

For Your Eyes Only: Tax Settlements and Confidentiality

by Mary T. Benton and Michael M. Giovannini



Introduction

Many states have standardized the process for seeking, negotiating, and documenting settlements. That is true for voluntary disclosure and amnesty settlement initiatives and in the course of general audits. Because of that standardization, the settlement agreements drafted by state revenue departments increasingly include a two-way confidentiality agreement.

A two-way confidentiality agreement really serves as a means for a state to preclude the taxpayer from disclosing the details of the settlement agreement to other taxpayers, because the revenue department is already subject to the confidentiality standards imposed by state statutes. Such a prohibition can adversely affect taxpayers by preventing them from learning what settlements states are reaching with other similarly situated taxpayers.

The enforceability and propriety of those two-way confidentiality agreements have not been scrutinized. The investigation should begin with an analysis of the state laws governing the confidentiality of tax information.

A Suggested Framework for the Analysis

Despite the growing prevalence of settlement agreements between state revenue departments and taxpayers, state law does not typically address the

confidentiality of those agreements.¹ So taxpayers must look to general state law confidentiality provisions to determine whether settlement agreements will be confidential; that process can lead to unclear and unsatisfactory results. This problem is compounded by a general lack of uniformity among the states, which necessarily makes any inquiry dependent on a state-by-state analysis.

Therefore, we suggest that taxpayers follow a three-step framework to analyze the confidentiality of settlement agreements in any particular state. A taxpayer should consult the state's provisions that:

- prohibit some types of tax information from disclosure by the state;
- authorize the state revenue department to enter into settlement agreements with taxpayers; and
- grant public access to some documents and information in the possession of the state.

Most states' laws contain some version of those provisions.

¹Some states do have direct guidance. Idaho explicitly recognizes that a compromise agreement "contains confidential information" and thus "is not made available to the public." Attorney General Opinion July 15, 2008. Indiana protects the "terms of a settlement agreement executed between a taxpayer and the department" from disclosure. Ind. Code section 6-8.1-7-1(a). Similarly, Massachusetts affords tax settlement agreements the same treatment as "tax return[s] or document[s] filed with the commissioner," as long as liability for the tax is not in dispute. Mass. DOR Directive 03-5, May 17, 2003. They are thus confidential and not subject to disclosure under state law. Finally, the West Virginia Supreme Court of Appeals has held that "information related to tax compromises [is] exempt from disclosure in order to protect the taxpayer's right to privacy." *Daily Gazette Co. v. Caryl*, 380 S.E.2d 209, 211 (W.Va. 1989). In contrast, Louisiana provides that an offer in compromise is a "public record and is open to public inspection upon request." Louisiana Form R-20212, "Offer in Compromise Program." Likewise, Oklahoma provides that "any agreement entered into by the Tax Commission concerning a compromise of tax liability for an amount less than the amount of tax liability" is not subject to the state's confidentiality laws. Okla. Stat. section 205.C.15.

First, a taxpayer should research and review the provisions prohibiting the state from disclosing some types of tax information (Step One). In some states, the language in those provisions is broad enough to conclude that a tax settlement agreement will be confidential. In other states, however, that language will be either narrow or unclear, forcing a taxpayer to proceed with the other steps in the analysis.

Next, a taxpayer should research and review the relevant provisions authorizing the state revenue department to enter into settlement agreements with taxpayers (Step Two). Those provisions can undermine the conclusion that an agreement will be treated as confidential. For example, some statutes provide that some types of settlement agreements must be reflected in *public* records.

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Finally, a taxpayer should research and review the state's Freedom of Information Act provisions, which govern the circumstances and conditions under which a state must grant the public access to state documents (Step Three). The FOIA provisions can be decisive when the provisions analyzed under Steps One and Two do not result in a clear conclusion.

Although there is a dearth of authority in most states regarding the confidentiality of settlement agreements, these three steps should provide a helpful framework by which a taxpayer may reach a reasoned conclusion regarding whether settlements agreements are considered confidential in any particular state. To illustrate the application of this framework, the next section uses it to analyze the confidentiality of settlement agreements in five states.

