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## IRC §§ 7431 and 7433: Civil Remedies for Abusive Practices by the IRS

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- I. INTRODUCTION
- II. LIABILITY FOR UNAUTHORIZED DISCLOSURES
  - A. *Section 7431: Civil Damages for Violation of Section 6103*
    - 1. *There Must Have Been a Release of a Return or of Return Information*
    - 2. *The Information Must Have Been Return Information of the Taxpayer Bringing the Suit*
    - 3. *The Release Must Have Been a "Disclosure"*
    - 4. *The Release Must Have Been Made by an Officer or Employee of the United States*
    - 5. *The Person Making the Disclosure Must Have Acted "Knowingly or by Reason of Negligence"*
    - 6. *The Release Must Have Been in Violation of Section 6103*
    - 7. *Good Faith Defense*
  - B. *Elvis Johnson: Liability Under the Federal Tort Claims Act for Violation of Section 6103*
    - 1. *No FTCA Claim Can Be Based on the Violation of Federal Law*
    - 2. *The Claim Was Preempted by Section 7217*
- III. LIABILITY FOR COLLECTIONS ACTIVITIES: SECTION 7433
- IV. COORDINATION OF SECTIONS 7431 AND 7433: OVERLAP AND GAPS
  - A. *Overlap*
  - B. *Gaps in Coverage*
    - 1. *No Liability for Abuses During Assessment Phase*
    - 2. *Liability for Negligent Collections Activity*
    - 3. *Limit on Damages Under Section 7433*
- V. CONCLUSION

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## I. INTRODUCTION

A government must have revenue to exist, and a government the size of the present-day United States government requires a staggering amount of revenue.<sup>1</sup> As the revenue assessing and collecting branch of the government, the Internal Revenue Service performs the crucial function of ensuring the steady and continuous flow of revenue. To enable it to perform this function, Congress and the courts have granted the Service broad powers of investigation and seizure that are denied most other law enforcement agencies by statutory and constitutional safeguards, and have generally shielded the Service from accountability to the taxpayers involved or to any other authority.<sup>2</sup>

In 1976, however, Congress began enacting legislation intended to ensure the proper exercise by the Service of its extensive powers, and to prevent the misuse of the massive database that the Service has constructed on American taxpayers. Given the ever-expanding use of the tort system in the United States as a means of private law enforcement, it is not surprising that one of the tools chosen by Congress to police the Service was the taxpayer lawsuit for damages against the federal government. This Article will focus on two provisions, section 7431 (and its substantive base, section 6103) and section 7433, in which Congress established this method of accountability.<sup>3</sup>

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1. In 1992, for example, the federal government revenues totalled \$1,075,000,000,000 (while government expenditures totalled even more, \$1,475,000,000,000). Harry E. Figgie, Jr. & Gerald J. Swanson, *Bankruptcy* 195 143 (1992) (citing the Office of Management and Budget as the source of these figures).

2. David Burnham, *A Law Unto Itself* 21 (1989). This combination of power and unaccountability has inevitably resulted in a fear and hatred of the Service. In his testimony before the Senate in 1987, one tax practitioner told the Senators that "[t]he IRS is the most hated organization in the United States. People would rather deal with the KGB." Taxpayers Bill of Rights: Hearings on S. 579 and S. 604 Before the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service of the Senate Committee on Finance, 100th Cong., 1st Sess. 177 (Apr. 10, 1987) [hereinafter Hearings on S. 579 and S. 604] (testimony of Jack Warren Wade, Jr., author of "Power to Tax").

3. Outside the scope of this article are two other provisions of the Code enacted in 1988 that authorize actions for damages against the United States: § 7430 (concerning claims for attorneys' fees in cases where the taxpayer prevails and the government has taken an unreasonable position) and § 7432 (concerning claims for damages based on the government's refusal to release a lien). For a general discussion of § 7430, see Marilyn Devin, *Tax Court Review of IRS's Position: When May Taxpayers Recover Legal Fees?*, 68 *J. Tax'n* 368 (June 1988).

Also outside the scope of this article are other provisions of the Code that will, under appropriate circumstances, offer some protection and/or redress to the taxpayer and third parties, other than an award of damages. See IRC § 7421(a) (allowing injunction or judicial review of specific Service activities under limited circumstances); IRC § 7605 (prohibiting

Ideally, from the taxpayers' point of view, the statutes should cover the continuum of Internal Revenue Service activity, allowing the recovery of damages for injuries sustained as a result of any improper exercise of the Service's powers. In fact, however, the statutes leave large, and again from the taxpayers' point of view, unjustifiable, gaps in the coverage. These gaps, together with pending legislation designed to address some of these gaps are also discussed.

In analyzing these provisions, or any other legislation that purports to place significant limitations on the powers of the Service, one fact must be kept in mind: If the constant flow of revenue to the government stops, the government stops as well. Despite all the speechmaking and posturing and even, perhaps, sincere concerns about the need to curb abuses by the Service, the government cannot afford to enact legislation that would significantly interfere with the Service's enforcement of the tax laws or interrupt the constant flow of revenue into the government coffers.<sup>4</sup>

## II. LIABILITY FOR UNAUTHORIZED DISCLOSURES

The Internal Revenue Code requires taxpayers, lenders, employers, and others to provide information to the Service and authorizes the Service to tap other sources of information. Consequently, the Service's files have become a repository of extensive, detailed information regarding the financial affairs of American taxpayers. Congressional investigations into Watergate revealed that the White House had obtained access to this information and had used it for purposes unrelated to the collection of taxes.<sup>5</sup> This revelation raised serious concerns on the part of members of Congress about the use of

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unnecessary examinations or investigations of taxpayer; note that although an injunction is prohibited under § 7421(a), the taxpayer can assert impropriety in response to the Service's action to obtain an order to enforce summons or an action to collect deficiency or to collect refund); IRC § 7426(a) (allowing civil actions by third-parties to recover surplus proceeds of levy and sale by Internal Revenue Service).

4. In fact, § 7431 and § 7433 were themselves in no small part enacted to enhance, not limit, the Service's ability to administer the tax laws in such a way as to produce revenue most efficiently by encouraging the voluntary compliance aspect of our tax system. See, e.g., Hearings on S. 579 and S. 604, *supra* note 2, at 152 (testimony of Jack Warren Wade, Jr.); Taxpayer Rights Issues: Hearings on S. 2400 Before the Subcommittee on Oversight of the Internal Revenue Service of the Senate Committee on Finance, 98th Cong., 2d Sess. 129 (Mar. 19, 1984) (written statement of Edwin I. Davis, referring specifically to the Ombudsman Program); Proposals for Administrative Changes in Internal Revenue Service Procedures: Hearings Before the Subcommittee on Oversight to the House Committee on Ways and Means, 94th Cong., 1st Sess. 2, 6-7 (1975) [hereinafter Proposals] (testimony of Hon. Jerry Litton; testimony of Senator Lowell P. Weicker). See also *id.* at 7 (testimony of Senator Lowell P. Weicker).

5. See *infra* note 7.

the Service to further political ends, about the potential for abuse of privacy, and even about the continued existence of the "voluntary assessment" system that is considered critical to the efficient administration of the tax law in this country.<sup>6</sup>

These concerns led Congress to enact section 6103 in 1976.<sup>7</sup> Although various subsections of section 6103 have been amended since its enactment, the basic scheme remains the same: subsection "a" of section 6103 prohibits all disclosures of "return information" except those "authorized by this title," subsection "b" provides relevant definitions, and the remaining subsections of section 6103 provide numerous specific exceptions to the general prohibition of subsection "a."<sup>8</sup>

At the same time that it enacted section 6103, Congress enacted two provisions as the enforcement mechanisms of that section, one criminal and one civil. The criminal arm, now codified at section 7213(a), provides that

6. Rep. Jerry Litton, one of the sponsors of legislation proposed to address this misuse of information, made this point in his statement to the House Subcommittee on Oversight during its hearings on the proposed legislation. Regarding the issue of potential abuse of privacy by disclosure of Internal Revenue Service information, he said:

The important point that we have to establish first is that the IRS is there for one purpose: To collect taxes to run the country, not to collect information on the lives of private citizens like some Gestapo agency to turn over to whoever may be in power in the Government. This, in my opinion is the sole purpose of the IRS and the objective of our bill.

. . . .  
 . . . The documented use of the Internal Revenue Service as an intelligence body to derive information harmful to enemies of the Nixon administration and helpful to its friends, flaunts the fundamental principles on which our Government was founded.

. . . .  
 The method in which taxpayers voluntarily comply with our tax laws and, in most cases, fully report their earnings is the envy of most other nations where dishonesty is often the rule rather than the exception. If taxpayers become convinced that the confidential data they each submit is being used for political purposes, how long will it be before taxpayer compliance and trust in our system of taxation is forever lost?

See Proposals, *supra* note 4, at 3, 6-7 (testimony of Hon. Jerry Litton). See also *id.* at 7 (testimony of Senator Lowell P. Weicker). Regarding the concern that misuse of Internal Revenue Service information would impair the voluntary assessment system, see Joint Committee Explanation at 314, 1976-3 C.B. (vol. 2) 326.

7. Tax Reform Act of 1976, Pub. L. 94-455, § 1202(a), 90 Stat. 1667. This legislation might also be viewed, as many viewed the Watergate scandal itself, as another episode in the continuing power struggle between the legislative and executive branches of the federal government. There was no overt reference to such a motive in the legislative history.

8. For purposes of this article, one of the most important exceptions is § 6103(k)(6), which authorizes disclosures in the course of tax administration, including assessment and collection activity. See *infra* note 61 and accompanying text.

the unauthorized disclosure of return information in violation of section 6103(a) is a felony, punishable by a fine of up to \$5,000 and/or up to five years in prison.<sup>9</sup>

*A. Section 7431: Civil Damages for Violation of Section 6103*

The first civil mechanism which Congress devised for the enforcement of section 6103 was codified in 1976 as section 7217, the predecessor of the present section 7431.<sup>10</sup> Section 7217 authorized an action for damages against any person who “knowingly or by reason of negligence” made a disclosure of return information unauthorized under section 6103.<sup>11</sup> The section authorized both actual and punitive damages, with a statutory minimum of \$1,000, plus costs.<sup>12</sup>

Except for a very brief reference to negligence in the General Explanation of the Tax Reform Act of 1976,<sup>13</sup> the legislative history indicates that Congress’s primary motive in enacting this legislation was to prevent the intentional use of information gathered by the Internal Revenue Service, pursuant to policy decisions made at the highest levels, for purposes other than proper tax administration. The inclusion of negligence in section 7217 indicates that Congress must have had another goal as well, since negligence has nothing to do with such an organized, policy-directed misuse of information. Rather, the authorization for a negligence-based claim was intended to protect taxpayers’ right to privacy from the unintentional or careless actions of an individual, not made in furtherance of a carefully formulated Service policy.

In addition to the numerous specific exceptions in section 6103 to the general rule of nondisclosure, section 7217(d) provided significant protection from liability in the form of a “good faith” defense, i.e., no liability would

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9. Section 7213(a) significantly increased the already-existing criminal penalties for disclosure of return information, making the crime a felony rather than a misdemeanor, increasing the maximum imprisonment from one year to five, and increasing the maximum fine from \$1,000 to \$5,000.

10. The former § 7217 was enacted by Pub. L. 94-455, § 1202(e) and repealed in 1982 by Pub. L. 97-248, § 357(b)(1).

11. Note that this is different from present law under § 7431, which authorizes claims against any person other than a federal officer or employee, in which case the claim must be brought against the government.

12. According to the General Explanation of the Tax Reform Act of 1976, “Congress also decided that, in order to redress any injury sustained and to aid in the enforcement of the confidentiality rules, a civil action for damages should be provided to any person injured by a willful or negligent disclosure in violation of the Act.” 1976-3 C.B. (vol. 2) 355-56.

13. *Id.*

arise because of a disclosure which results from a good faith, but erroneous, interpretation of section 6103.<sup>14</sup>

In 1982, Congress reexamined the civil enforcement mechanism provided by section 7217 and, redesignating it as section 7431, retained all but one of the substantive provisions.<sup>15</sup> The one (very significant) change made was to provide that, where an employee of the federal government makes an unauthorized disclosure, the cause of action lies against the government rather than against the individual.<sup>16</sup> Congress made this change because it believed that the United States could be expected to exercise control over its own employees, so that the action should more appropriately lie against the United States.<sup>17</sup>

To maintain a cause of action against the United States under section 7431(a),<sup>18</sup> a taxpayer must show that:

1. There has been a release of a return or of return information;
2. The return or information was that of the taxpayer bringing the suit;
3. The person making this disclosure was an officer or employee of the United States;
4. This release constitutes a "disclosure";
5. The disclosure was made knowingly or by reason of negligence; and
6. The disclosure was in violation of some provision of section 6103.

