MAY 11 2001

CC:CT:NO-118351-00; 101503-01
MYanes

MEMORANDUM FOR CHIEF, CRIMINAL INVESTIGATION
Attn: John Fowler

FROM: Nancy J. Jardini /S/
Division Counsel/Associate Chief Counsel (Criminal Tax)

SUBJECT: FinCEN's Change to its Networking Disclosure Policy and CI's Use of FinCEN's SAR Database

This responds to your request for an opinion regarding potential disclosure issues that could arise from Criminal Investigation's ("CI") use of FinCEN databases. Specifically, in September 2000, you requested a legal opinion on the potential disclosure ramifications of FinCEN's change to its networking disclosure policy. In December 2000, you requested a legal opinion of the feasibility, within the framework of I.R.C. § 6103, of CI participating in a FinCEN pilot program using FinCEN's suspicious activity report ("SAR") database. We forwarded each request to the Disclosure and Privacy Law Division of Chief Counsel ("Disclosure") for an analysis of the issues. Because the requests involved similar issues, they combined their response. In their attached opinion, Disclosure concludes the change in FinCEN's networking disclosure policy violates I.R.C. § 6103 when FinCEN makes disclosures to other agencies in tax administration cases without CI's prior authorization. With respect to the SAR pilot program, Disclosure concludes CI should not be completing FinCEN's tracker form when accessing SARs in connection with Title 26 investigations. By filling out the form, CI would be violating I.R.C. § 6103. Their conclusions are premised on the fact that CI cannot control the use or redisclosure of return information obtained by any other federal, state or local agency through access to the various FinCEN databases.

Basis for Disclosure - I.R.C. § 6103(k)(6)

Based on the information contained in your request, Disclosure determined the only basis for disclosure potentially available to CI is the general authority to disclose return information for investigative purposes found in I.R.C. § 6103(k)(6). Under the authority of I.R.C. § 6103(k)(6) and its implementing regulations, IRS employees are authorized to disclose return information (not returns) to the extent that 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 the Code. This disclosure authority does not anticipate a wholesale sharing of information as is involved here.

Recipients of return information under the authority of I.R.C. § 6103(k)(6) are not subject to restrictions, nor are they subject to the safeguarding requirements set out in I.R.C. § 6103(p). Nonetheless, a literal reading of I.R.C. § 6103(a) suggests that Federal agency employees are prohibited from redisclosing return information obtained under any authority, even I.R.C. § 6103(k)(6). Since the statute is not clear on the proper interpretation of I.R.C. § 6103(a), Treasury has recommended that I.R.C. § 6103 be amended to clarify that persons otherwise included in I.R.C. § 6103(a) who receive return information under I.R.C. § 6103(k)(6), are not subject to the redisclosure restrictions for such information.

Change in Networking Policy

As of September 5, 2000, FinCEN no longer seeks the consent of one law enforcement agency prior to informing another law enforcement agency of its interest in the same target. Now, when a match occurs, FinCEN will automatically, and without any agency's notice or consent, contact both agencies directly to inform them that requests for information on the same target have been received from both. There is no specific authority in the Code for the redisclosure by FinCEN of return information to other agencies querying the general database as envisioned in connection with the new networking policy.

Disclosure is concerned about the I.R.C. § 6103(k)(6) disclosure of return information to FinCEN in light of the redisclosure of that information to an unknown number of potential recipients without CI's ability to consent to the disclosure. They also question whether such disclosure is limited to the disclosure of only that return information as is necessary to obtain information as anticipated by I.R.C. § 6103(k)(6). [redacted] DP

SAR Database

The SAR database contains a tracker index with disposition statements regarding each agencies' disposition of downloaded SARs. The disposition statements contained in this index are available to all law enforcement agencies with access to the SAR database. CI uses this database for both tax and non-tax investigations and routinely downloads SARs in two ways. First, CI downloads SARs in large batches with no connection to any taxpayer's liability or potential liability under the Code. These downloads do not implicate I.R.C. § 6103. Secondly, special agents may access an

SAR from his or her own office's internal database in connection with a particular project of investigation. Under these circumstances, if the project or investigation involves a Title 26 investigation, including investigations where a related statute call has been made, any information gathered by or created by the IRS in connection with, or otherwise concerning a taxpayer's liability or potential liability under the Code, is confidential and disclosure of such return information must be authorized by I.R.C. § 6103. Accordingly, any information included on the tracker index with respect to these types of projects or investigations violate I.R.C. § 6103. Based on the above discussion, I.R.C. § 6103(k)(6) is not a viable means for authorizing disclosure.

