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COST
COUNCIL ON STATE TAXATION

Confidentiality of Taxpayer Information

Policy Position

Position: *Taxpayers have a justifiable expectation of privacy. State departments of revenue audit business taxpayers on a regular basis to ensure that all relevant tax laws are appropriately enforced; releasing specific business tax returns or information from those returns to the public would serve no policy purpose.*

Explanation: The proposition that confidential tax returns should be made available for public inspection so that the public can determine whether a business is paying its "fair share" is fundamentally wrong. The determination of one's "fair share" of taxes is inherently subjective. A taxpayer's tax liability is determined by law, not by subjective criteria. The public's right to set appropriate levels of taxation for different groups is through the lawmaking power of its elected representatives. Those laws, once made, must be fairly interpreted and enforced.

Because tax laws are inherently complex, every state has a dedicated agency of specialists to ensure that tax laws are fairly interpreted and enforced. If lawmakers are concerned that those laws are not being correctly administered, the appropriate response is proper oversight of the tax agency and not disclosure of confidential taxpayer information. If, however, the legislative branch is concerned that certain classes of taxpayers are inappropriately taxed, it can and should ask the executive branch for aggregate information on that class of taxpayers.

From an empirical perspective, having legislators or the public examine specific tax returns is not useful in formulating policy. When such disclosures have been made in past, they have generally been counter-productive due to the lack of public understanding of the complexities of corporate income taxes, especially as they apply to multistate business entities. For example, in New Jersey, tax return information was used to allege that "Public Company A" employed thousands of workers and earned significant income but was paying the State's minimum tax. In fact, those employees worked for and those profits were earned by a subsidiary of the public company; that subsidiary paid a substantial amount of tax to the state. Furthermore, such disclosures of confidential information make public trade secrets and other sensitive information that can be used by competitors—including competitors not located in the state and subject to the state's tax system. Thus, taxpayers will be disadvantaged to the extent that they must disclose information that is then available to their competitors.

In 2000, the United States Congress Joint Committee on Taxation completed an exhaustive review of taxpayer confidentiality. The Committee concluded:

> Taxpayers have a justifiable expectation of privacy in the extensive information they furnish under penalty of fine or imprisonment....Our tax system is based on voluntary compliance. Many observers believe that the degree of voluntary compliance is directly affected by the degree of confidentiality given the information that is provided to the IRS.
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> If returns and return information were publicly available, it would invite a variety of intrusions into a taxpayer's privacy. Business competitors could use the information to gain economic advantage....A lack of confidentiality could also facilitate the use of return information for political gain.

Federal Treatment of Tax Returns: The general rule of §6103 of the Internal Revenue Code (IRC) is that tax returns and tax return information are confidential and not subject to public disclosure.

State Treatment of Tax Returns: The IRC contains a provision prohibiting the sharing of federal tax return information with a state or local government unless the state or local government is likewise required to protect the information.

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