Even if the taxpayer can show all six of these elements, the government can still avoid liability by showing that the disclosure resulted from a good faith, but erroneous, interpretation of section 6103.<sup>19</sup> As a

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14. Pub. L. 94-455, § 1202(e), codified at § 7217(b), redesignated § 7217(c) by Pub. L. 95-6000, § 701(bb)(7)(A), repealed by Pub. L. 97-248, § 357(b)(1).

15. Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. 97-248, § 357.

16. All persons other than federal officers or employees remained subject to personal liability. *Id.*

17. General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982, at 434.

18. Section 7431(a)(1) provides:

Disclosure by Employee of United States. If any officer or employee of the United States knowingly, or by reason of negligence, discloses any return or return information with respect to a taxpayer in violation of any provision of section 6103, such taxpayer may bring a civil action for damages against the United States in a district court of the United States.

19. Section 7431(b) provides that "[n]o liability shall arise under this section with respect to any disclosure which results from a good faith, but erroneous, interpretation of

waiver of sovereignty, section 7431 must be strictly construed in favor of the government.<sup>20</sup> The question of waiver is a jurisdictional one.<sup>21</sup>

1. *There Must Have Been a Release of a Return or of Return Information.*—Section 7431(e) adopts the definitions of “return” and “return information” provided in section 6103(b). Under that section, a “return” is defined to include any tax or information return, declaration of estimated tax, or claim for refund, together with any amendment, supplement and attachment;<sup>22</sup> “return information” includes virtually any information that might be contained in the Internal Revenue Service’s files, including the taxpayer’s identity and financial information, and any information concerning tax determination or collection.<sup>23</sup> Given the very broad definitions of these terms, plaintiffs have generally had no difficulty proving this element. There are, however, some significant issues lurking here.

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section 6103.”

20. *Haywood v. United States*, 642 F. Supp. 188, 191 (D. Kan. 1986) (citing *Ruckelshaus v. Sierra Club*, 463 U.S. 680, 685 (1983)).

21. *Id.*

22. Section 6103(b)(1) defines “return” 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, and any amendment or supplement thereto, including supporting schedules, attachments, or lists which are supplemental to, or part of, the return so filed.

23. Section 6103(b)(2) defines “return information” as:

(A) 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, and

(B) any part of any written determination or any background file document relating to such written determination . . . which is not open to public inspection under section 6110.

The flush language of § 6103(b) specifically excludes from this definition “data in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer.”

a. *The “Immediate Source” Rule.*—In *Thomas v. United States*,<sup>24</sup> the Service had followed its long-standing policy of issuing a press release to publicize a judicial victory over a taxpayer. The press release, which was issued after the Tax Court’s opinion, contained information that fell within the definition of “return information” in section 6103(b); all of this information was also contained in the Tax Court’s opinion. The taxpayer brought suit under section 7431, claiming that the press release constituted an unauthorized release of return information under section 6103.

First, the court noted a conflict between the circuits regarding whether the release of return information previously included in the public record constituted the unauthorized “disclosure” of that information.<sup>25</sup> The court then ruled that it did not have to enter the fray, because it did not reach that issue. The court found the press release was not a publication of the taxpayer’s return information, but rather a publication of the Tax Court opinion:

[T]he definition of return information comes into play only when the immediate source of the information is a return, or some internal document based on a return, as these terms are defined in section 6103(b)(2), and not when the immediate source is a public document lawfully prepared by an agency that is separate from the Internal Revenue Service and has lawful access to tax returns. The Tax Court is such an agency.<sup>26</sup>

On the initial reading of the opinion, this “immediate source” rule appears to be a simple and satisfactory method of avoiding the controversial “disclosure” issue. Further analysis, however, shows that this approach is not as simple as it first appears and that it raises other, rather thorny, issues.

The immediate source rule allows the government to rebut the “return or return information” requirement by showing four elements: first, that an agency separate from the Internal Revenue Service lawfully obtained the taxpayer’s return or return information; second, that this separate agency made an authorized disclosure of the information; third, that the disclosure was made in a public document; and, fourth, that the Service’s subsequent disclosure was based on the information contained in the separate agency’s disclosure.<sup>27</sup>

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24. 890 F.2d 18, 19 (7th Cir. 1989).

25. See *infra* part II.A.3.

26. *Thomas*, 890 F.2d at 20-21.

27. See *id.* at 21.



The first objection to the “immediate source” rule is that there is no support for it in either the statutory language or legislative history. On the contrary, the definition of “return information” given in section 6103(b) is very broad and straightforward, and contains no suggestion that information otherwise falling within its terms might be redefined by virtue of the context in which it is disclosed.

Statutory construction aside, application of the Seventh Circuit’s “immediate source” rule to common fact patterns requires some interesting and troubling conclusions, which can best be illustrated by a series of hypothetical situations. For example, assume that Taxpayer’s identity and amount of income reported, and deductions claimed (information within the definition of “return information”) were included in a pleading filed by counsel for the Service<sup>28</sup> in a Tax Court proceeding,<sup>29</sup> and that the Service subsequently issued a press release based on the pleadings, reciting the return information. Under the “immediate source” rule, Taxpayer will be able to satisfy the “return or return information” element of liability under section 7431 because the underlying disclosure (the pleading) was prepared by the Service, not by an agency separate from it.

Suppose, instead, that the pleading, containing the identical return information, was filed in federal district court, where the Internal Revenue Service was represented by attorneys from the Justice Department. Here, under the “immediate source” rule, Taxpayer will *not* be able to satisfy the “return or return information” requirement, and therefore cannot establish liability under section 7431, because the underlying disclosure was made by an agency separate from the Internal Revenue Service.<sup>30</sup>

The “immediate source” rule, by focusing inquiry on the immediate source of the information rather than on the nature of the information itself, creates a situation where the very same information from ultimately the same source can co-exist in both protected and unprotected forms. Suppose that, in the *Thomas* case itself, the plaintiff had (somehow) been able to prove that the Internal Revenue Service had taken the information contained in its press release from the pleading of the Service’s counsel, rather than from the Tax

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28. In the Tax Court, the Internal Revenue Service is represented by attorneys from within the Service, not attorneys from the Justice Department. See IRC § 7452.

29. This is an authorized disclosure under § 6103(h)(4). See *infra* part II.A.3.

30. See *Thomas*, 890 F.2d at 21. Perhaps a question might be raised as to whether the Justice Department in this hypothetical is “separate” from the Internal Revenue Service within the meaning of the *Thomas* opinion, which does not define this term. Regardless of the answer to this question, the analysis of the “immediate source” rule is still valid, since the same conclusion would be reached if the underlying disclosure was made by a state attorney general in a state tax case; the state attorney general is certainly “separate” from the Internal Revenue Service.

Court's opinion. In the language of the *Thomas* holding, the "immediate source" of the information is now the underlying pleading, and the information is therefore still protected "return information" even though it has already been disclosed in a Tax Court opinion and even though a press release based on that judicial opinion would not be actionable.

Viewed in light of the damage potentially caused by the Service's disclosure, the factual distinctions in these hypothetical situations do not justify the difference in the results. The identical information has been publicly released in the Service's press release, regardless of whether the underlying pleading was filed by the Service's counsel or by the Justice Department and regardless of whether the Service copied the facts from the pleading or from the Tax Court opinion. The potential injury to the taxpayer is the same in each case.<sup>31</sup>

b. *Erroneous Information.*—Another potential issue under the "return or return information" requirement of section 7431 is whether erroneous information comes within the definition of protected "return information."<sup>32</sup> Section 6103 defines "return information" as, in essence, any information concerning the taxpayer's financial or tax situation, including amount of income, which was "received by, recorded by, prepared by, furnished to, or collected by" the Internal Revenue Service for tax administration purposes. There is no express requirement that, to qualify as "return

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31. The "immediate source" rule becomes much more rational (and interesting) if § 7431 is interpreted as granting taxpayers a privilege in the information which the Service has assembled concerning them, similar to the attorney-client privilege. This is a variation of the "loss of confidentiality" defense that the government has raised, which is discussed *infra* note 38 and part II.A.3. If this interpretation is in fact the theoretical underpinning of the "immediate source" rule, the *Thomas* opinion certainly contains nothing to make this clear, and it has not been picked up by any other courts.

32. A disclosure of erroneous information by the Service can arise in one of three ways: first, if the source of the information, whether it is the taxpayer or someone else, provides erroneous information to the Service; second, if correct information is supplied to the Service, but is recorded incorrectly in the Service files and the disclosure is based on the erroneous information as it appears in the file; or, third, if the information is correctly supplied and recorded, but the person making the disclosure incorrectly relates the information contained in the files. Although some secondary issues may differ depending on the precise manner in which the situation arose, all three are similar enough in nature that the following discussion, which focuses on the third possibility, applies equally to the other two.

The author has found no reported decision expressly addressing the issue under discussion. For examples of cases involving this situation but not directly addressing it, see *Mallas v. Kolak*, 721 F. Supp. 748 (M.D.N.C. 1989) (holding that disclosure of incomplete, outdated information is actionable), *aff'd*, 993 F.2d 1111 (4th Cir. 1993); *Haywood v. United States*, 642 F. Supp. 188 (D. Kan. 1986) (holding that procedurally proper disclosure of erroneous information is not actionable).

information,” the information be correct as supplied to or recorded by the Service. A strict reading of the statute thus supports the conclusion that erroneous information is included in “return information;” a looser reading of the statute will support the contrary conclusion. Support for both positions can be found in the congressional purposes underlying the legislation, depending on which of the two underlying purposes is emphasized.

For example, assume that a taxpayer has correctly reported income of \$1,000 for a particular taxable year. Also assume that the Service makes an unauthorized disclosure regarding the taxpayer for political reasons, but erroneously states that he had income of \$500. A court could look at this situation and find that the Service made an unauthorized disclosure of the taxpayer’s “amount of income” and, strictly construing the statutory language, rule that such a disclosure falls within the definition of return information, regardless of whether the specific amount disclosed is accurate. Such a ruling would be consistent with the congressional purpose of preventing misuse of Service information for political reasons. The accuracy of the information wrongfully disclosed is irrelevant to this policy.

Another court, however, could look at the same situation, and focus on the specific information disclosed, i.e., that the taxpayer’s amount of income was \$500. Since this was not in fact the amount of the taxpayer’s income, it cannot be considered information regarding the taxpayer. Since the information does not concern the taxpayer, it cannot be defined as his “return information,” and there has therefore been no disclosure of return information and no violation of sections 6103 and 7431. This approach is supported by an emphasis on the other congressional purpose, to prevent the negligent or intentional invasion of taxpayers’ right to privacy, since a taxpayer cannot have a reasonable expectation of privacy in information that by definition does not actually concern him.

The spirit of the legislation, based on promoting taxpayer rights and preserving the institutional integrity of the Internal Revenue Service, supports the imposition of liability for the disclosure of erroneous information. Even if the information being disseminated by the Service is erroneous, it is nonetheless being represented as information pertaining to the taxpayer. Such a disclosure is no less damaging to the taxpayer’s business and reputation merely because the information is false. On the contrary, the very fact that it is erroneous suggests that it may be even more damaging. Likewise, the intentional disclosure of erroneous information for political purposes is at least as far outside the legitimate function of the Service as is the disclosure of correct information for political purposes.

2. *The Information Must Have Been Return Information of the Taxpayer Bringing the Suit.*—In *Haywood v. United States*,<sup>33</sup> the plaintiff's husband had died with an unpaid tax liability incurred in years when he filed separately; the plaintiff was not jointly liable. Even after it was advised of the facts, the Internal Revenue Service sent a notice of levy to the plaintiff's employer, levying her salary. This notice correctly stated the existence and amount of the tax liability but incorrectly stated that the plaintiff was jointly liable with her late husband's estate. The only correct "return information" of the plaintiff's that was disclosed by the levy was her name and social security number.

In dismissing the plaintiff's section 7431 cause of action, the court reasoned that two types of information were released by the notice of levy. The first was the plaintiff's correct name and social security number. Regarding this information, the court simply found that there was not an improper "disclosure," since the information was already known to the employer.<sup>34</sup>

The second type of information was that regarding the plaintiff's late husband's deficiency, incorrectly attributed to her. The court characterized this situation as one where the government had mistakenly levied on a third party's property, and held that sections 6103 and 7431 were neither intended nor designed to address that situation, concluding that the plaintiff's sole remedy lay under section 7426, which authorizes an action for recovery by third parties of property wrongfully levied.

