

## TAX LITIGATION ISSUES

# Tax Return Confidentiality: Recent Developments

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**A**dopted in 1976, 26 U.S.C. §6103 prohibits the Internal Revenue Service (IRS) from disclosing tax returns and “return information” absent specified exceptions. The statute was initially enacted in response to widespread concern over the misuse of tax filings to pursue political vendettas, but more recently has drawn attention as a battleground over efforts to obtain copies of former President Trump’s tax returns. See J. Temkin, “Confidentiality of Tax Returns, Congressional Authority and the President”, N.Y.L.J. (Sept. 19, 2019).

Although the Supreme Court ultimately put an end to the Trump tax return saga, §6103 has remained in the news. This past September, Hunter Biden sued the IRS for civil damages claiming that two agents shared confidential information in media interviews and testimony before Congress without authorization. In October, an IRS contractor, Charles Littlejohn, pleaded guilty to a felony in connection with his disclosure of information from tax returns filed by former President Trump and thousands of wealthy individuals.

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While these high-profile cases have heightened the general public’s awareness of the statutory limits on the disclosure of tax return information—which is broadly defined to include essentially any information particular to a taxpayer

and that taxpayer’s returns, but only if such information can “be associated with, or otherwise identify, directly or indirectly, a particular taxpayer,” see 26 U.S.C. §6103(b)(2)—practitioners in the area have been litigating more nuanced aspects of §6103 for years.

Over the past year, federal courts across the country have issued decisions clarifying the extent to which §6103 shields tax returns and return information from disclosure in civil litigation, the extent to which the IRS is permitted to disclose confidential information during and in connection with investigations, and the application of a safe harbor shielding



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the government from liability for unauthorized disclosures.

### **Disclosure of Tax Return Information During Civil Litigation**

In *Church of Scientology of California v. Internal Revenue Service*, 484 U.S. 9 (1987), the Supreme Court concluded that §6103 provides the IRS with a valid basis to withhold records sought pursuant to the Freedom of Information Act, rather than merely redact portions of those records, as petitioner had requested. Courts have, however, split over whether §6103 provides a basis for the government to withhold discovery requested under the Federal Rules of Civil Procedure. Magistrate Judge Karen S. Crawford of the U.S. District Court

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for the Southern District of California recently explored this split in *Aroeste v. United States*, 2023 WL 5246345 (S.D. Cal. Aug. 15, 2023).

In *Aroeste*, the plaintiffs sued to recoup penalties (and discharge additional liabilities) imposed for their failure to file foreign bank and financial accounts reports. In discovery, the plaintiffs requested the administrative record generated during the underlying IRS audit. That record included two memoranda drafted by staff attorneys in the IRS Office of Chief Counsel in connection with audits of other taxpayers that the agent auditing the plaintiffs had consulted for legal guidance. The government redacted portions of those memos to withhold case-specific analysis that, it

claimed, constituted return information, and the plaintiffs challenged the scope of the redactions.

Although both parties assumed §6103 provided a basis to withhold certain discovery materials, the court questioned the assumption. The court explained that, like the parties in *Aroestes*, the Court of Federal Claims has assumed that §6103 provides the government with a basis to withhold discovery, see *Cencast Services v. United States*, 91 Fed. Cl. 496, 509 (2010); *First Heights Bank, F.S.B. v. United States*, 46 Fed. Cl. 312, 322-23 (2000), and the Federal Circuit did not question that assumption on appeal. See *Cencast Services v. United States*, 729 F.3d 1352 (Fed. Cir. 2013), *cert. denied*, 573 U.S. 931 (2014); *First Heights Bank v. United States*, 422 F.3d 1311 (Fed. Cir. 2005). The court then contrasted that approach with the one taken by the court in *McSurely v. McAdams*, 502 F. Supp. 52 (D.D.C. 1980), which concluded that the historical purpose of §6103—“to prevent political bullying by actors in the executive branch of the federal government from gaining access to the personal information included in tax returns filed by private citizens”—did not support applying the confidentiality provisions in the context of a civil discovery dispute. *Aroestes*, 2023 WL 5246345, at \*4

Judge Crawford agreed with the reasoning in *McSurely*, noting that that court had “analyzed what Congress intended when it enacted §6103 rather than simply assuming the statute applies.” While concluding that §6103 is “likely not a valid basis for objecting to discovery,” the court avoided ruling on this “tricky question” by concluding that the contested information was protected by the attorney-client privilege.

Section 6103 also governs the release of information during civil litigation and §6103(h)(4) permits the disclosure of confidential materials in judicial and administrative tax proceedings pertaining to “tax administration.”

The plaintiffs in *Silver v. United States*, 2023 WL 1100747 (D.D.C. Jan. 30, 2023), *aff'd* 2023 WL 8724220 (D.C. Cir. Dec. 19, 2023), had previously brought two lawsuits against the IRS alleging violations of the Administrative Procedure Act relating to the promulgation of regulations under the Tax Cuts and Jobs Act. In connection with those actions, the IRS provided confidential tax returns to the Department of Justice, which included information from those returns in public filings. The plaintiffs then brought an action pursuant to 26 U.S.C. §7431 seeking damages for the alleged unauthorized disclosure of tax returns.

