The Internal Revenue Service and the Bureau of Economic Analysis

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In the few minutes I have today, I will briefly summarize some views on interagency data sharing from my perspective in the Statistics of Income (SOI) Division of the Internal Revenue Service (IRS), including:

- Background information on the issue of interagency data sharing from my current and previous roles in the Federal statistical system;
- A brief overview of the IRS's and Treasury Department's views on the potential benefits and costs associated with interagency data sharing;
- A summary of access to IRS tax information by the Bureau of Economic Analysis (BEA) of the Commerce Department; and
- Closing thoughts as to why our relationship with BEA has been beneficial to both organizations and is, in some ways, a successful model of interagency cooperation.

Background

The views I express are my own and do not constitute an "official position" of the Internal Revenue Service or the Department of the Treasury. Nevertheless, they have been shaped by years of discussion and closely mirror those articulated in the recent comments that we (IRS and Treasury) have made on the Statistical Confidentiality Act (SCA), as well as the "Companion Bill" to amend the Internal Revenue Code (IRC) section 6103(j), which specifically addresses interagency access to confidential tax data.

First, I want to provide a brief chronology of my background in other Federal statistical agencies. I began my career as a staff economist at BEA in the early 1970's. I spent four years there, primarily as a user of public and private data from many sources, particularly the Bureau of the Census (e.g., retail and merchandise line sales), the Bureau of Labor Statistics (e.g., consumer and producer prices), and private industry (e.g., production and distribution data from motor vehicle manufacturers and petroleum producers). Like other BEA analysts, I did not create or produce data but, more descriptively, "assimilated" data from many other sources to estimate components of the national income and product accounts--mainly certain personal consumption and gross private domestic investment expenditures, as well as overall output of the auto industry.

I left BEA to work as an economist at the Social Security Administration (SSA), where I became a "Census Agent" and worked extensively on the 1972 CPS-SSA-IRS exact match file. This interagency study linked confidential microdata from the three agencies, using the Census Bureau's March Supplement to the Current Population Survey (CPS) as a "base" data set. I personally made 500+ tabulations of various iterations of this linked microdata file to analyze and adjust the income and tax data to national income and product account totals. This began as a Social Security research project, but later evolved into a joint BEA/SSA interagency study.

In 1980, I joined SOI where I have spent the last 16+ years as an economist, statistician, and supervisor. Although SOI is primarily a data-producing organization, which exists primarily as an offshoot of Federal tax processing, I have continued to analyze data and present findings at various professional meetings. SOI relies almost exclusively on IRS tax and information returns to conduct its mission, which is the compilation and dissemination of tax and income statistics. SOI's primary customers are the Treasury's Office of Tax Analysis (OTA) and the Congressional Joint Committee on Taxation (JCT). Both agencies have, by law, access to all identifiable data in our samples and other files. OTA, together with IRS senior management, determines SOI's level of resources and operational priorities.

From a resource standpoint, SOI is one of the "top ten" Federal statistical agencies. SOI data, in aggregate and identifiable form, are highly sought by other Federal agencies, academia, other researchers, and the public, since they are a very reliable source of information on the business, individual, and nonprofit sectors of the economy. Other agencies are generally unwilling to share identifiable microdata with SOI even though it could improve our data sets, as well as the policy analysis that could be carried out by OTA and JCT. This is partly true because, as employees of the IRS, we are required, by law, to report evidence of failure to comply with the Tax Code. Even if this were not the case, however, it has been made clear that other major Federal statistical agencies would not want to share identifiable microdata with SOI because it gives the impression that they are providing data "for tax compliance," and they fear an adverse effect on survey response rates.

I will conclude these background remarks with a question: "For what reason have I digressed to describe these different roles in the Federal statistical system?" My answer should be obvious--it is in these different roles that I have been a producer as well as a user of both macro- and microdata. I have been a principal supplier and a primary customer. And, from these perspectives, I feel that I can offer a balanced view of inter-agency data sharing.

■ Confidentiality and Data Sharing

As an employee of the Internal Revenue Service, I have very real concerns with the impact (or potential impact) of sharing confidential tax data. For example, among these concerns are:

- ❒ The public's perception of IRS and its effect on the level of tax compliance,
- ❒ The IRS's ability to monitor the use of shared data, and, in particular,
- ❒ The right of taxpayers to privacy with respect to the sensitive personal information contained in tax returns.

For these reasons, we in the "Service" (including the Commissioner's Office, Office of Disclosure, and Chief Counsel), as well as persons in the Treasury Department, have worked with Kathy Wallman and her staff at the Office of Management and Budget (OMB) and other statistical agencies in drafting amendments to section 6103(j) of the Internal Revenue Code (IRC) that are included in the "Companion Bill" to the proposed Statistical Confidentiality Act (SCA). (Section 6103(j) of the Tax Code governs the disclosure of tax return information for statistical purposes.)

The IRS/Treasury guiding principle behind the proposed amendments to section 6103(j) was balancing the *potential benefits* of:

- ❒ Lowering agency costs and increasing efficiency,
- ❒ Improving quality and timeliness of data, and
- ❒ Reducing respondent burden,

against the *potential costs* of:

- ❒ Lower tax compliance,
- ❒ Creating an adverse public perception of IRS,
- ❒ Monitoring use of shared data, and, *most importantly,*
- ❒ Compromising taxpayers' right to privacy.