The *Haywood* court correctly determined the rather limited scope of sections 6103 and 7431. The purpose of these statutes is to prevent the misuse of the Service's formidable information-gathering powers by prohibiting the use of its information for political or other reasons not related to proper tax administration. In furtherance of that goal, section 7431 was fashioned to address one specific situation, creating a cause of action for the improper use of information regarding the complaining taxpayer. It was not designed to apply to situations such as the one presented in *Haywood*, which are more properly the province of section 7433<sup>35</sup> or section 7426.<sup>36</sup>

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33. 642 F. Supp. 188, 192 (D. Kan. 1986).

34. *Id.* The reasoning of the court was similar to that used by the courts adopting the government's "loss of confidentiality" argument regarding disclosure of information contained in public records. See discussion *infra* part II.A.3.

35. See *infra* part III. Note that § 7433 was enacted after *Haywood* and therefore was not discussed in the opinion.

36. It should be noted that the situation presented in *Haywood* is different from that discussed *supra* part II.A.1.b. (regarding the unauthorized disclosure of erroneous information). In *Haywood*, the Service erroneously attributed one taxpayer's information to another taxpayer and then commenced otherwise proper collection procedures based on that attribution, including a disclosure that would have been authorized had the attribution been correct. The

To constitute protected return information of the taxpayer, however, it is not necessary that the information be obtained or prepared specifically in regard to the plaintiff's tax liability. In *Mallas v. United States*,<sup>37</sup> the Fourth Circuit imposed liability for the release of information that fell within the section 6103(b) definition of "return information," which had been prepared in connection with the determination of the tax liabilities of third-parties, who were investors in plaintiff's project.

3. *The Release Must Have Been a "Disclosure."*—Section 6103(b)(8) defines "disclosure" as "the making known to any person in any manner whatever a return or return information." This statutory element has become an issue in cases where return information was released in a manner not authorized under section 6103(a), but where the information either was already known to the person to whom it was released or had previously been introduced into the public record by way of pleadings or evidence in some judicial proceeding.

In determining whether there has been an unauthorized "disclosure," the courts have developed two, mutually exclusive approaches,<sup>38</sup> the method

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issue here is whether the incorrect attribution somehow taints the subsequent disclosure, subjecting the Service to liability under § 7431; the conclusion correctly reached in *Haywood* is that it does not.

The discussion in part II.A.1.b., however, concerns the Service's disclosure of erroneous information, where the disclosure would be unauthorized even if the information had been correct. The issue here is whether information that the Service identifies as a taxpayer's return information comes within the definition of "return information" and thus within the protection of §§ 6103 and 7431 even though it is erroneous and therefore not, in fact, information contained in the taxpayer's return.

Hybrid situations can be similarly analyzed. Assume, for example, that the Service makes a disclosure of what it identifies as Taxpayer's return information but which is in fact information from Third Party's tax return. If the disclosure is otherwise authorized, it should be treated as *Haywood*-type disclosure, properly the subject of actions under §§ 7426 or 7433, but not § 7431. If, on the other hand, the disclosure would be unauthorized even if the Service had used Taxpayer's correct return information, it should be treated as any other unauthorized disclosure of erroneous information. The source of the erroneous information is irrelevant to a determination of the Service's liability.

37. 993 F.2d 1111, 1114 (4th Cir. 1993).

38. See, e.g., *Lampert v. United States*, 854 F.2d 335, 337-38 (9th Cir. 1988) (comparing *Lampert* court's approach with that taken by the Tenth Circuit in *Rodgers v. Hyatt*, 697 F.2d 899 (10th Cir. 1983)), cert. denied, 490 U.S. 1034 (1989). The court in *Thomas v. United States*, 890 F.2d 18 (7th Cir. 1989), may implicitly have been propounding a third approach, based on a taxpayer privilege existing in the return information, and similar to the "loss of confidentiality" argument discussed below. That opinion, through its "immediate source" rule, seems to maintain the protection of § 6103 and § 7431 on any document prepared internally by the Service, regardless of whether the information contained therein has been otherwise publicized. Once the information has been legally disclosed by an agency

of analysis chosen invariably determines the outcome.<sup>39</sup> The courts that side with the government on this issue look beyond the statutory language to the congressional purpose underlying sections 6103 and 7431, which they define as the protection of the taxpayers' right to privacy. These courts, led by the Ninth Circuit in *Lampert v. United States*,<sup>40</sup> have unanimously held that the condition precedent to the protection afforded by sections 6103 and 7431 is the confidentiality of the information, reasoning that if the information is already in the public record or is already actually known to the individual receiving the information from the government, the information has lost its confidentiality, and the taxpayer can have no reasonable expectation of privacy and therefore no remedy under section 7431.

The second group of courts, led by the Tenth Circuit in *Rodgers v. Hyatt*,<sup>41</sup> frames the issue as one of simple but strict statutory analysis. These courts hold that the questions of "confidentiality" and "right to privacy" are irrelevant to a determination of liability under section 7431, and that the only question is whether the disclosure was authorized. As one court said: "In light of that explicit statutory and legislative history, this Court concludes that it cannot judicially carve any additional exceptions to section 6103's general ban against disclosures."<sup>42</sup>

The government's "loss of confidentiality" argument, adopted by *Lampert*, is flawed for at least three reasons. First, the "loss of confidentiality" argument, as expressed in *Lampert* and later cases, is based on the premise that the sole public policy underlying the legislation is protection of

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separate from the Internal Revenue Service (e.g., in a Tax Court opinion), the Service is allowed to publicize information taken from *that* source, even though the identical facts in its own files remain "privileged" information.

39. Perhaps because this statute is relatively new, this issue has arisen in only a few cases. Although the two positions are well-defined, they have not yet established themselves as the clear "minority" or "majority" view, contrary to the government's identification of the more restrictive definition of "disclosure" (the pro-government definition) as being the majority view. *Rubel v. United States*, 89-1 U.S. Tax Cas. (CCH) ¶ 9149, 62 A.F.T.R.2d (P-H) 88-5468 (W.D.N.C. 1988).

40. 854 F.2d 335 (9th Cir. 1988), cert. denied, 490 U.S. 1034 (1989). See also *Haywood v. United States*, 642 F. Supp. 188 (D. Kan. 1986) (finding that notice of levy wrongfully included taxpayer's name and social security number but information was already known to the recipient).

41. 697 F.2d 899 (10th Cir. 1983). *Rodgers* was decided under § 7217. Since the relevant language in § 7217 regarding the definition of "disclosure" is identical to that in § 7431, its holding is equally applicable to the later statute, and is routinely so cited. See also *Chandler v. United States*, 687 F. Supp. 1515 (D. Utah 1988), aff'd, 887 F.2d 1397 (10th Cir. 1989); *Husby v. United States*, 672 F. Supp. 442 (N.D. Cal. 1987); *Malis v. United States*, 87-1 U.S. Tax Cas. (CCH) ¶ 9212, 59 A.F.T.R.2d (P-H) 87-988 (C.D. Cal. 1986).

42. *Chandler*, 687 F. Supp. at 1519 (quoting with approval *Johnson v. Sawyer*, 640 F. Supp. 1126, 1133 (S.D. Tex. 1986), aff'd, 980 F.2d 1490 (5th Cir. 1992)).

the taxpayers' right to privacy. If the government can show that the specific information involved in that case is somehow no longer "confidential," so the argument goes, then the taxpayer had no reasonable expectation of privacy and is therefore entitled to no remedy under section 7431.

A review of the legislative history shows that this premise is wrong. Although protection of the right to privacy in individual cases was one of the congressional purposes, Congress was also motivated by a much broader, "institutional" concern: that the Internal Revenue Service was, as a matter of policy, being used as an intelligence gathering and disseminating agency by the executive branch.<sup>43</sup> Sections 6103 and 7431 were intended to bring immediate and very tight controls to the practice of releasing return information for purposes unrelated to proper tax administration. Congress sought to achieve this goal by prohibiting the release of *any* return information for any purpose not expressly authorized by section 6103 or some other section of the Code. This second congressional purpose is not satisfied by a showing that the information was not within the taxpayer's reasonable expectation of privacy.

Second, the defense is mooted by the plain statutory language. As the courts in *Rodgers* and its progeny have stated, there is no requirement in the statute that the return information be "confidential," whatever that may mean, before it falls within the protection of sections 6103 and 7431.<sup>44</sup> Further, even if "confidentiality" were a prerequisite for protection under sections 6103 and 7431, that status is clearly provided by the opening sentence of section 6103(a), which flatly provides that all "[r]eturns and return information *shall be* confidential." (Emphasis added.) There is no provision in sections 6103 or 7431 or elsewhere for the loss of that status.

Finally, laying aside for the moment these flaws in the theory of the "loss of confidentiality" defense, the courts have improperly applied it as a question of law, rather than the question of fact that it is. As it has been presented and adopted, the defense assumes that information available in a "public record" is, by virtue of that fact alone, completely outside of the taxpayer's right of privacy. The Fourth Circuit rejected that assumption in *Mallas v. United States*,<sup>45</sup> holding that there is no exception to section 6103(a)'s disclosure prohibition that would permit the disclosure of return information simply because it was available to the public through a public record. The court describes as a "fiction" the notion that any information

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43. See *supra* note 6 and accompanying text.

44. *Rodgers*, 697 F.2d at 906.

45. 993 F.2d 1111, 1121 (4th Cir. 1993).

contained in a public document is thereby known to the whole world, so that further disclosure can do no additional harm.<sup>46</sup>

The Fourth Circuit in *Mallas* was correct. Even accepting the interpretation of the statutes adopted by the Ninth Circuit in *Lampert*, focusing solely upon the taxpayer's reasonable expectation of privacy, these statutes do not create the black and white dichotomy that the *Lampert* court apparently envisioned, and cannot be applied easily to any situation other than the extremes. When the return information has been included in a judicial opinion, as in the *Thomas* case discussed above,<sup>47</sup> it is surely beyond argument that the taxpayer no longer has a reasonable expectation of privacy in that specific information. The converse is equally clear: a taxpayer most certainly does have a reasonable expectation of privacy in return information contained only in Internal Revenue Service files.

In the vast middle ground, however, the conclusions are much more difficult to draw. In the majority of cases addressing the issue,<sup>48</sup> the return information has been included in court pleadings but not in a published opinion. Unless the court file has been sealed by the court, such documents are public records, legally accessible by the media and the general public. In reality, however, this access is unexercised in all but the highest profile cases. Although the information may technically fall outside of whatever definition of "confidential" the government may argue, it is still within the taxpayer's reasonable expectation of privacy. If the "loss of confidentiality" defense is to be recognized at all, it must be applied on a case-by-case basis, with the outcome turning on a resolution of a question of fact: whether the taxpayer had a reasonable expectation of privacy under the specific circumstances presented in that case.

The application of this defense also raises a more basic policy concern. The government has asserted this defense even where it was the only party that played any role in either placing the information in the public record or subsequently disclosing it:<sup>49</sup> the government assessed the tax that led to the dispute, the government filed the criminal information containing the information, and then the government publicized it. It takes no great effort to imagine the potential for abuse in this situation, where the government could make an end run around the intended protection of sections 6103 and 7431.

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46. *Id.* at 1120 (quoting with approval *Thomas v. United States*, 890 F.2d 18, 21 (7th Cir. 1989)).

47. See *supra* part II.A.1.a.

48. See cases cited *supra* notes 40-41.

49. This was the situation in *Lampert*, as discussed in the trial court's opinion, *Figur v. United States*, 662 F. Supp. 515 (N.D. Cal. 1987), *aff'd sub nom. Lampert v. United States*, 854 F.2d 335 (9th Cir. 1988), *cert. denied*, 490 U.S. 1034 (1989).