Applying the Framework to Select States

1. California

STEP ONE. California makes it a misdemeanor for any state official or employee to disclose information contained in a taxpayer's return, report, or other document required to be filed with the Franchise Tax Board.² It is also a misdemeanor for a state official or employee to inspect without au-

thorization materials containing that information.³ There are a handful of exceptions to those prohibitions, including disclosure when required in a judicial or administrative proceeding or to the state attorney general under some circumstances.⁴

The analysis under this step alone does not lead to the conclusion that an agreement will be confidential. The plain language of this provision is narrow, and settlement agreements do not appear to be contemplated, because they are not returns, reports, or other documents required to be filed with the state. Thus, it is necessary to proceed to Step Two.

STEP TWO. California authorizes the FTB to enter into three distinct agreements with taxpayers: compromise agreements, closing agreements, and settlements of civil tax disputes. Each is governed by its own statutory provision, and each type of agreement serves a different purpose.

Compromise agreements settle final tax liabilities, including penalties, additions, and interest.⁵ The state can compromise a liability if the taxpayer establishes that the amount offered is the most that it is able to pay and compromise is in the state's best interests.⁶ If a compromise agreement involves a liability greater than \$500, the state requires it to be in a public record.⁷ Closing agreements are "final and conclusive" agreements between the FTB and taxpayers "in respect of any tax, interest, penalty, or addition."⁸ Finally, settlements of civil tax disputes pertain to "civil tax matters in dispute that are the subject of protests, appeals, or refund claims."⁹ Those settlements must also be made in public records.¹⁰

Because compromise agreements and civil tax dispute settlements with the state include requirements that they be made in a public record, those agreements will not be protected as confidential based on these statutes. However, closing agreements, which are not required to be made part of the public record, may indeed be confidential, unless they are subject to disclosure by the state's FOIA provisions.

STEP THREE. In its Public Records Act, California mandates that all public records be open to inspection by members of the public, unless there is an exemption "by express provision of the law."¹¹

²Cal. Rev. & Tax. Code section 19542.

³Cal. Rev. & Tax. Code section 19542.1(a).

⁴Cal. Rev. & Tax Code sections 19545, 19546, and 19546.5.

⁵Cal. Rev. & Tax. Code section 19443(a).

⁶Cal. Rev. & Tax. Code section 19443(c).

⁷Cal. Rev. & Tax. Code section 19443(g).

⁸Cal. Rev. & Tax. Code section 19441(a).

⁹Cal. Rev. & Tax. Code section 19442(a).

¹⁰Cal. Rev. & Tax. Code section 19442(c).

¹¹Cal. Gov't Code section 6253.

Public records are defined as “any writing containing information relating to the conduct of the public’s business prepared, owned, used, or retained by any state or local agency regardless of physical form or characteristics.”¹² All three settlement agreements, including closing agreements that are in writing, would likely be public records according to this broad statutory language. Thus, if requested by a member of the public, a taxpayer’s settlement agreement with the FTB is likely subject to disclosure.

Therefore, it is likely that tax settlement agreements are not considered confidential under California law.

2. Georgia

STEP ONE. Georgia provides that all information “secured by the commissioner incident to the administration of any tax” is both confidential and privileged.¹³ All state officials and employees are prohibited from disclosing this information outside the Department of Revenue. That broad language suggests that tax settlement agreements are protected from disclosure by the DOR under Georgia law, despite a lack of direct statutory or regulatory guidance. It is prudent, however, to proceed to Steps Two and Three to determine whether other provisions undermine this conclusion.

STEP TWO. Georgia authorizes the settlement of actions or judicial proceedings for the collection of state taxes.¹⁴ Also, the DOR can settle a proposed or final tax assessment “where there is doubt as to liability or there is doubt as to collectability, and the settlement or compromise is in the best interests of the state.”¹⁵ The commissioner is required to keep a record of any settlement explaining the DOR’s reasons for settling.¹⁶

This information is not particularly instructive as to whether tax settlement agreements would be considered confidential.

STEP THREE. Georgia’s Public Records Act generally requires that all public records be open for inspection by any Georgia citizen.¹⁷ Public records are defined as “all documents, papers, letters, maps, books, tapes, photographs, computer based or generated information, or similar material prepared and maintained or received in the course of the operation of a public office or agency.”¹⁸ Notably, the act declares that it “shall not be construed to repeal” any “state laws making certain tax matters confi-

dential.”¹⁹ Thus, the confidentiality provisions discussed in Step One appear to trump the FOIA provisions, leading to the conclusion that settlement agreements would be confidential.