Disclosure points out the Service's position has consistently been, since 1976, that I.R.C. § 6103(k)(6) does not authorize the disclosure of case updates or other statute information as a condition of receiving information from another agency. They find the disclosures here do not meet the necessity test of I.R.C. § 6103(k)(6). Disclosure did provide an alternative to wholesale nondisclosure, noting that CI may provide FinCEN statistical data on the types and classes of cases in which CI gathers and uses SARs without violating I.R.C. § 6103. Accordingly, to the extent CI can produce such data, it may provide it to FinCEN to enable FinCEN to satisfy its mandate that it gather information on the need for and use of SARs by its customers.

Based on the conclusions reached by Disclosure contained herein, we believe a meeting to discuss the issues raised with respect to the use and redisclosure of IRS information input into FinCEN databases would be beneficial. Accordingly, we are in the process of coordinating a meeting with FinCEN, Disclosure, our office and a representative from your office, if you desire. If you have any questions or comments, please feel free to contact me on (202) 622-4460 or Marta Yanes of my staff on (202) 622-4470.

Attachments

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OFFICE OF
CHIEF COUNSEL

**DEPARTMENT OF THE TREASURY**
**INTERNAL REVENUE SERVICE**
**WASHINGTON, D.C. 20224**

CC:CT:NO-100135-00
CC:CT:NO-101503-01
CC:PA:DPL:JSchwartz

MAR 8 2001

MEMORANDUM FOR NANCY JARDINI
DIVISION COUNSEL/ASSOCIATE CHIEF COUNSEL
(CRIMINAL TAX) CC:CT
Attn: MARTA YANES

FROM: Lynnette N.M. Platt
Senior Technician Reviewer
Disclosure & Privacy Law
CC:PA:DPL:B1

SUBJECT: CI's Use of FinCEN's SAR Database

We have received two separate requests for advice from your office concerning the Criminal Investigation Division's (CI) use of two databases maintained by the Financial Crimes Enforcement Network (FinCEN). Since the disclosure issues surrounding CI's use of these databases are similar, we have chosen to respond in one consolidated memorandum.

Specifically, by memorandum dated October 19, 2000, you asked us to review FinCEN's change in its "networking policy" for law enforcement agencies seeking information on its "general database"[1], advising as to any potential disclosure issues arising from this change. By memorandum dated January 12, 2001, you asked that we address potential disclosure issues that could arise from CI's use of FinCEN's Suspicious Activity Report (SAR) database. We will address each database separately, beginning with the SAR database.

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[1] We are using the term "general database" to differentiate this database from the more specific SAR database.

SAR DATABASE[2]

We understand that the SAR database contains a tracker index with statements regarding each agencies' disposition of downloaded SARs. FinCEN has requested that participating agencies provide the disposition statements. The disposition statements contained in this index are available to all law enforcement agencies with access to the SAR database.[3] We also understand that CI uses this database for both tax and non-tax investigations.

According to information we have received from CI, each local CI field office has a Bank Secrecy Act (BSA) liaison who has access to FinCEN's Currency and Banking Retrieval System (CBRS). Although specific procedures vary from field office to field office, one of the BSA Liaison's jobs is to access CBRS and download SARs on a routine basis. For example, a field office BSA Liaison may be instructed, on a weekly basis, to download SARs filed by financial institutions in zip codes falling within the field office's

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[2] According to the Bank Secrecy Act, 31 U.S.C. section 5311, et. seq., and 31 C.F.R. part 103.18, banks and other depository institutions are required to report suspicious transactions relevant to possible violations of federal law or regulations to the Department of the Treasury. FinCEN is the office within the Department of the Treasury's Office of Enforcement that is responsible for the collection and maintenance of information under the Bank Secrecy Act, including SARs. A transaction requires reporting on a SAR if it is conducted or attempted by, at or through a bank, involves or aggregates at least $5,000 in assets, and the bank knows, suspects or has reason to suspect that it is:

1) a transaction involving funds derived from illegal activity or intended or conducted in order to hide or disguise funds or assets derived from illegal activity as part of a plan to violate or evade federal law;

2) a transaction designed to evade the requirements of the Bank Secrecy Act; or

3) a transaction that appears to have no business purpose or vary substantially from normal commercial activities appropriate for the particular customer, and the bank knows of no reasonable explanation for the transaction after examining available facts.

[3] All Federal, state and local law enforcement agencies that participate in the FinCEN Gateway program have access to the SAR database and the tracker index. We understand that Gateway has a very large number of participants.

jurisdiction. Regardless of the precise procedures used by a particular field office, SARs are downloaded to an internal CI database on some routine basis by the BSA Liaison.[4] Special Agents who want access to SARs in connection with their work can then access the SARs already downloaded to the internal CI database by the BSA Liaison. According to CI, in some offices this may be done on a routine basis in connection with every investigation, and in others this may be done only when the CI employee has established a reason to look at SARs.