The converse situation, where the taxpayer himself places the information in the public record, does not present any more palatable a context for the "loss of confidentiality" argument. In this situation, the government is arguing that, by filing a Tax Court petition or a claim for refund and pleading the facts necessary to state a cause of action, the taxpayer is waiving the confidentiality of any return information included in the pleading and thus waiving the protection of sections 6103 and 7431. In effect, the government is putting the taxpayer to an election: he can choose either to file in court or to maintain the statutory protection of his return information. As the court in *Husby v. United States* said, "Congress could not have intended such an absurd result."<sup>50</sup>

Although the court in *Malis v. United States*<sup>51</sup> agreed with the courts in *Rodgers* and *Husby*, and extended the statutory protection to the situation where the taxpayer himself had made the information part of the public record, it also correctly noted that the taxpayer's own prior disclosure of the information could have a very important effect on his potential recovery under section 7431: even though the prior release of the information would not preclude a finding of liability, it could negate the proximate cause nexus between the unauthorized governmental disclosure and plaintiff's alleged damages.<sup>52</sup>

4. *The Release Must Have Been Made by an Officer or Employee of the United States.*—As with the "return information" requirement, this element has not yet been the source of much controversy. Two points should

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50. 672 F. Supp. 442, 444 (N.D. Cal. 1987). In *Husby*, the Service was apparently arguing that the inclusion of any return information in the Tax Court petition constituted the waiver of all return information relevant to that case. *Id.* See also *Chandler v. United States*, 687 F. Supp. 1515 (D. Utah 1988) (Service arguing waiver of confidentiality upon filing of injunctive suit), *aff'd*, 887 F.2d 1397 (10th Cir. 1989).

51. 87-1 U.S. Tax Cas. (CCH) ¶ 9212, 59 A.F.T.R.2d (P-H) 87-988 (C.D. Cal. 1986).

52. 87-1 U.S. Tax Cas. (CCH) at 87,351, 59 A.F.T.R.2d (P-H) at 87-992. Even in the total absence of proximate cause between the subsequent disclosure and the asserted damages, a plaintiff is still entitled to a recovery of at least the minimum statutory damages of \$1,000 and his costs. IRC § 7431(c). The courts have split on the question of whether a plaintiff who is not entitled to actual damages is nonetheless entitled to punitive damages. Cases holding against plaintiffs on this issue include *Smith v. United States*, 730 F. Supp. 948 (C.D. Ill. 1990), *aff'd*, 964 F.2d 630 (7th Cir. 1992), *cert. denied*, 113 S. Ct. 1015 (1993); *William E. Schrambling Accountancy Corp. v. United States*, 689 F. Supp. 1001 (N.D. Cal. 1988), *rev'd on other grounds*, 937 F.2d 1485 (9th Cir. 1991). Cases holding in favor of plaintiffs include *Mallas v. United States*, 993 F.2d 1111 (4th Cir. 1993); *Malis v. United States*, 87-1 U.S. Tax Cas. (CCH) ¶ 9212, 59 A.F.T.R.2d (P-H) 87-988 (C.D. Cal. 1986) (citing *Mid-South Music Corp. v. United States*, 85-2 U.S. Tax Cas. (CCH) ¶ 9782, 56 A.F.T.R.2d (P-H) 85-6250 (M.D. Tenn. 1985)).

be noted, however. First, the statute subjects the government to potential liability for the disclosures by *any* employee, not just those working for the Internal Revenue Service.<sup>53</sup> Second, the statute does not require that the person be acting in his capacity as a federal employee (i.e., within the course and scope of his employment) at the time the disclosure is made.<sup>54</sup>

At first glance, this element might appear to be a non-issue, since a taxpayer failing to prove that the person making the disclosure was an officer or employee of the United States for purposes of section 7431(a)(1) would simply proceed under section 7431(a)(2), which authorizes an identical action for damages against any person not an officer or employee of the United States.<sup>55</sup> This could, however, be a critical issue to both the taxpayer and the government. From the government's perspective, the materiality of the issue is obvious: if the person making the disclosure was not its officer or employee, the government is not liable. This is also an important issue from the taxpayer's standpoint, since the infinitely deep pocket of Uncle Sam would be replaced by the much shallower pocket of the individual.<sup>56</sup>

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53. The actions of judges, as government officers or employees, can just as easily subject the government to liability under § 7431 as can the actions of Internal Revenue Service agents. A release of return information in a court opinion is permitted under § 6103(h)(4), which authorizes disclosure "in a Federal or State judicial or administrative proceeding pertaining to tax administration" where, among other limitations, the taxpayer is a party. If a judge were to release such information under other circumstances, however, such as in an extrajudicial setting or in another action to which the taxpayer was not a party, he would subject the government to liability under § 7431.

54. The specific provision, contained in the flush language of § 6103(a), is somewhat muddled: "[N]o officer or employee of the United States . . . shall disclose any return or return information obtained by him in any manner in connection with his service as such an officer or any employee or otherwise or under the provisions of this section."

It is not clear whether the phrases "in any manner" and "in connection with his service" modify "disclose" or "obtained." When read together with the phrase "or under the provisions of this section," the most logical interpretation is that they modify "obtained," so that the subsection prohibits any disclosure of information (regardless of whether the disclosure is related to the employment), whether that information was obtained in connection with his service, or obtained under the provisions of § 6103, or otherwise obtained.

This question is rendered moot, however, by the phrase "or otherwise." Even if "in any manner in connection with his service" modifies "disclose," the immediately following phrase "or otherwise" would extend the prohibition to all other disclosures.

55. Such a situation would arise, for example, where an unauthorized disclosure of return information is made by a state tax official who was provided with return information by the Service under the provisions of § 6103(d).

56. A summary judgment ruling dismissing the government might also complicate the taxpayer's pre-trial discovery, since the extensive discovery powers over parties to the litigation would no longer apply to the government, the source of much of the relevant information.

5. *The Person Making the Disclosure Must Have Acted "Knowingly or by Reason of Negligence."*—Section 7431 provides for liability where "any officer or employee of the United States knowingly, or by reason of negligence, discloses any return or return information."<sup>57</sup> This language goes far beyond establishing the standard by which liability is to be determined. It also sharply limits the government's potential liability by restricting the cause of action to claims based on the intent or negligence of only the specific person making the disclosure. Neither the legislative history nor the reported cases directly address this issue. It is clear from the reported opinions, however, that this interpretation of the statute is the accepted standard.<sup>58</sup> For example, in *Flippo v. United States*,<sup>59</sup> a mistake or delay by the Internal Revenue Service in updating its files led an agent to issue a notice of lien based on old information that erroneously indicated that the plaintiff had not paid a deficiency assessed against him. In ruling that there was no showing of negligence or intentional misdeeds, the court discussed only the actions of the agent making the disclosures and not those of the employees who failed to timely update the files or, at a higher level, to institute the proper procedures to ensure timely updating.

The "knowingly or by reason of negligence" language is a hold-over from section 7217, the predecessor to section 7431, under which only the individual officer or employee making the disclosure was potentially liable for damages. In the context of that prior statutory scheme, the limitation makes sense: absent some sort of vicarious liability not relevant here, an individual cannot be held liable for someone else's intentional or negligent wrongdoing. This limitation is, however, neither necessary to the current statutory approach nor conducive to achieving the congressional purposes.

As discussed above, the congressional purposes underlying sections 6103 and 7431 were to prevent the intentional, policy-based disclosure of return information for reasons other than tax administration and to prevent the violation of citizens' right to privacy by the intentional or negligent disclosure of return information. If the government is not liable for the negligent or intentional actions of any person involved in an erroneous disclosure except the final actor, the Service can, by design or neglect, maintain an outmoded, inefficient, or chronically unreliable system or procedure that may with great frequency result in inappropriate disclosures of return information. As long as the last employee in the chain relies on the information provided to him

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57. IRC § 7431(a).

58. But cf. *Johnson v. Sawyer*, 640 F. Supp. 1126 (S.D. Tex. 1986), aff'd in part and modified in part, 980 F.2d 1490 (5th Cir. 1992) (reserving ruling on question of whether only government employee directly involved in press release could be held liable under § 7217).

59. 670 F. Supp. 638 (W.D.N.C. 1987), aff'd, 849 F.2d 604 (4th Cir. 1988).

by this system or procedure, the government is not liable. In effect, it is shielded by its own incompetence. Such a result frustrates both of the congressional purposes, but especially the concern for taxpayers' right to privacy.<sup>60</sup>

To close this large gap in taxpayer protection, Congress should amend the language of section 7431 to provide expressly for liability whenever negligent or intentional actions on the part of any governmental officer or employee, whether alone or in concert, result in an unauthorized disclosure of information.

The cost, in terms of required modernization, monitoring of employees, and liability, however, may be more than Congress is willing to pay to protect the rights of individual taxpayers. There is no legislation currently pending to amend this facet of section 7431.

6. *The Release Must Have Been in Violation of Section 6103.*—Generally speaking, to further the congressional goal of preventing the misuse of information gathered by the Internal Revenue Service, section 6103 provides a blanket prohibition on the disclosure of such information "except as authorized by this title." The succeeding subsections of section 6103, which provide exceptions to the general rule of nondisclosure, are drafted to permit only the minimum disclosure necessary to achieve specific purposes. Section 6103(k)(6), for example, authorizes disclosure of return information by agents in connection with audits, collections, and civil or criminal tax investigations.<sup>61</sup> The statute allows such disclosure, however,

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60. This is not to say that actionable negligence occurs any time a disclosure is prompted by incorrect information from Service personnel or computers. If the incorrect information is the result of an isolated problem and the Service takes reasonable actions both to correct any harm to that specific taxpayer and to ensure that the underlying problem does not recur, then the Service has not acted knowingly or negligently. Any more stringent standard would be unreasonable. See *Christensen v. United States*, 733 F. Supp. 844, (D.N.J. 1990), *aff'd*, 925 F.2d 416 (3d Cir. 1991). If, however, the underlying cause of the erroneous information is a recurrent problem, of which the Service is aware but which it has made no attempt to correct, then it would be reasonable to impose liability.

61. Section 6103(k)(6) provides that:

An internal revenue officer or employee may, in connection with his official duties relating to any audit, collection activity, or civil or criminal tax investigation or any other offense under the internal revenue laws, disclose return information to the extent that such disclosure is necessary in obtaining information, which is not otherwise reasonably available, with respect to the correct determination of tax, liability for tax, or the amount to be collected or with respect to the enforcement of any other provision of this title. Such disclosures shall be made only in such situations and under such conditions as the Secretary may prescribe by regulation.

only “to the extent that such disclosure is necessary” to achieve the defined purposes; each of the other authorization provisions is similarly limited. Disclosures in excess of the specific authorization are actionable.<sup>62</sup>

A difficult question is presented where the assessment underlying the collection is erroneous: Is an otherwise authorized disclosure made in connection with the procedurally-proper effort to collect an erroneous assessment still “authorized” under section 6103(k)(6)? This question highlights a gap in the statutory scheme to provide damages for improper activities by the Internal Revenue Service.<sup>63</sup>

In *Flippo v. United States*,<sup>64</sup> an agent mistakenly thought that the plaintiff had not paid an assessed deficiency, and disclosed return information in the course of his efforts to collect that deficiency. The court held that this disclosure was not actionable under section 7431 because of what the court interpreted as congressional intent that section 7431 should not interfere with the collection of taxes. The court held that section 7431 simply does not apply to any action taken in the process of tax collection, even where the collection effort is mistaken.

In *Husby v. United States*<sup>65</sup> and *Rorex v. Traynor*,<sup>66</sup> however, the courts reached the contrary conclusion, holding that such a disclosure is not authorized under section 6103(k)(6) and is therefore actionable under section 7431. The court in *Husby* ruled that section 6103(k)(6) authorizes the disclosure of information only to the extent that it is necessary to the collection of *valid* tax deficiencies, stating: “The plain language of this subsection authorizes only disclosures which are necessary in obtaining information related to official duties. The disclosures at issue clearly were not

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Although the language of this section is somewhat murky, and might be interpreted to authorize disclosures only during the investigative phase, any doubt as to the broader scope of this authorization is resolved by reference to §§ 6323 and 6331, which are incorporated into § 6103(a) by the phrase “as authorized by this title.”

62. E.g., *Heller v. Plave*, 657 F. Supp. 95 (S.D. Fla. 1987) (decided under § 7217, in which the court also noted that Regs. § 301.6103(k)(6)-1(a) provides similar restrictions on disclosures). On a side issue relevant to this point, the court in *Timmerman v. Swenson*, 79-2 U.S. Tax Cas. (CCH) ¶ 9588, 44 A.F.T.R.2d (P-H) 79-5727 (D. Minn. 1979), citing § 6103(k)(6) and Regs. § 404.6103(k)(6)-1(b) (now § 301.6103(k)(6)-1(b)), held that where the taxpayer had disappeared with outstanding tax deficiencies, the Service was authorized to send levies to any financial institution in the area, hoping to locate property belonging to the taxpayer. The fact that some of the levies were sent to banks not holding the taxpayer's property did not render the levies improper so as to form the basis for § 7217 liability.