3. New York

STEP ONE. New York prohibits the disclosure of taxpayer information contained in annual corporate franchise tax returns and sales and use tax returns, subject to a few exceptions.²⁰ The plain language used in those provisions is considerably narrower than the correlative language in Georgia and thus more akin to the California provision, because the statutes extend protection only to some limited categories of taxpayer information. It is difficult to conclude that tax settlement agreements are confidential in New York based on Step One alone.

STEP TWO. New York authorizes the commissioner of the Department of Taxation and Finance to either compromise a taxpayer’s civil tax liability or enter into a written agreement regarding a taxpayer’s tax liability, depending on the facts of the particular situation.²¹

To compromise a taxpayer’s civil tax liability, the commissioner must show that there is doubt as to either the liability or collectability of the tax.²² Any compromise reached for unpaid taxes of \$25,000 or more must be reflected in a record filed with the department stating the amount of tax subject to compromise; the amount of interest, additions, or penalties imposed; and the amount required to be paid under the terms of the compromise.²³ The commissioner may also enter into a written agreement with a taxpayer to settle a tax liability dispute before a formal proceeding has been instituted by either party.²⁴

Those provisions are not determinative regarding the confidentiality of those settlement agreements, so it is necessary to proceed to Step Three.

STEP THREE. New York’s Freedom of Information Law generally provides that the public should “have access to the records of the government.”²⁵ All state agencies must “make available for public inspection and copying all records,” unless there is a relevant exception such as protection from disclosure by state or federal statute.²⁶

A letter from the New York Department of State Committee on Open Government addresses whether a Freedom of Information Law request for a copy of

¹²Cal. Gov’t Code section 6252(e).

¹³Ga. Code Ann. section 48-2-15(a).

¹⁴Ga. Code Ann. section 48-2-60(a).

¹⁵Ga. Code Ann. section 48-2-18.1(a).

¹⁶Ga. Code Ann. sections 48-2-60(a), 48-2-18.1(a).

¹⁷Ga. Code Ann. section 50-18-70.

¹⁸Ga. Code Ann. section 50-18-70(a).

¹⁹Ga. Code Ann. section 50-18-72(e)(3).

²⁰N.Y. Tax Law sections 1825, 1145(a).

²¹N.Y. Tax Law section 171.

²²N.Y.C.R.R. 5000.1(a).

²³N.Y.C.R.R. 5000.4.

²⁴N.Y. Tax Law section 171.

²⁵N.Y. Pub. Off. Law section 84.

²⁶N.Y. Pub. Off. Law section 87(2).

a settlement agreement can prevail over that agreement's confidentiality provision. The letter concludes that the request would be honored, because the law is based on a "presumption of access."

Based on this opinion letter and the broad language of the Freedom of Information Law, Step Three leads to the conclusion that settlement agreements would be subject to disclosure and not considered to be confidential.

4. North Carolina

STEP ONE. With a few exceptions, North Carolina requires secrecy from all officers, employees, and agents of the state regarding any "tax information," which is defined broadly as any information "concerning the liability of a taxpayer for a tax."²⁷ The statute enumerates examples of things not considered to be tax information, but tax settlement agreements are not on that list. Thus, because of the broad statutory language, those agreements would likely be tax information and therefore protected from disclosure by statute. However, as in Georgia, prudence dictates that a taxpayer should consider steps two and three before reaching a conclusion regarding confidentiality.

STEP TWO. North Carolina authorizes the secretary of the DOR to compromise a taxpayer's liability for a collectible tax under specific conditions.²⁸ The compromise must be in the best interests of the state, and the taxpayer must either be insolvent or there must be an improbable chance of collecting more than offered by the compromise.²⁹ For a tax liability greater than \$1,000, the secretary must keep a written record of the compromise that details the amount of the liability, the amount of the compromise, the pertinent facts, and the "findings on which the compromise is based."³⁰ There is no provision specifically addressing the confidentiality of those written records. However, it is reasonable to believe that the settlement agreements would constitute tax information that is kept confidential in accordance with Step One.

STEP THREE. North Carolina's Public Records Act allows general access to all public records.³¹ One provision designates "settlement documents in any suit, administrative proceeding or arbitration instituted against any agency" as an example of public records.³² Another provision of the act, however, exempts those settlement agreements that constitute "confidential communications," and tax infor-

mation is listed.³³ Accordingly, it appears that most settlement agreements would be subject to disclosure, but consistent with the broad cloak covering tax information identified in Step One, North Carolina has designated settlements containing tax information as confidential documents, which are not compromised by a FOIA request.

