to Financial Privacy Act and the Fair Credit Reporting Act to such programs.

2. We note, but do not address, issues such as the relative likelihood of compliance benefits flowing to the Service as a result of its participation in income verification programs, and the propriety of diverting Service resources away from direct tax administration activities in favor of servicing the business needs of lenders, albeit on the assumption, tested or untested, that tax administration may be advanced in the process.

In this regard, we are aware of a Fresno, California, program that has been designed on the premise that the Service will be provided with earned income data that loan applicants supply to lenders and asked, with the consent of the loan applicant, to verify the accuracy of that tax information. In the event of a substantial discrepancy between the income data provided to the lender and that reflected in tax returns filed with the Service, the lender will assist the Service in taking appropriate compliance action against the loan applicant.

- With respect to user fees generally, we note that the Service has independent authority, separate from proposed user fee legislation, to charge reasonable fees for income verification services.

Disclosures made pursuant to I.R.C. § 6103(c) are covered by the procedures set forth in I.R.C. § 6103(p)(2). See e.g., I.R.C. § 6103(p)(2)(B) (providing that return information disclosed under the provisions of title 26 may be provided in such form, including such form of copy or reproduction, as the Secretary determines and, that "[a] reasonable fee may be prescribed for furnishing such return information.")

Moreover, I.R.C. § 7809(c)(1) operates in conjunction with the procedural provisions of section 6103(p) providing that:

> Moneys received in payment for--
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> (1) work or services performed pursuant to section 6103(p) (relating to furnishing of copies of returns or of return information), ...

shall be deposited in a separate account which may be used to reimburse appropriations which bore all or part of the costs of such work or services, or to refund excess sums when necessary.

Questions as to the application of section 7809(c)(1) to specific fee proposals fall within the authority of the Service's General Legal Services (GLS) function. Accordingly, if definitive guidance is needed on this issue, we recommend that GLS' opinion be solicited on the matter of the Service, potentially, charging and recouping a fee for providing income verification services to lenders.

If you have any questions, please contact Lynnette Platt, the attorney assigned to this matter, at (202) 622-4570.

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