63. See *infra* text accompanying notes 106-18 for a discussion of liability under § 7433 for collection activities undertaken pursuant to an erroneous assessment.

64. 670 F. Supp. 638 (W.D.N.C. 1987), *aff'd*, 849 F.2d 604 (4th Cir. 1988).

65. 672 F. Supp. 442 (N.D. Cal. 1987), *aff'd sub nom. United States v. Lisle*, 1993 U.S. App. LEXIS 20987 (9th Cir. 1993).

66. 771 F.2d 383 (8th Cir. 1985) (decided under § 7217).

necessary to official duties because the underlying assessment was improper.”<sup>67</sup>

Although the *Husby* court expressly based its ruling on the “plain language” of the statute, it in fact went beyond the statutory language, reading into the statute an implicit requirement that the underlying assessment be valid.

In *Rorex*, revenue agent Traynor served a notice of levy on plaintiffs’ bank, despite the fact that plaintiffs had timely made all payments due under an installment settlement agreement with the Service. In his defense to plaintiffs’ claims under section 7217, the predecessor to section 7431, Traynor argued that his disclosure of return information was authorized by section 6103(k)(6). The court rejected this defense, noting that such a holding “would open a significant loophole in section 7217 in that Internal Revenue Service employees could disclose return information about any taxpayer simply by making the disclosure in the form of a notice of levy. The employees would never be subject to liability under section 7217. . . .”<sup>68</sup>

Although the holdings in *Husby* and *Rorex* advance the goals of taxpayer protection, they do so only by expanding upon the language of the statute. The *Flippo* court’s ruling, denying governmental liability, is correct, based upon a strict interpretation of the statute. Congress has, whether intentionally or not, created a very large gap in its scheme of taxpayer protection. The present statutory scheme, strictly construed, will not impose liability for disclosures made in the course of collection activities that are based on an assessment, regardless of how completely unjustified and unsupported that assessment may be.<sup>69</sup>

7. *Good Faith Defense*.—Section 7431(b) provides that “[n]o liability shall arise under this section with respect to any disclosure which results from a good faith, but erroneous, interpretation of section 6103.” The courts that have addressed the issue agree that the determination of “good faith” is to be made using an objective standard, defined as whether the agent’s conduct violated clearly established statutory or constitutional rights, as interpreted in regulations and manuals, of which a reasonable agent would have known.<sup>70</sup>

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67. 672 F. Supp. at 445. Cf. *William E. Schrambling Accountancy Corp. v. United States*, 689 F. Supp. 1001 (N.D. Cal. 1988)(holding that where levy was based on correct assessment, but proper notice not given, liability under § 7431 could be imposed), rev’d on other grounds, 937 F.2d 1485 (9th Cir. 1991).

68. *Rorex*, 771 F.2d at 386.

69. For further discussion of this gap in coverage, see *infra* part IV.B.

70. See *Huckaby v. United States Dep’t of Treasury, IRS*, 794 F.2d 1041, 1048 (5th Cir. 1986).

This standard has been applied, for example, to hold agents not liable under section 7217 based on their misinterpretation of section 6103 as allowing the disclosure of return information to assist state tax administrators with an investigation into personnel matters.<sup>71</sup> Another court found that the existence of a split in authority on the “loss of confidentiality” defense would support a “good faith” defense.<sup>72</sup> This latter interpretation of the “good faith” defense puts the government in the enviable heads-I-win-tails-you-lose position of being able to argue, in any circuit except the Tenth, that it is not liable for a disclosure of information already in the public record because either the information was not protected, or the Service just thought it was not protected. It is unlikely, at least in the short run, that the government will lose many cases on this issue.

By the express terms of section 7431(b), the “good faith” defense applies only to misinterpretations of section 6103, not to alleged mistakes of fact.<sup>73</sup> It must be noted, however, that an implicit “good faith” defense with regard to factual issues exists by virtue of the “knowingly or by reason of negligence” element of section 7431(a)(1), discussed above. This implicit defense would apply, for example, if the person making the disclosure relies on erroneous information supplied to him by other governmental employees (or by anyone else).

#### B. *Elvis Johnson: Liability Under the Federal Tort Claims Act for Violation of Section 6103*

No discussion of governmental liability for the unauthorized disclosure of return information under section 6103 would be complete without reference to the recent case of *Johnson v. Sawyer*,<sup>74</sup> in which the plaintiff was awarded approximately ten million dollars for the Service’s publication of return information in press releases.<sup>75</sup> Although the size of the verdict may be an encouraging portent for future actions by taxpayers, changes in the law since the *Johnson* claim arose have rendered *Johnson* of questionable value as legal precedent.

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71. *Rueckert v. Gore*, 587 F. Supp. 1238 (N.D. Ill. 1984), *aff’d* in result only sub nom. *Rueckert v. IRS*, 775 F.2d 208 (7th Cir. 1985).

72. *Rubel v. United States*, 89-1 U.S. Tax Cas. (CCH) ¶ 9149, 62 A.F.T.R.2d (P-H) 88-5468 (W.D.N.C. 1988).

73. See *Husby v. United States*, 672 F. Supp. 442 (N.D. Cal. 1987).

74. Slip Opinion, Docket No. 91-2763 (Oct. 14, 1993), supplementing and modifying 980 F.2d 1490 (5th Cir. 1992), *aff’g* in part and modifying in part 640 F. Supp. 1126 (S.D. Tex. 1986).

75. It should be noted immediately that liability in *Johnson* was found under the Federal Tort Claims Act, not § 7217 or § 7431. *Johnson*, Slip Opinion at \_\_\_, 980 F.2d at 1492.

In *Johnson*, the plaintiff, a prominent businessman, had entered into a plea arrangement with the Department of Justice, whereby he pleaded guilty to tax evasion in return for, among other consideration, the agreement by the Department of Justice that it would not issue a press release concerning his case. Also pursuant to the plea agreement, the pleadings did not include certain identifying information, including the plaintiff's address and the nickname by which he was universally known. Following the entry of the plea, the Internal Revenue Service (not Justice) issued press releases which included the identifying information intentionally excluded from the court records.<sup>76</sup>

The plaintiff filed this action for damages against the agent under section 7217, the predecessor of section 7431, asserting that the press releases violated the provisions of section 6103. Because section 7217 created a cause of action against only against the individual agents, plaintiff could not assert liability against the government based on that statute. Rather, he asserted a more imaginative claim against the government, based on the Federal Tort Claims Act (FTCA).<sup>77</sup>

To maintain a claim under the FTCA, a plaintiff must show that he suffered damages caused by the negligent or wrongful act or omission of an employee of the federal government, committed while acting within the scope of his office or employment, and that the act or omission occurred under circumstances where the United States, if a private person, would be liable to the plaintiff in accordance with the law of the place where the act or omission occurred.<sup>78</sup> In *Johnson*, the plaintiff based his FTCA claim alternatively on two separate state torts: first, the tort of public disclosure of private facts (a form of invasion of privacy), which is independent of section 6103; and second, the tort of negligence per se, based on a violation of section 6103.

The government asserted an array of defenses against the FTCA claim.<sup>79</sup> For purposes of this discussion, the most important of these are,

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76. *Johnson*, Slip Opinion at \_\_\_, 980 F.2d at 1492-93.

77. *Id.* at \_\_\_, 980 F.2d at 1494.

78. 28 U.S.C. § 1346(b) (1988).

79. In addition to the two defenses discussed in the text, the government raised, and the Fifth Circuit rejected, the following defenses:

(1) The action sounded in contract, not in tort. The court found this to be a simple mischaracterization of the plaintiff's claims, which were based on a violation of § 6103. *Johnson*, 980 F.2d at 1500-01.

(2) The information disclosed was no longer confidential under § 6103, since it was included in court documents, i.e., the "loss of confidentiality" defense discussed supra part II.A.3. The court avoided the controversy inherent in this defense, noting that the press releases contained information not contained in the court records. Slip Opinion at \_\_\_, 980 F.2d at \_\_\_.



first, that no FTCA claim can be based on the violation of federal law and, second, that the claim was preempted by section 7217. The Fifth Circuit rejected all of the government's defenses, holding the United States was indeed liable under the FTCA and affirmed the trial court's multi-million dollar judgment in favor of plaintiff.<sup>80</sup>

1. *No FTCA Claim Can Be Based on the Violation of Federal Law.*—In response to the negligence per se cause of action as a basis for the FTCA claim, the government argued that no FTCA claim can be based on the violation of federal law. The court acknowledged that this statement is irrefutable under the language of 28 U.S.C. 1346(b), which requires that the United States be liable under the laws of the relevant state. As the court noted, however, plaintiff's argument had a twist to it.

Johnson does not contend simplistically that § 6103 creates a duty the breach of which constitutes a state tort, or that the violation of that statute ipso facto creates FTCA liability. Rather, he asserts that, for purposes of the state tort of public disclosure of private facts, § 6103 sets a standard of care for those actors who owe the duty, and that, under Texas tort law, the violation of such a statutory standard of care is negligence per se when one to whom the duty is owed is damaged by violation of this standard of care.<sup>81</sup>

The court analyzed the plaintiff's negligence per se argument, and agreed that the violation of section 6103 did in fact establish a state cause of action under the Texas negligence per se doctrine, by creating an applicable standard of care.<sup>82</sup>

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(3) The claim was barred by the "discretionary function exception" to the FTCA. The court ruled that this exception "does not shield the government from liability for acts of its agents taken in furtherance of a general discretionary policy—such as the IRS policy to deter tax evasion" through publicity of cases such as plaintiff's. 980 F.2d at 1503.

(4) The claim was barred by the "tax assessment and collection" exception to the FTCA. The court ruled that the actions of Service officers in preparing and issuing press releases did not constitute the assessment or collection of taxes, so that this exception did not apply. *Id.* at 1503-04.

80. Slip Opinion at \_\_\_, 980 F.2d at 1505-06.

81. Slip Opinion at \_\_\_. Surprisingly, this argument was not discussed in the opinion of the district court, which based its finding of liability on state law theories of respondeat superior and negligent supervision of employees. *Johnson v. Sawyer*, 760 F. Supp. 1216, 1231-32 (S.D. Tex. 1991), *aff'd in part, modified in part and remanded in part*, 980 F.2d 1490 (5th Cir. Tex. 1992).

82. Judge Garwood filed a strong dissent in the case, based primarily on his opinion

Since the causes of action in *Johnson* arose, the relevant federal law has been amended in a manner quite significant to the court's holding on this point. As discussed above, section 7217 was repealed, replaced by section 7431. The major difference in the two Code provisions is that section 7431 authorizes an action for damages against the United States, rather than against the federal employee as under section 7217.

Under general principals of negligence per se, that doctrine does not apply where the legislature has already provided a civil remedy for the negligent violation of the standard set forth in the statute.<sup>83</sup> In *Johnson*, decided under section 7217, this was not an issue, since that statute did not address the question of a claim against the United States. Section 7431 expressly provides such a claim, however, and therefore prevents the application of the doctrine of negligence per se.

2. *The Claim Was Preempted by Section 7217.*—Holding that a remedial statute must be both comprehensive and exclusive to be preemptive of the FTCA, the court found no evidence of congressional intent that section 7217 “be the exclusive remedy for each and every section 6103 violation.”<sup>84</sup> Rather, the court found, section 7217 merely provides a remedy against the governmental employee for violations of section 6103, and Congress did not purport to make section 7217 preemptive of the FTCA.<sup>85</sup>

As with the negligence per se issue, subsequent changes in the law have undermined the future application of the court's reasoning on this point. The only remedy provided under section 7217 was a suit for damages against the individual; the statute was silent with regard to liability on the part of the United States. This silence enabled the *Johnson* court, speaking in the context of an action asserting the liability of the United States, to find that the statute was not exhaustive. On this point, the provisions of section 7431, the successor to section 7217, are significantly different: section 7431 expressly provides for liability on the part of the United States. Even though Congress did not include any language in section 7431 regarding the exclusivity of that remedy, it is very unlikely that any court, even the Fifth Circuit, would find that section 7431 has not preempted FTCA liability.

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that the majority had improperly expanded the waiver of sovereign immunity under the FTCA by incorporating the entire federal code into state law under the doctrine of negligence per se. *Johnson*, 980 F.2d at 1509 (Garwood, J., dissenting).

83. See, e.g., Restatement (Second) of Torts § 287 (1965) (providing that: “[a] provision for a penalty in a legislative enactment or an administrative regulation has no effect upon liability for negligence unless the penalty is found to be intended to exclude it”).