In an effort to determine use being made of SARs, FinCEN has requested that agencies downloading SARs fill out a tracker form. Ideally, FinCEN would like the BSA Liaison to fill out the tracker form every time he or she does the periodic download of SARs. In reality, according to CI, it is more likely the tracker form would be filled out only when a Special Agent accesses an SAR from his or her own office's internal database in connection with a particular project or investigation. The Special Agent would have to give the information for the tracker form to the BSA Liaison who will then fill out the form on CBRS. The information on this tracker form is then available to every Federal, state and local law enforcement agency participating in the FinCEN Gateway program and having access to CBRS. The tracker form requests that CI input the Special Agent's name, address, phone and agency and fill out as many of the following statements as apply:

- Case opened/reopened (mm/dd/yyyy)
- Incorporated into pending investigation
- No action taken due to state/local prosecution
- Amount of loss does not meet prosecutive guidelines
- Matter presented to USA and prosecution declined
- Investigation unaddressed - lack of resources
- No apparent federal violation
- Violation under USSS Jurisdiction

To the extent CI is conducting a Title 26 tax investigation, including investigations where a related statute call has been made, any information gathered by or created by the IRS in connection with, or otherwise concerning, a taxpayer's liability or potential liability under the Internal Revenue Code is confidential and disclosure of such return

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[4] We have been told that an IRS indicator is put on CBRS every time the IRS performs a download of SARs, [redacted] 7(E)
Insomuch as BSA Liaisons download groups of SARs on a routine basis, and do not do so in connection with any taxpayer's liability or potential liability under the Code, there is no disclosure of return information when an IRS indicator is placed on CBRS, and I.R.C. § 6103 is not implicated.

information must be authorized by the Internal Revenue Code. See I.R.C. § 6103(a) for the general confidentiality rule and I.R.C. § 6103(b)(2) for the definition of return information. Courts have held that the Code defines "return information" in the broadest way. United States v. Barrett, 837 F.2d 1341 (5th Cir. 1988), cert. denied, 492 U.S. 926, reh'g denied, 493 U.S. 883 (1989).[5]

There is no specific authority in the Code for the disclosure of return information as envisioned here. The general authority to disclose return information for investigative purposes in accordance with I.R.C. § 6103(k)(6) is the only basis for disclosure potentially available to CI. Under the authority of I.R.C. § 6103(k)(6) and its implementing regulations, IRS employees are authorized to disclose return information (not returns) to the extent that 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 the Code. Treasury Regulations clarify that such disclosure for the purpose of obtaining information necessary to properly carry out tax administration duties should be made only if such necessary information cannot, under the facts and circumstances of the particular case, otherwise reasonably be obtained in accurate and sufficiently probative form, or in a timely manner, and without impairing the proper performance of such duties and responsibilities. Treas. Reg. § 301.6103(k)(6)-1(b).

The disclosure authority found in I.R.C. § 6103(k)(6) does not anticipate a wholesale sharing of information. Judicial review of I.R.C. § 6103(k)(6) disclosures has looked very closely at the facts of each case and each disclosure to ensure that disclosure of each element of return information is necessary to obtain essential information that is not otherwise reasonably available. See DiAndre v. United States, 968 F.2d 1049, 1053 (10th Cir. 1992) citing Barrett v. United States, 795 F.2d 446 (5th Cir. 1986) (subsequent history omitted). Disclosure of only that return information that must be made known in order for the IRS to obtain the information it needs is permitted.

The tracker form requires the disclosure of a great deal of information from the IRS. This information is, in turn, available to the law enforcement community generally. This in itself suggests that the systemic reliance on I.R.C. § 6103(k)(6) to authorize disclosure would be misguided and improper under these facts. Furthermore, it is questionable whether the information in the SAR database would not be available to the IRS without disclosing all of the information required by the tracker form, insomuch as CI has informed us that the FBI has refused to fill out the tracker form, and has not been barred from participating in the program. This fact makes it even less likely that

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[5] When the IRS downloads a SAR in connection with a nontax investigation, the disclosure of information does not implicate I.R.C. § 6103 since there is no Title 26 liability at issue.

I.R.C. § 6103(k)(6) would authorize the expected disclosures. It has consistently been the Service's position, since 1976, that I.R.C. § 6103(k)(6) does not authorize the disclosure of case updates or other status information as a condition of receiving information from another agency. These disclosures do not meet the necessity test of I.R.C. § 6103(k)(6). Since the authority to disclose so much return information, and to so many people, is not authorized by I.R.C. § 6103(k)(6), CI should not be filling out the tracker form when accessing SARs in connection with Title 26 investigations.[6]

GENERAL DATABASE

Your October 19, 2000, request for advice provides that FinCEN has changed its "networking policy" on information contained in its general database. As we understand it, the general database tracks cases and work products (such as various reports collected and maintained by FinCEN under the authority of the Bank Secrecy Act) providing a case tracking system and management reporting facility. The database is a vehicle through which a government agency may request research on whether there are any other agencies interested in the requesting agency's target. Government agencies seeking information fill out a Request for Research form that includes information about the requesting agent (including agency case number and project name) information about the authorizing official, information about the type of request and investigative information. (Draft Request for Research form attached.)

