

Legislative Recommendation #63**Require the IRS to Specify the Information Needed in Third-Party Contact Notices****SUMMARY**

- *Problem:* The IRS may contact third parties to obtain information or documentation relating to taxpayers. Recognizing that third-party contacts “may have a chilling effect on the taxpayer’s business and could damage the taxpayer’s reputation in the community,” Congress has required the IRS to provide advance notice to affected taxpayers. However, the IRS sometimes does not tell the taxpayer what information it is seeking or give the taxpayer a reasonable opportunity to provide the information so that it can avoid a third-party contact.
- *Solution:* Require the IRS to provide taxpayers with a tailored notice that identifies the specific information it plans to request from a third party. Before the IRS seeks such information from a third party, it should give taxpayers a reasonable period of time to respond to the notice, including by providing the requested information, unless advance notice would jeopardize the collection of tax or another statutory exception applies.

PRESENT LAW

IRC § 7602(c)(1) generally requires the IRS to give taxpayers notice before contacting third parties (*e.g.*, banks, employers, employees, vendors, customers, friends, and neighbors) to request information about them. The IRS may provide this third-party contact (TPC) notice only if it intends to make a TPC during the period specified in the notice, which may not exceed one year. Generally, the IRS must send the notice at least 45 days before making the TPC.

IRC § 7602(c)(3) waives the TPC notice requirement if (i) the taxpayer has authorized the contact; (ii) the IRS determines for good cause that notice would jeopardize the IRS’s tax collection efforts or may involve reprisal against any person; or (iii) the contact is made in connection with a criminal investigation. No law expressly requires the IRS to let the taxpayer know what specific information it needs (or needs to verify) before contacting third parties.

REASONS FOR CHANGE

The TPC notice requirement was enacted as part of the IRS Restructuring and Reform Act of 1998 (RRA 98). The Senate report accompanying the bill explained that “taxpayers should have the opportunity to resolve issues and volunteer information before the IRS contacts third parties.”¹ The House-Senate conference report accompanying RRA 98 stated that “in general” the TPC notice “will be provided as part of an existing IRS notice.”² Based on the conference report language, the IRS implemented the TPC notice requirement by including generic language in Publication 1, *Your Rights as a Taxpayer*, which the IRS sends to taxpayers in a variety of circumstances, whether or not it plans to make a TPC.³

1 S. REP. NO. 105-174, at 77 (1998).

2 H.R. REP. NO. 105-599, at 277 (1998) (Conf. Rep.).

3 IRS, Pub. 1, *Your Rights as a Taxpayer* (Sept. 2017), <https://www.irs.gov/pub/irs-pdf/p1.pdf>. Under the heading “Potential Third Party Contacts,” Pub. 1 states, in part: “[W]e sometimes talk with other persons if we need information that you have been unable to provide or to verify information we have received.”

When Congress enacted the Taxpayer First Act (TFA), it rejected the generic approach of including the TPC language in Publication 1. The TFA amended IRC § 7602(c) to require the IRS to send the TPC notice only when it intends to make a TPC and to send the TPC notice at least 45 days before making the contact.⁴ In explaining the change, the House report accompanying the TFA quoted testimony from a former IRS official, who said the then-existing TPC notice requirement was “useless and does not effectively apprise taxpayers that such contact will be made, to whom it will be made, or that the taxpayer can request a third party contact report from the IRS.”⁵ The House report said TPCs “may have a chilling effect on the taxpayer’s business and could damage the taxpayer’s reputation in the community.” It also said the change would “provide taxpayers more of an opportunity to resolve issues and volunteer information before the IRS contacts third parties.” If the IRS included TPC notices “as part of an existing IRS notice,” such as Form 4564, Information Document Request, which requests information from the taxpayer, then the new 45-day period would give the taxpayer a realistic opportunity to avoid a TPC that seeks new information by providing the information requested on the form. However, the IRS generally does not include a request for that information with the TPC notice.⁶

A tailored notice that identifies the specific information the IRS plans to request from a third party would be more effective than a generic notice in motivating taxpayers to provide the information themselves. The IRS has previously tailored TPC notices in this way.⁷ Generating tailored notices would not unduly burden the IRS because most IRS TPCs occur in the collection context, where the IRS is seeking assets rather than information.⁸ In the subset of cases where the IRS is seeking specific information, identifying what information the IRS is seeking would empower the taxpayer to protect his or her reputation by providing the information so that the TPC is unnecessary. Thus, using tailored TPC notices is consistent with a taxpayer’s *rights to be informed* and *to privacy*, which includes the right to expect enforcement to be no more intrusive than necessary,⁹ and it might reduce the need for the IRS to spend resources needed to make the TPCs as well.

RECOMMENDATION

- Amend IRC § 7602(c) to require the IRS to provide taxpayers with a tailored notice that identifies the specific information it plans to request from a third party. Before the IRS seeks such information from a third party, it should give taxpayers a reasonable period of time to respond to the notice, including by providing the required information, unless an exception under IRC § 7602(c)(3) applies.¹⁰

4 Pub. L. No. 116-25, § 1206, 133 Stat. 981, 990 (2019).

5 H.R. REP. NO. 116-39, pt. 1, at 44-45 (2019). This report accompanied H.R. 1957, 116th Cong. (2019). Congress ultimately made one change to H.R. 1957 unrelated to the TPC provision and enacted the TFA as H.R. 3151, 116th Cong. (2019). However, H.R. Rep. No. 116-39 remains the sole committee report explaining the TFA.

6 See, e.g., Internal Revenue Manual 5.9.3.12.1, Third Party Contacts (May, 26, 2020), https://www.irs.gov/irm/part5/irm_05-009-003r; IRS, Letters 3164, Notification of Third Party Contact.

7 For further discussion, see National Taxpayer Advocate 2015 Annual Report to Congress 123, 127 (Most Serious Problem: *Third Party Contacts: IRS Third Party Contact Procedures Do Not Follow the Law and May Unnecessarily Damage Taxpayers’ Businesses and Reputations*), https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/ARC15_Volume1_MSP_12_Third-Party-Contacts.pdf; National Taxpayer Advocate Fiscal Year 2018 Objectives Report to Congress 98 (Area of Focus: *IRS Third Party Contact (TPC) Notices Should Be More Specific, Actionable, and Effective*), https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/JRC18_Volume1_AOF_12.pdf.

8 TPCs often arise from IRS requests for payment from third parties, such as banks served with a levy for the taxpayer’s funds on deposit or in connection with the advertising or conduct of public auction sales of the taxpayer’s property. A prior TAS study found that the IRS made TPCs in 68.1 percent of its field collection cases and 8.5 percent of its field examination cases. National Taxpayer Advocate 2015 Annual Report to Congress 123 (Most Serious Problem: *Third Party Contacts: IRS Third Party Contact Procedures Do Not Follow the Law and May Unnecessarily Damage Taxpayers’ Businesses and Reputations*), https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/ARC15_Volume1_MSP_12_Third-Party-Contacts.pdf. This proposal generally does not cover collection contacts because in those cases, the IRS is not asking a third party for information that the taxpayer could provide.

9 IRS, Pub. 1, Your Rights as a Taxpayer (Sept. 2017), <https://www.irs.gov/pub/irs-pdf/p1.pdf>.

10 If the taxpayer responds, the IRS may still contact a third party if it has a legitimate need to interview witnesses or corroborate information provided by the taxpayer.