84. *Johnson*, Slip Opinion at \_\_\_, 980 F.2d at 1501.

85. *Id.*

### III. LIABILITY FOR COLLECTIONS ACTIVITIES: SECTION 7433

H.R. 4333, the House bill that eventually became the Technical and Miscellaneous Revenue Act of 1988, originally contained no provisions regarding the protection of taxpayers' rights.<sup>86</sup> The Senate version of the legislation, however, contained the Taxpayer Bill of Rights, which provided, among other protections, that a taxpayer could sue the federal government for damages for careless, reckless, or intentional disregard by an Internal Revenue Service employee of any provision of federal law or any regulation under the Code in the determination or collection of any federal tax.<sup>87</sup> The Joint House and Senate Conference adopted the Senate version, with some significant modifications,<sup>88</sup> and the Taxpayer Bill of Rights was subsequently enacted as section 6241(a) of the Technical and Miscellaneous Revenue Act of 1988.<sup>89</sup>

Under the express language of section 7433,<sup>90</sup> a plaintiff must show

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86. H.R. Conf. Rep. No. 1104, 100th Cong., 2d Sess. 229, reprinted in 1988 U.S.C.C.A.N. 5048, 5288.

87. *Id.*

88. H.R. Conf. Rep. No. 1104, 100th Cong., 2d Sess. 229, reprinted in 1988 U.S.C.C.A.N. 5048, 5289. The Conference Report noted the following significant modifications between the Senate version and the version finally enacted. First, the cause of action can be based only on allegations of reckless or intentional disregard by an Internal Revenue Service employee, and not on mere negligence or carelessness. Second, the actions complained of must be in connection with the collection of tax; an action may not be maintained on actions taken in connection with the determination of tax. Third, the reckless or intentional disregard must be of the Code or regulations thereunder; a cause of action may not be maintained on the alleged violation of any other federal law or regulation. Fourth, the conference agreement deleted a provision in the Senate bill which would have barred recovery if the taxpayer was contributorily negligent. Fifth, the Conference Agreement placed a cap on damages of \$100,000, whereas the Senate bill had no such limitations. Sixth, jurisdiction was given to the federal district courts, and not the Tax Court. Seventh, with the exception of the remedy provided in § 7432 for failure to release a lien, this provision would provide the exclusive remedy for recovering damages resulting from reckless or intentional disregard of a provision of the Code, or a regulation promulgated thereunder, by an Internal Revenue Service employee engaged in the collection of any federal tax. *Id.*

89. Pub. L. No. 100-647, 102 Stat. 3342 (1988).

90. Section 7433 provides, in pertinent part:

(a) In General. If, in connection with any collection of Federal tax with respect to a taxpayer, any officer or employee of the Internal Revenue Service recklessly or intentionally disregards any provision of this title, or any regulation promulgated under this title, such taxpayer may bring a civil action for damages against the United States in a district court of the United States. Except as provided in section 7432, such civil action shall be the exclusive remedy for recovering damages resulting from such actions.

the following elements to prevail in an action against the United States: (1) that an officer or employee of the Internal Revenue Service (2) disregarded a provision of the Internal Revenue Code or of any regulation promulgated thereunder; (3) that this disregard was reckless or intentional; (4) that the disregard occurred in connection with the collection of federal tax with respect to the plaintiff; and (5) that the disregard was the proximate result of actual direct economic damages sustained by the plaintiff. If the plaintiff proves all of these elements (as well as follows the procedural requirements of section 7433(d)), he is entitled to a maximum recovery (including costs) of \$100,000.

These elements impose three significant restrictions on the cause of action under section 7433. First, the statute targets only actions performed in connection with the collection process. Abuses connected with the assessment process are not covered and no action will lie, regardless of how grievous the abuses may be. The Senate bill did not limit the scope of the coverage to collections, but would have included abuses committed in the determination phase, as well.

The legislative history of the Senate bill provides some insight into the compromise bill's limitation to the collections area. The Senate bill was the result of hearings dating back to 1984, in which the Senate heard

(b) Damages. In any action brought under subsection (a), upon a finding of liability on the part of the defendant, the defendant shall be liable to the plaintiff in an amount equal to the lesser of \$100,000 or the sum of—

- (1) actual, direct economic damages sustained by the plaintiff as a proximate result of the reckless or intentional actions of the officer or employee, and
- (2) the costs of the action.

. . . .

(d) Limitations.

(1) Requirement that administrative remedies be exhausted. A judgment for damages shall not be awarded under subsection (b) unless the court determines that the plaintiff has exhausted the administrative remedies available to such plaintiff within the Internal Revenue Service.

(2) Mitigation of damages. The amount of damages awarded under subsection (b)(1) shall be reduced by the amount of such damages which could have reasonably been mitigated by the plaintiff.

(3) Period for bringing action. Notwithstanding any other provision of law, an action to enforce liability created under this section may be brought without regard to the amount in controversy and may be brought only within 2 years after the date the right of action accrues.

testimony regarding extensive abuses in the collections process.<sup>91</sup> In his testimony before the Senate Oversight Subcommittee, Jule R. Herbert, Jr., president of the National Taxpayers Legal Fund, identified two important reasons why the collections area is perhaps more prone to abusive practices by the Internal Revenue Service than the area of assessment: first, although as many as fifty percent of taxpayers being audited are represented by tax practitioners, less than five percent are represented during the collection process; and, second, even when taxpayers are represented in the collection process, tax practitioners themselves know very little about Internal Revenue Service collection procedures.<sup>92</sup>

In response to inquiries as to the necessity of providing additional taxpayer protection during the collection process, then Commissioner Lawrence B. Gibbs made comments<sup>93</sup> in opposition to the legislation that, ironically, effectively pointed out the need for that very protection. In attempting to show that sufficient safeguards already existed to protect taxpayers, Commissioner Gibbs noted that a cause of action under the *Bivens*<sup>94</sup> doctrine is available for taxpayers whose constitutional rights are violated by revenue agents under color of law. In an apparent effort to show that there was no real abuse by his agents, Commissioner Gibbs also noted that, although over 1,000 *Bivens* actions were filed against Internal Revenue Service employees from 1980 to 1986, *none* of those actions was ultimately successful.<sup>95</sup> In light of the testimony that the Subcommittee had already heard regarding the very real abuses that do occur, the astounding failure of the *Bivens* plaintiffs could hardly have reassured the Senators that no further protection was needed.<sup>96</sup>

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91. See, e.g., Hearings on S. 579 and S. 604, *supra* note 2, at 55 (testimony of Thomas L. Treadway) (relating abuses visited upon him and his companion during collection of taxes erroneously assessed against him, as result of which both lost their businesses). See also reprints of Reader's Digest articles introduced into the hearings record: John Barron, Tyranny in the Internal Revenue Service, Reader's Dig., Aug. 1967, at 42; Robert S. Holzman with Ann Dear, Needed: New Curbs on the IRS, Reader's Dig., Jan. 1977, at 87; John Barron, The Tragic Case of John J. Hafer and the IRS, Reader's Dig., Jan. 1969, at 53.

92. Taxpayer Rights Issues: Hearings on S. 2400, *supra* note 4, at 92-93 (testimony of Jule R. Herbert, Jr., president of National Taxpayers Legal Fund).

93. Hearings on S. 579 and S. 604, *supra* note 2, at 233 (statement of Lawrence B. Gibbs, Commissioner, Internal Revenue Service, accompanied by James I. Owens, Deputy Commissioner, Thomas Coleman, Acting Associate Commissioner for Operations, and Jack Petrie, Taxpayer Ombudsman).

94. *Bivens v. Six Unknown Named Agents of Fed. Bureau of Narcotics*, 403 U.S. 388 (1971).

95. Hearings on S. 579 and S. 604, *supra* note 2, at 243 (Internal Revenue Service Comments on Taxpayer Bill of Rights Legislation Submitted by Lawrence B. Gibbs, Commissioner of Internal Revenue Service).

96. An outstanding example of the inadequacy of the *Bivens* action to protect

In proposing the additional protection for taxpayers, the Senate was concerned not only about the denial of taxpayers' rights but, as with sections 6103 and 7431, about the continued viability of the voluntary assessment system. In his statement submitted to the Senate Oversight Committee, the Chairman of the United States Chamber of Commerce Small Business Taxation Subcommittee, focusing on the Service's "heavy handed collection tactics," warned that "in too many cases, honest individual and small business taxpayers have experienced such frustrations in their dealings with the Service that the very idea of volunteerism in the tax collection process is threatened."<sup>97</sup>

The other two restrictions on the cause of action provided by section 7433 reveal a marked contrast between section 7431 and section 7433 with regard to both the difficulty of establishing liability and the damages available to a plaintiff once liability is established. Under section 7433, the plaintiff must prove that the Internal Revenue Service's employee's actions were reckless or intentional. It will not suffice to show that the actions were negligent, or even grossly negligent. Contrast this with the significantly lower burden of proving the "knowingly or by reason of negligence" requirement under section 7431.

Even after the plaintiff has scaled the higher barrier to establish liability, he is entitled only to significantly lower damages. Under section 7433, the plaintiff's damages are limited to his "actual, direct economic damages" up to a maximum of \$100,000; punitive damages are not authorized. This is in contrast to the damages allowed under section 7431, which include "actual" (not "actual, direct economic") damages and punitive damages, with no maximum amount. Thus, the baseline level of scienter on the part of the Internal Revenue Service employee that is necessary for the finding of *any* liability under section 7433, would be sufficient for an award of punitive damages under section 7431, damages which are not even available under section 7433.

From the Conference Report, it appears that these restrictions were the result of a compromise between the Senate and the House. The Senate bill would have required only a showing of negligence, rather than the "reckless or intentional" requirement of the compromise bill; and the Senate bill had no limitation on the amount of damages recoverable. There is, unfortunately,

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taxpayers' rights is the case of *Lojeski v. Board*, 788 F.2d 196 (3d Cir. 1986). The Third Circuit reversed the trial court's judgment in favor of the plaintiff, finding that, despite the continued and entirely unjustified harassment of the plaintiff and the liens and levies upon her property, there had been no violation of her constitutional or statutory rights.

97. Hearings on S. 579 and S. 604, *supra* note 2, at 179-80 (statement of James D. McCarthy, Chairman of the United States Chamber of Commerce Small Business Taxation Subcomm.).

no public record of the Conference Committee's deliberations to indicate why the conferees adopted these amendments. The very existence of the limitations suggests that the conferees must have been concerned that unlimited liability would have undesirable effects of some sort. Perhaps they were concerned that the government's collection activities would expose it to liability with such frequency that significant restrictions had to be imposed.

It seems more likely, however, that the conferees were concerned that unlimited liability would threaten government revenues in ways more serious, and much more difficult to predict, than the relatively minor cost of damage awards. To the extent that Congress intended for the statute to deter improper collection activities, and not merely to compensate injured taxpayers, it must have expected that the threat of liability would induce the Internal Revenue Service to employ both education and coercion to ensure that its agents would not engage in any actionable activities. Given this expected mechanism, it would be reasonable for Congress to assume that, as the financial threat posed by the statutory cause of action was increased, the Service would pursue its program of deterrence with increased vigor and that the more vigorously the program was pursued, the more likely it would be to intimidate agents into refraining from the more aggressive collection tactics, even in circumstances where they would be entirely proper. Such inhibition of agents in their collection efforts would not only reduce revenues directly, it could also have an indirect effect. Less aggressive collections would likely reduce the incentive for taxpayers to engage accurately and promptly in the voluntary self-assessment process. In the face of such an unpredictable cost, the limitations on damages would appear to be a reasonable compromise.

In comparing governmental liability under section 7433 with the relatively unlimited liability under section 7431, it must be remembered that section 7431 does not restrict collections activities; rather, section 7431(d)(6) expressly authorizes disclosure of return information in connection with tax administration, including collections activities.<sup>98</sup> Indeed, one of the reasons underlying the enactment of sections 6103 and 7431 was to enhance collections by encouraging voluntary compliance.

Very few cases have been decided under section 7433, and most of those either simply reiterate the requirements of the statute without lucidating comment of any sort, or summarily describe the court's determination of fact questions. With one exception, discussed below, the cases do not raise any significant issues. A few points worth noting have come out of the cases, however:

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98. See also *Flippo v. United States*, 670 F. Supp. 638 (W.D.N.C. 1987) (holding that § 7431 does not apply to disclosures made in connection with collections activities), *aff'd*, 849 F.2d 604 (4th Cir. 1988).