This principle led us to an approach to expand limited and closely-controlled access to a restricted number of agencies, primarily for constructing sample frames for censuses and surveys and related statistical purposes authorized by law. Only the *minimum amount of information needed* would be releasable (i.e., minimum in terms of items included, years covered, and number of taxpayers covered, and with the data often in categorical form).

■ BEA Access to Tax Information

BEA has access to IRS tax microdata files in three general areas, which are summarized below.

SOI Corporation Returns

First, BEA has access to SOI sample files of corporations by law, specifically section 6103(j)(1)(B) of the Internal Revenue Code (as specified in the accompanying Regulations). It is increasingly difficult to trace the history of this relationship (since the people who established it on both sides are no longer in our agencies), but from the information that I could piece together, BEA's access to SOI corporate samples began in the 1940's and was established by Executive Order in 1961. This access was incorporated into law with the revision of Internal Revenue Code section 6103 in the Tax Reform Act of 1976. Under this provision, BEA is allowed access, as defined in the supporting Regulations to this section, to:

> "Statistics of Income transcript-edit sheets containing return information" and "micro-filmed records of return information reflected on such returns."

However, despite this access to identifiable microdata, BEA generally prefers to receive SOI corporation data in the form of tabulations of selected financial data classified by major and minor industry.

Unincorporated Business Tax Returns

A second type of BEA access is by means of a contract initiated in 1985, primarily to allow BEA access to partnership data showing evidence of underreporting of income through the use of tax shelters. This agreement added access to SOI sole proprietorship returns as well. BEA initially detailed a staff member to my office to help us analyze these data.

The problem first surfaced when it was observed that profits or losses reported on partnership information returns, which closely paralleled partnership profits or losses reported by partners on individual income tax returns, began to diverge significantly in the early 1980's. While this was theoretically possible, since partners could be corporations, fiduciaries, or virtually any other legal entity, it implied that something "unusual" was happening, primarily in the corporate partner data (which are a source of potential double counting in the national accounts). It appeared that partners were understating profits from partnerships but fully reporting losses.

This situation led to my proposal to the IRS tax forms designers to expand the partnership information return (Form 1065) to add summaries of financial activity for each legal type of partner. This initiative succeeded--financial summaries by type of partner were added to Schedule K of the *U.S. Partnership Return of Income,* Form 1065--despite pressure from OMB to reduce the content of tax forms to lower taxpayer burden. However, I successfully argued that OMB had also formally recognized that underreporting unincorporated business income was a key deficiency in the national accounts.

As is the case for corporations, BEA generally receives IRS partnership and proprietorship data in the form of tabulations of selected financial data classified by major and minor industry.

Geographic Data for Unincorporated Businesses

A third type of BEA access to tax information is by means of a contract between the agencies for IRS master file (specifically, business and individual returns transaction file) extracts for partnerships and sole proprietorships. This arrangement was made under section 6103(n) of the IRC in which BEA is essentially a contractor to SOI to tabulate these data at the State and county level for SOI analysis and/or publication. This arrangement began in the early 1980's, was briefly interrupted but resumed, and continues to this day.

■ A Model of Successful Interagency Cooperation

Over the years, the IRS/BEA data-sharing relationship has been a success story, and, as part of a "lessons learned," I will summarize at least four broad reasons why:

The Need for Data

As a former BEA employee, I am quite aware of their dependence on data providers. In my work at BEA, those data were for production and/or expenditures--what BEA collectively refers to as "product-side data." Although I personally had minor involvement with the "income-side" estimates, BEA is heavily dependent on both corporate profits and unincorporated business income data from tax and information returns. I am not aware if BEA has *many options* on the corporate side, nor am I aware of *any options* on the unincorporated side. Thus, there is a monopoly factor--tax data are a unique, important, and irreplaceable source of data for the national accounts, and the alternatives are limited.

Continuing Education

BEA has been a knowledgeable user and has helped SOI to better understand our data. SOI's primary role is that of data producer since we often do not spend as much time as we could probing our data to more fully understand their subtleties. This is partly true since OTA, JCT, and BEA all have major roles to examine and analyze these data in the context of their own missions.

BEA has provided constructive feedback and insight into some tough issues of analysis and interpretation as to what the tax data actually show. Not only has this helped us better understand the data, it has helped us plan future studies. We regard this as a nonpecuniary *quid pro quo* of the arrangement. Further, SOI and BEA analysts have briefed their respective staffs on processes and priorities, as well as helped orient new employees and international trainees. Both agencies have consistently supported each other with speakers and briefings as needed.

Professional Cooperation

Overall, BEA has been complimentary of our work; their criticisms have generally been well-justified and focussed on future improvements. Although BEA (as well as other users) sometimes do not fully comprehend the anomalies that taxpayers report on their tax returns and the impact that these could have on successful completion of an SOI study, they are, by and large, appreciative of our quality and timeliness. We have responded by attempting to be sensitive to their needs and schedules.

Provisions of Resources

BEA has helped expand tight SOI budgets with reimbursable funding for unincorporated business data since the early 1980's, and more recently, for corporation advance data. And, even though funds for the unincorporated business data have been eroded by inflation (since they have remained at approximately the same level since the inception of this arrangement), they have allowed us to continue annual unincorporated business studies, uninterrupted to this day. Plus, funding for advance corporate data has been used to augment our data-processing capabilities, which have, in turn, enabled this work to be accomplished in a shorter timeframe.

Conclusion

Let me end my remarks by reiterating the importance we place on interagency data sharing and the success of the initiatives in this area. But let me also reemphasize that one of IRS's primary responsibilities is that of maintaining all taxpayers' rights to privacy.