In dismissing the complaint, Judge Reggie B. Walton of the U.S. District Court for the District of Columbia held that the disclosures at issue were permitted under §6103(h)(4)(A), which allows the

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disclosure of tax returns or tax information in a judicial proceeding pertaining to tax administration when the taxpayer is a party to the proceeding.

Judge Walton went on to reject plaintiffs’ arguments that §6103(h)(4) only permits disclosure to the extent necessary for the government to achieve its litigation objective, concluding that the “last resort” requirement invoked by plaintiffs did not apply to disclosures made during court proceedings.

Finally, Judge Walton rejected plaintiffs’ argument that including the confidential information in documents that were accessible to the general public through PACER violated §6103, concluding that nothing in the statute expressly precludes the public filing of documents whose disclosure is

permitted under §6103(h)(4), and the “strong presumption” in favor of public access to judicial proceedings weighs against filing information under seal. After hearing oral argument, the D.C. Circuit summarily affirmed Judge Walton’s dismissal of the complaint in an unpublished decision.

**Disclosure of Tax Return Information During Investigations**

*Crow v. United States*, 2023 WL 6317803 (D. Idaho Sept. 28, 2023), arose out of a promoter penalty audit during which Stanley Crow, a shareholder and director of S. Crow Collateral Corporation (SCCC), provided the IRS with detailed information about transactions involving SCCC and his employment arrangements.

Seven years later, a third party challenged the IRS’s tax treatment of a transaction to which SCCC was a counterparty, and the IRS filed a motion to amend its answer to include information obtained during the promoter penalty audit such as Crow’s role as the president and director of SCCC, SCCC’s employer identification number, and the fact that SCCC was located in Crow’s personal residence. The IRS’s motion also disclosed that the transaction at issue was the subject of an ongoing investigation. In response, Crow and SCCC sued the IRS for violating §6103.

Judge Amanda K. Brailsford of the U.S. District Court for the District of Idaho agreed with the government that the disclosure that the IRS had pursued a promoter investigation of Crow and SCCC, and that Crow is SCCC’s president and shareholder was not actionable since those facts had been disclosed in prior judicial proceedings and were no longer confidential. The court further concluded that the allegation the IRS’s investigation was ongoing was “self-evident” based on the pending litigation, and therefore not actionable.

The court, however, denied the motion as to other disclosures, including SCCC’s employer

identification number, that Crow worked remotely from his personal residence, and that SCCC was located at that residence, holding that absent proof that the information was disclosed in prior judicial proceedings or authority for the proposition that such information does not qualify as “return information,” plaintiffs had stated a claim for relief.

Judge Brailsford also addressed whether the confidential information fell within the exception to confidentiality set forth in §6103(h)(4)(C), which permits disclosure of return information in a proceeding pertaining to tax administration “if such return or return information 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.”

The court concluded that the exception was inapplicable since the information about SCCC that was disclosed during a third-party proceeding did not “‘directly relate[]’ to the transactional relationship between [the third-party] and SCCC,” and did not “‘directly affect[]’ the resolution of an issue in [the third-party suit].”

### **Safe Harbor From Liability**

Regardless of whether a specific exception applies, 26 U.S.C. §7431(b) permits the government to avoid liability if the disclosure in question “result[ed] from a good faith, but erroneous, interpretation of section 6103[.]”

The U.S. Court of Appeals for the Fifth Circuit recently addressed the scope of this safe harbor provision in *Castro v. United States*, 2023 WL 8825316 (5th Cir. Dec. 21, 2023). The plaintiff in *Castro* alleged that an IRS agent had improperly disclosed to two witnesses that the plaintiff was under criminal investigation. The lower court granted the government’s motion for summary

judgment, finding that at least one disclosure was “necessary” as understood in §6103(k)(6)—which permits an IRS agent to disclose return information “in connection with his official duties relating to any audit, collection activity, or civil or criminal tax investigation...to the extent that such disclosure is necessary in obtaining information, which is not otherwise reasonably available”—because the witness would not speak to the agent until the agent revealed the subject of the investigation.

The district court, however, further concluded that even if §6103(k)(6)’s exception did not apply, the disclosure was not actionable because it fell within §7431(b)’s safe harbor. See *Castro v. United States*, 2023 WL 4444980, at \*2 (N.D. Tex. March 29, 2013).

On appeal, the Fifth Circuit agreed with the lower court. In the court’s view, the agent “reasonably and in good faith believed that—based on case law, statutory authority, regulations and the IRS Manual (“IRM”)—the disclosures were ‘necessary’” within the meaning of section 6103(k)(6). *Castro*, 2023 WL 8825316, at \*1.

Thus, *Castro* demonstrates that apart from the numerous exceptions to §6103(a), an aggrieved plaintiff must demonstrate that the government’s interpretation of any potentially applicable exception was objectively unreasonable to overcome a “good faith” exception to liability.

### **Conclusion**

Historically, §6103 has protected a broad swath of tax return information from disclosure. While Hunter Biden’s civil case and especially Charles Littlejohn’s criminal prosecution demonstrate that the prohibitions on disclosure have teeth, taxpayers and their professionals should be aware of the numerous exceptions to the general rule of confidentiality and the difficulty in holding the government to account for perceived violations.