— As with any waiver of sovereign immunity, section 7433 must be strictly construed in the government's favor.<sup>99</sup>

— As might be expected with a statute that grants the right to sue the Internal Revenue Service, section 7433 has attracted a lot of action from tax protestors.<sup>100</sup>

— Only the taxpayer with regard to whose tax liability the collection efforts were directed has standing to sue under section 7433.<sup>101</sup>

— "Collection" is to be given its ordinary meaning: making an assessment is not a collection action; a notice and demand for payment does constitute a collection action, as does filing a notice of tax lien; where the assessment incorporates a demand for payment in same document, it is a collection action.<sup>102</sup>

— Section 7433 waives sovereign immunity only where an agent has violated the taxing statutes or regulations. Rights created by Internal Revenue Service policy alone do not fall within the waiver; even if a plaintiff may have substantive administrative rights created by that

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99. *Gonsalves v. IRS*, 975 F.2d 13 (1st Cir. 1992); *V-1 Oil Co. v. United States*, 813 F. Supp. 730 (D. Idaho 1992).

100. See, e.g., *Rogers v. United States Dep't of Treasury*, No. 91-35132, 1992 U.S. App. LEXIS 1570 (9th Cir. Jan. 28, 1992) (not for citation); *Zegzula v. United States*, No. 90-35777, 1992 U.S. App. LEXIS 13439 (9th Cir. June 2, 1992) (not for citation). It was perhaps in recognition of this fact that Congress enacted § 6673(b)(1), which authorizes the court to impose a penalty of up to \$10,000 for "frivolous or groundless" positions maintained by a taxpayer in an action under § 7433.

101. *God's Helping Hands v. United States*, 92-1 U.S. Tax Cas. (CCH) ¶ 50,262, 69 A.F.T.R.2d (P-H) 92-897 (D. Minn. 1992). The procedural facts of *God's Helping Hands* are rather interesting, if irrelevant to the topic at hand. The government had filed liens against land owned by the plaintiff corporation, on the theory that the corporation was the alter ego of James and Joan Noske. The corporation brought this § 7433 action based on those collection efforts, but the court here dismissed the § 7433 claim for lack of standing. The court, with no expression of regret, noted the Catch-22:

Plaintiff could possibly assert a section 7433 action if it conceded that it is in fact the alter ego of James and Joan Noske. By making such a concession, however, plaintiff would be conceding the validity of the tax liens and levies it challenges in this case, and its action would necessarily be without merit.

92-1 U.S. Tax Cas. at 84,028, 69 A.F.T.R.2d at 92-898. All but one of the Noskes' own § 7433 claims were dismissed for failure to state a claim; the court granted the government's motion for summary judgment on the one remaining § 7433 claim. *Noske v. United States*, 92-2 U.S. Tax Cas. (CCH) ¶ 50,429 (D. Minn. 1992).

102. *Miller v. United States*, 763 F. Supp. 1534 (N.D. Cal. 1991).



policy, courts cannot enforce those rights because of sovereign immunity.<sup>103</sup>

— One lien may give rise to causes of action under both section 7432 and section 7433: the section 7433 action could be based on the unauthorized filing of the lien, and the section 7432 action on the intentional or negligent failure to release it.<sup>104</sup>

As discussed above, section 7433 is expressly limited to collections. The question has arisen of whether liability can be based on otherwise proper activities undertaken to collect an erroneous assessment. The Federal District Court in Alaska addressed this question in *Miklautsch v. Gibbs*<sup>105</sup> and held that a cause of action does lie under those circumstances. In *Miklautsch*, the Tax Court had ruled that a tax shelter in which the plaintiffs had invested was a sham, and that neither the income reported nor the deductions claimed were to be given any tax effect. Contrary to this ruling, the Service assessed a deficiency based on the income from the tax shelter and, when plaintiffs failed to pay the deficiency, began collection procedures. The plaintiffs then filed this action, asserting governmental liability on a number of theories, including section 7433.

The district court denied the government's motion to dismiss, noting, but rejecting, the Service's argument that section 7433 is inapplicable where procedurally-correct collection methods are used, regardless of whether the underlying tax is correctly assessed. In rejecting that argument, the court clearly identified one of the serious shortcomings of section 7433, its limitation to collection procedures. Then, without citation to authority, the court concluded that Congress could not have intended such a limitation, saying:

Under the IRS's view, the IRS could arbitrarily—and without any justification whatsoever—assess a tax, and then collect on that tax with impunity so long as procedurally proper methods were employed. It was the intent of Congress to protect taxpayers, not to allow the IRS to wrongfully bring a person to financial ruin so long as its collection methods were procedurally correct.<sup>106</sup>

As a matter of fact, however, this limitation is clearly, if unfortunately, the expression of congressional intent. As noted above, the Senate's

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103. *Gonsalves v. IRS*, 975 F.2d 13 (1st Cir. 1992).

104. *Information Resources, Inc. v. United States*, 950 F.2d 1122 (5th Cir. 1992).

105. 90-2 U.S. Tax Cas. (CCH) ¶ 50,587 (D. Alaska 1990).

106. *Id.* at 86,026.

version of the legislation had provided that an action would lie for abusive assessment practices as well as for abusive collection activities. The compromise bill, however, expressly limited the coverage to the collection process, a fact noted in the Conference Report.<sup>107</sup>

The *Miklautsch* court also sought support for its holding in a very strained reading of the statute itself. The court turned the limiting phrase, "in connection with any collection of Federal tax," on its head, reading it to allow a damages action based on any act in disregard of *any* provision in the Code, so long as there is an eventual "forced collection" of a tax.<sup>108</sup> The court expressed its expansive reading of section 7433 as follows:

Under a proper interpretation of section 7433, where a tax has been wrongfully assessed, and the IRS goes ahead and enforces collection on that tax, an action shall lie. It is true Congress chose not to extend section 7433 to damages arising from the wrongful determination of a tax alone. Yet, all this means is that where a tax is wrongfully assessed but the taxpayer voluntarily remits payment, there is no action for damages because there has been no enforced collection.<sup>109</sup>

As before, the court cited no authority for this surprising proposition.

The court's holding raises significant questions that must be answered before the court's interpretation of section 7433 can be applied. When does "enforced collection" begin? When does it end and "voluntary payment" begin? Does the mailing of a deficiency notice constitute "enforced collection," or does that term apply only to a demand letter, or only to notices of liens and levies, or only to the actual execution of the liens and levies? If only to the last, is the Service exempt from liability for any action connected with the others? If a taxpayer responds to a notice of deficiency, demand, or notice of lien or levy by paying the tax assessed, is that "voluntary payment," thus removing liability?

The court, unfortunately, failed to define the two terms, "voluntary payment" and "enforced collection," which are critical to its decision and which are not used in the statute or in the legislative history. From the facts of the case and from the rationalization of its holding,<sup>110</sup> it appears that the

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107. H.R. Conf. Rep. No. 1104, 100th Cong., 2d Sess. 229 (1988), reprinted in 1988 U.S.C.C.A.N. 5048, 5289.

108. *Miklautsch*, 90-2 U.S. Tax Cas. (CCH) at 86,026.

109. *Id.* at 86,026-27.

110. In the *Miklautsch* case itself, the collections actions complained of were the seizures of three properties owned by the plaintiffs and the levy on their bank accounts and

court viewed only the actual seizure of assets to be the potential source of liability for the Service. Apparently, under the *Miklautsch* court's reasoning, if the Service can utilize abusive assessment and collection practices well enough that the taxpayer is sufficiently terrorized or demoralized to pay an assessed tax (whether correctly or erroneously assessed) before the Service has to engage in the actual seizure of assets, then there can be no liability. Only where the Service uses those tactics inexpertly, and is unable to coerce a "voluntary" payment, will it be liable to the taxpayer. Surely this is not what Congress, or even the *Miklautsch* court, intended. It is certainly not what Congress enacted in section 7433.<sup>111</sup>

Although the court was apparently oblivious to this effect of its ruling, it did realize that its expansive reading of the scope of section 7433, taken together with the exclusive remedy provision of that section, in fact worked to the government's benefit. Indeed, the court found this to be further support for its interpretation of the statute. The court correctly noted that one clear purpose of the statute is to limit the government's liability for Internal Revenue Service collection activities, by expressly making the remedy provided under section 7433 the exclusive damages remedy for such actions.<sup>112</sup> From that jumping-off point, however, the court somehow divined that it was Congress's intent that section 7433 also be the exclusive remedy for "capricious and arbitrary assessment[s]."<sup>113</sup> The court, again, provided no authority for this conclusion, but reasoned that a contrary holding would:

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their grandchildren's trust accounts. *Id.* at 86,023. In trying to justify its insertion of these concepts into the statute, the court stated:

The distinction between enforced collection and voluntary payment is sensible in that a taxpayer who has voluntarily paid is not likely to suffer the severe damage that occurs when the IRS brings its full collection powers to bear. Moreover, a taxpayer who voluntarily makes payments usually does so in cash which can easily be recouped by way of a refund. When the IRS collects an outstanding tax, it does so by seizures and levies on property, creating losses that (as this case demonstrates) cannot be recovered in an ordinary refund action.

*Id.* at 86,027.

111. The flaws in the *Miklautsch* court's reasoning are exposed from another angle as well: where the Service has engaged in the behavior of properly attempting to collect an erroneously assessed tax, the *Miklautsch* holding would require that the government's liability stand or fall on whether the taxpayer voluntarily pays the tax prior to instituting the action. But there is no such provision in § 7433. Where the government engages in improper collection activities, regardless of whether the tax is properly assessed, the taxpayer's voluntary payment of the tax is irrelevant.

112. IRC § 7433(a).

113. *Miklautsch*, 90-2 U.S. Tax Cas. (CCH) at 86,027.

open[] the door to whatever causes of action creative lawyers could conjure up. In this case alone, plaintiffs have asserted causes of action under RICO, *Bivens*, and the Federal Tort Claims Act. Under any one of these theories, the damages could well exceed \$100,000. Under this view, the Government becomes exposed to potential liability far in excess of \$100,000. Such is a result Congress sought to avoid.<sup>114</sup>

Because the court found that section 7433 provided the exclusive remedy for the actions complained of, the court dismissed plaintiffs' damages claims under *Bivens*, RICO, and the Federal Tort Claims Act. Recognizing that "this is a hollow victory for plaintiffs,"<sup>115</sup> the court appeared to express regret that it was forced to so hold, announcing with surely unintended irony, "This court cannot ignore a clear congressional mandate."<sup>116</sup>

The *Miklautsch* opinion shows quite well both the need for taxpayer protection from procedurally proper collections actions based on erroneous assessments, and the fact that section 7433 does not provide that protection. The attempts by the district court to interpret that statute so as to authorize a cause of action in this situation serve only to emphasize the statutory language and legislative history expressly limiting the statute to abusive collections activities.

#### IV. COORDINATION OF SECTIONS 7431 AND 7433: OVERLAP AND GAPS

##### A. *Overlap*

As discussed above, the enactment of sections 6103 and 7431 arose out of congressional concerns that information collected by the Internal Revenue Service was being used for purposes unrelated to proper tax administration. Section 7431 does not, therefore, create a cause of action for disclosures legitimately related to tax administration, including collection efforts.<sup>117</sup> Conversely, section 7433 is expressly limited to, and the exclusive remedy for, improper practices during the collection process. Statutory construction compels the conclusion that, in a situation where both sections

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114. *Id.*

115. *Id.* at 86,028.

116. *Id.* One cannot help wondering if perhaps the court did not actually begin from its conclusion that Congress intended that there be only limited liability in any action involving, ultimately, the collection of a tax.

117. See, e.g., *Elias v. United States*, 91-1 U.S. Tax Cas. (CCH) ¶ 50,040, 67 A.F.T.R.2d (P-H) 91-438 (C.D. Cal. 1990), *aff'd*, 974 F.2d 1341 (9th Cir. 1992); *Flipppo v. United States*, 670 F. Supp. 638 (W.D.N.C. 1987), *aff'd*, 849 F.2d 604 (4th Cir. 1988).

might arguably apply,<sup>118</sup> section 7433 controls. In the ordinary case, the courts have generally had little difficulty in reaching the same conclusion.<sup>119</sup>

## B. Gaps in Coverage

1. *No Liability for Abuses During Assessment Phase.*—A more difficult question arises in a situation not directly addressed by either statute, where an otherwise authorized disclosure of information or otherwise proper collection effort is based on an erroneous assessment. Because Congress has provided no direct action for improper assessment of tax deficiencies, taxpayers have sought to mold their claims for such activities to fit the definitions of section 7431 and section 7433. Although some courts have extended section 7431 liability to such situations with little apparent violence to the statutory language or legislative history,<sup>120</sup> the same is not true with regard to section 7433 actions.<sup>121</sup>

Under the present statutory scheme, taxpayers have no adequate recourse for damages caused by the disregard of proper assessment procedures or by the procedurally proper collections (and, in some jurisdictions, the disclosures) that follow. The taxpayer is, of course, entitled to have the assessment reversed following an administrative or judicial determination that it was erroneous, and to the return of the seized property (or the proceeds from the sale thereof). In many cases, however, such a limited remedy will be completely inadequate to restore the direct, economic damages sustained by the taxpayer as a result of the unjustified seizure of property and interruption of business, to say nothing of collateral injuries such as damage to the taxpayer's credit and reputation.