Prior to September 5, 2000, all requests for research of the FinCEN database from participating law enforcement agencies were input into the general database and then queried against the database for matches (i.e. other requests for research on the same target). Once a match was identified, FinCEN used the "third party rule" prior to disclosing the match to the most recent requesting law enforcement agency. The third party rule required that a research requester to the general database affirmatively consent to being identified by FinCEN to other law enforcement agency research requesters as interested in the same target. The other requester's identity remained confidential absent such consent. Consent was sought from both the law enforcement agency making the request, as well as the law enforcement agency whose request is archived within the general database. In the event either law enforcement agency responded negatively, no disclosure was made.

As of September 5, 2000, FinCEN no longer seeks the consent of one law enforcement

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[6] We understand from CI that FinCEN has created the tracker form in order to satisfy a mandate that it gather information on the need for and use of SARs by its customers. Section 6103 would not prohibit CI from gathering and providing statistical data to FinCEN on the types and classes of cases in which CI gathers and uses SARs, to the extent CI can produce such data.

agency prior to informing another law enforcement agency of its interest in the same target. Now, when a match occurs (i.e. two law enforcement agencies seeking information on the same target), FinCEN will automatically, and without anyone's notice or consent, contact both agencies directly to inform them that requests for information on the same target have been received from both. FinCEN will inform each requesting law enforcement agency:

1.) Name of the subject/target
2.) Name of other agency submitting the request
3.) Name of other agency requester and telephone number
4.) Agency case number

According to the latest draft Request for Research form, attached, there are three exceptions to the automatic network rule: Grand Jury, National Security, and Public Corruption.

As noted above in the discussion concerning the SAR database, to the extent CI is conducting a Title 26 tax investigation, including investigations where a related statute call has been made, any information gathered by or created by the IRS in connection with, or otherwise concerning, a taxpayer's liability or potential liability under the Internal Revenue Code is confidential, including the taxpayer's identity/name of the target, and disclosure of such return information must be authorized by the Internal Revenue Code. Although the disclosure to FinCEN of information in the Request for Research form may be authorized by I.R.C. § 6103(k)(6) on a case by case basis in accordance with the analysis of I.R.C. § 6103(k)(6) as set out above, there is no specific authority in the Code for the redisclosure by FinCEN of return information to other agencies querying the general database as envisioned here in connection with the new networking policy.

Recipients of return information under the authority of I.R.C. § 6103(k)(6) are not subject to use restrictions, nor are they subject to the safeguarding requirements set out in I.R.C. § 6103(p). Nonetheless a literal reading of I.R.C. § 6103(a) suggests that Federal agency employees are prohibited from redisclosing return information obtained under any authority, even I.R.C. § 6103(k)(6). In its October 2000 Report to the Congress on Scope and Use of Taxpayer Confidentiality and Disclosure Provisions, mandated by § 3802 of the Internal Revenue Service Restructuring and Reform Act of 1998, Treasury notes that a better interpretation of I.R.C. § 6103(k)(6) based on the structure of section 6103 as a whole is that Congress did not intend to regulate or control redisclosures of return information obtained pursuant to I.R.C. § 6103(k)(6). However, since the statute is not clear on this issue, in an effort to protect Federal agency recipients of tax information under I.R.C. § 6103(k)(6) Treasury has recommended that I.R.C. § 6103 be amended to clarify that persons otherwise included in I.R.C. § 6103(a) who receive return information under I.R.C. § 6103(k)(6) are not subject to the redisclosure restrictions for such information. Until such requested

amendments are enacted, a routine practice by Federal agency employees of redisclosing return information received under I.R.C. § 6103(k)(6) is vulnerable to challenge as not authorized by Title 26 and potentially exposes the United States to the risk of suit under I.R.C. § 7431, by taxpayers seeking monetary damages for the unauthorized disclosure of their return information by Federal employees.

[redacted]

AWP

In sum, we are concerned about the I.R.C. § 6103(k)(6) disclosure of return information to FinCEN in light of the redisclosure of that information to an unknown number of potential recipients without CI's ability to consent to the disclosure. We question whether such disclosure really is the disclosure of only that return information as is necessary to obtain information as anticipated by I.R.C. § 6103(k)(6). As such, the best course of action, initially, would be to seek to have tax cases added to the list of exceptions to the automatic networking policy.

Please contact me at 622-4590 if you have any questions.

Attachments:
As stated.