The danger created by this gap in the coverage, which is most egregious in the collections area, is that the Internal Revenue Service is under no direct pressure to prevent or avoid unjustified assessments or overassessments. The worst that can happen, after all, is that the Service will have to

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118. An example of such a situation would be where an unauthorized disclosure (to the wrong person, or of incorrect information) is made by way of a procedurally-flawed collection activity, such as in the case of a levy without proper notice to the taxpayer.

119. See, e.g., *Traxler v. United States*, 88-2 U.S. Tax Cas. ¶ 9627, 63 A.F.T.R.2d 89-577 (E.D. Cal. 1988); *Flippo v. United States*, 670 F. Supp. 638 (W.D.N.C. 1987), *aff'd*, 849 F.2d 604 (4th Cir. 1988).

120. See *supra* text accompanying notes 64-67.

121. The opinion in *Miklausch*, discussed *supra* part III, illustrates the ungainly results that obtain when a court tries to fill this gap judicially, yet still cling to a pretense of honoring the statutory language.

return property that was improperly taken, and then only if the overassessment is discovered, contested, and ruled erroneous.

At least with regard to collections based on erroneous assessments, this gap in coverage cannot be judicially corrected unless the courts abandon the language and legislative history of section 7433, as demonstrated by the opinion in *Miklautsch*.<sup>122</sup> The only rational and effective solution is for Congress to address the issue by either expanding the coverage of section 7433 to include disregard of assessment provisions or enacting new legislation specifically directed toward assessment-based abuses.

Congress is, in fact, aware of this gap in the present statutory provisions. In his testimony before the Senate Oversight Subcommittee in February of 1992, the general counsel for a national small business group stated that many of the group's members "have described the experiences of undergoing Internal Revenue Service employment tax audits as 'living in hell,' being 'coerced by terror tactics' and as being 'victimized by legalized extortion.'" <sup>123</sup> Among the specific abuses cited were:

- Internal Revenue Service auditors unfairly contacting a taxpayer's customers and workers, which is at least intimidating to the third parties and may in fact destroy the business relationships involved;
- Internal Revenue Service auditors using threats of jeopardy assessments to obtain waivers of the statute of limitations;
- Internal Revenue Service auditors refusing to disclose workers' tax returns to a taxpayer even in cases where the auditors themselves have relied upon those returns to impose an employment tax liability on the taxpayer, as the workers' employer; and
- Internal Revenue Service auditors using the audit process as a method of building the government's best case against

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122. See *supra* part III.

123. Taxpayer Bill of Rights 2: Hearings on S. 2239 Before the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service of the Senate Finance Committee, 102d Cong., 2d Sess. 256, 257 (Feb. 21, 1992) (testimony of Harvey J. Shulman, General Counsel, National Association of Computer Consultant Businesses, addressing the abuses that occur during the assessment of employment taxes).

the taxpayer, rather than as an impartial fact-gathering process.<sup>124</sup>

Legislation now pending before the House of Representatives, the Taxpayer Rights Amendments of 1993,<sup>125</sup> addresses this problem, expanding the coverage of section 7433 to include improper actions during the assessment or determination phase as well as the collections phase. When he introduced the legislation, Representative Joel Hefley noted that agents are not only aware of this flaw in the statutory scheme, but are in fact exploiting it. He said:

What is happening here is pretty obvious. IRS agents are using the knowledge that they can't be sued for actions taken during the determination process to intimidate and harass taxpayers into paying excess taxes. . . . Until the IRS actually presents an official tax bill, they are immune from recourse. . . . [H]arassment and mistreatment by IRS agents can occur during the determination process as well as the collection process.<sup>126</sup>

The legislation proposed by Representative Hefley would simply insert language into the current section 7433 to authorize a cause of action for damages caused by governmental activities during the assessment phase. Although this proposed amendment does possess the virtue of simplicity and does extend statutory coverage to an area now unregulated, it does not directly address the problem of collections based on erroneous assessments. The amended statute could reasonably be interpreted strictly to compartmentalize assessment activities and collection activities, since it mentions them only as separate concepts.

Assume, for example, the following scenario. The Internal Revenue Service erroneously assessed a deficiency against a taxpayer. During the assessment phase, the agents engaged in no activity that could be proved to have caused any damage to the taxpayer, except that it formed the basis of the subsequent collection activities. Procedurally proper collection activities do, however, result in direct economic damages to the taxpayer. A court could interpret section 7433, as amended by the proposed legislation, as indicating legislative approval of the current case law holding that the assessment and collection phases are to be kept separate and distinct. Since

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124. *Id.*

125. H.R. 1145, 103d Cong., 1st Sess. § 1(a)(1) (1993).

126. 139 Cong. Rec. E455, E456 (daily ed. Feb. 25, 1993) (comments of Rep. Joel Hefley, introducing the bill).

the activities during the assessment phase did not directly result in any damages, the taxpayer will be unable to collect an award for those activities; since the collection was based on an assessment, the government will not be held liable for those activities.

Although the amendment proposed by Representative Hefley is a step in the right direction, section 7433 should be amended to provide protection for the taxpayer during the assessment period, certainly, but the amendment should also clearly provide that collection activities and disclosures cannot be based on an erroneous assessment.

2. *Liability for Negligent Collections Activity.*—As discussed above, the protection afforded by section 7433 against the disregard of proper collection procedures is expressly limited to willful or reckless actions; the merely negligent disregard of the relevant provisions is not actionable. To escape liability, the government need only show that the Internal Revenue Service agent involved was simply not aware of the particular provision violated. The government fisc is therefore better served, under the present statutory scheme, by maintaining a staff of poorly-informed but zealous agents to press all manner of collection tactics, proper and improper, resulting in the maximum collection of taxes without running the risk of governmental liability in the event that an abused taxpayer should protest.

The expansion of liability to include negligent activities would reduce, if not eliminate, the shield of ignorance that the law now provides, encouraging the proper training and restraint of collections agents. This expanded protection for the taxpayer will, of course, have a price tag. The imposition of negligence liability under section 7433, by encouraging the proper training of agents, would lower revenues in two ways. First, conscientious agents would be informed of the law, which would restrain their more overreaching (and productive) collection activities. Second, the government would be subjected to liability for damages for the actions of the unscrupulous or overzealous agents who continue to engage in improper collections activities even after being advised of the impropriety of those actions.

The House of Representatives has taken note of the omission of negligence from section 7433, and legislation is currently pending before the House to include negligent behavior within the coverage of section 7433.<sup>127</sup> Curiously, the Senate's 1993 taxpayer rights legislation<sup>128</sup> has no such provision, even though the Senate proposed the inclusion of negligent actions in the original legislation leading to the enactment of section 7433 in 1988

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127. H.R. 1145, 103d Cong., 1st Sess. § 1(b)(1) (1993).

128. S. 542, 103 Cong., 1st Sess. (1993) (Taxpayer Bill of Rights 2).



and again in amendments proposed in 1992,<sup>129</sup> and despite being advised of the effect of its omission.<sup>130</sup>

3. *Limit on Damages Under Section 7433.*—As discussed above, one of the odd discrepancies between the remedy provided by section 7431 and that provided by section 7433 is that, even though a plaintiff under section 7433 has a significantly higher burden to carry regarding the willful or intentional nature of the Internal Revenue Service employee's actions, the damages recoverable are significantly limited compared to those allowed under section 7431. Under section 7433, the taxpayer is limited to a recovery of \$100,000, while there is no limit on damages under section 7431; under section 7433, the taxpayer cannot recover punitive damages, which are available under section 7431.

The 1993 version of the Taxpayers Bill of Rights 2<sup>131</sup> addresses the first of these limitations. It contains a provision that would raise the cap on damages under section 7433 from \$100,000 to \$1,000,000. If damages are limited, as they are under section 7433, to the taxpayer's "actual, direct economic damages," any further limit, even one as generous as the proposed \$1,000,000, is difficult to justify. Congressional insistence on maintaining a limitation on damages, especially when this provision is contrasted with section 7431, could be interpreted as an acknowledgement that unlimited liability under section 7433 would have a serious effect on government revenue, either directly through the cost of the damages awards or indirectly through the ripple effects that this liability would have on the amount of revenues collected by the Internal Revenue Service. In any event, the limitation seems to reflect a balancing of the rights of taxpayers with some other governmental interest, which Congress has never identified. Barring an adequate explanation of the need for such a limitation, a more appropriate amendment would be to lift the cap on damages entirely.

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129. The 1992 version of Taxpayer Bill of Rights 2 provided for an amendment to include negligent actions in § 7433's coverage. S. 2239, 102d Cong., 2d Sess. § 505(a) (1992).

130. In his testimony before the Senate Subcommittee on Oversight in 1991, David Keating, Executive Vice-President of the National Taxpayers Union, noted that although Congress has expanded the liability of taxpayers and tax preparers for negligent actions, "incredibly, Congress refuses to require the IRS to exercise reasonable caution in using its vast array of enforcement powers." Taxpayers Bill of Rights 2: Hearings on S. 2239 Before the Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service of the Senate Committee on Finance, 102d Cong., 1st Sess. 135, 135 (Dec. 10, 1991) (statement of David Keating, Executive Vice-President of the National Taxpayers Union).

131. S. 542, 103d Cong., 1st Sess. § 504(a) (1993).

## V. CONCLUSION

In sections 7431 and 7433, Congress has taken the first steps in an effort to use the civil justice system as a check on the extensive powers of investigation and seizure which Congress and the courts have granted the Service. In whole, the causes of action which these statutes authorize appear to be effective tools to accomplish that end. An analysis of the statutes and a review of the case law, however, reveal some gaps and ambiguities in the coverage that must be addressed.

Section 7431 imposes liability for the unauthorized disclosure of return information, incorporating the substantive provisions of section 6103. The scope of this protection is not clear, however, and the courts have struggled with the question of whether it extends to information previously disclosed in public records. Although legislative action might clarify the scope of coverage, this may well be an area more suitable to judicial resolution, with the evolution of standards flexible enough to adapt to a wide variety of factual settings.

Section 7431 is also ambiguous as to whether its prohibition applies to the unauthorized disclosure of erroneous information. The congressional purposes behind the legislation would be advanced by including such disclosures within the ambit of the statute. Although the courts should have no difficulty finding that coverage in the statutory language, a few courts have, in fact, interpreted it to the contrary. The statute should be amended to remove the ambiguity.

Another issue that has arisen in the application of section 7431 is whether a cause of action will lie for a procedurally correct disclosure of return information made in the course of collecting an erroneous assessment. As desirable as such a cause of action may be, at least from the taxpayers' point of view, it is not provided in section 7431, which was designed to prevent the use of Internal Revenue Service information for political and other purposes without interfering with the routine administration of taxes. It was not intended to provide a remedy for damages caused by an erroneous assessment or by the collection activities based on such an assessment. This issue is more properly addressed by section 7433, as discussed below.

A final issue that arises under section 7431 is whether the government is liable for the unauthorized disclosure of return information where the unauthorized disclosure was proximately caused by the negligence, not of the person actually making the disclosure, but of other governmental officers or employees. The statute is, at best, ambiguous on this point. To further the congressional purposes, the statute should be amended to provide expressly for liability in such cases.

In a sense, section 7433 is a rather broad statute, providing governmental liability for the violation of any tax provision during the collection of

taxes. There are three significant limitations on this liability, however, which should be removed by amendment. First, the statute applies only to reckless or intentional violations of the law, not to negligent violations. Second, the statute provides liability only for actions occurring during the collections phase of tax administration, leaving taxpayers with no remedy for abusive practices during the assessment phase or for collections based on erroneous assessments. Third, the statute limits the government's liability to a maximum of \$100,000. The removal of each of these limitations would further the congressional purpose of providing taxpayers statutory protection from abusive practices in the administration of taxes.