5. Texas

STEP ONE. Texas protects from disclosure "all information secured, derived, or obtained by the comptroller or the attorney general during the course of an examination of the taxpayer's books, records, papers, officers, or employees."³⁴ That protection is inapplicable in a handful of situations, such as when information is subpoenaed in a judicial or administrative proceeding in which the state or federal government is a party.³⁵ Texas also has specific confidentiality provisions for information in franchise and sales and use tax reports.³⁶

It is unclear whether tax settlement agreements would be confidential under those provisions because the language is narrower than the generally encompassing language used in the Georgia and North Carolina provisions. Faced with that uncertainty, it's necessary to proceed to steps two and three for a more decisive conclusion.

STEP TWO. Texas authorizes the state comptroller to settle a claim for tax, penalty, or interest if the total costs of collection are greater than the amount due from the taxpayer.³⁷ The comptroller can also settle a claim for a refund if the total costs of defending the claim are greater than the amount owed to the taxpayer.³⁸ Also, the comptroller can enter into a settlement with a taxpayer as part of a redetermination order. Those claims may be settled if collecting the amounts would make the taxpayer insolvent or if the taxpayer is already insolvent, in liquidation, or has ceased to do business and has no property that can be seized by any court to offset the amount due.³⁹

Notably absent from these provisions is any mention of confidentiality, so the research gained in this step is not determinative.

STEP THREE. Texas's Public Information Act generally requires that public information be available to members of the public.⁴⁰ A settlement agreement "to which a governmental body is a party" is an example of information considered to be public.⁴¹

²⁷N.C. Gen. Stat. section 105-259(c).

²⁸N.C. Gen. Stat. section 105-237.1.

²⁹N.C. Gen. Stat. sections 105-237.1(a)(1)-(a)(5).

³⁰N.C. Gen. Stat. section 105-237.1(b).

³¹N.C. Gen. Stat. section 132-1.

³²N.C. Gen. Stat. section 132-1.3(a).

³³N.C. Gen. Stat. sections 132-1.3(c), 132-1.3(b).

³⁴Texas Tax Code Ann. section 111.006(a).

³⁵Texas Tax Code Ann. section 111.006(b).

³⁶Texas Tax Code Ann. sections 171.206, 151.027.

³⁷Texas Tax Code Ann. section 111.101(a).

³⁸Texas Tax Code Ann. section 111.101(b).

³⁹Texas Tax Code Ann. section 111.102.

⁴⁰Texas Gov't Code Ann. section 552.021.

⁴¹Texas Gov't Code Ann. section 552.022(a)(18).

According to the act, a court in Texas cannot force a state agency or official to withhold particular public information from inspection “unless the category of information is *expressly* made confidential under other law.”⁴² The act further proclaims that it “shall be liberally construed in favor of granting a request for information.”⁴³

The narrow language regarding the confidentiality of tax information coupled with the express intent that settlement agreements constitute public records leads to the likely conclusion that tax settlement agreements will generally not be considered confidential.

Other Relevant Guidance

The three types of provisions discussed in depth above are not the exclusive sources of guidance affecting the confidentiality of tax settlement agreements. Others include the protection of business secrets, whistleblower reports, rules governing mediation and arbitration, public policy, and contract law. A taxpayer should consider those as the situation demands in addition to our framework above.

First, the existence of whistleblower reports filed with a state could influence that state’s position on the confidentiality of tax settlements. For example, in Idaho one of the state’s tax auditors sent a whistleblower report to the Legislature.⁴⁴ The auditor charged the state tax commission with “routinely waiving tax bills for corporations” through confidential settlements to such an extent that “the relief had been dubbed the ‘Idaho tax break.’”⁴⁵ As a result, the governor ordered the tax commission to keep the Legislature informed of the frequency and scope of these settlement agreements.⁴⁶

Tax disputes that are resolved by arbitration or mediation can be subject to their own set of confidentiality rules, which would trump other provision. In Louisiana, for instance, all participants, including the arbitrator, of alternative dispute resolution sessions involving tax matters must sign confidentiality agreements.⁴⁷

In states that do not *require* it, confidentiality can still be an important aspect of a mediation or arbitration. A recent case study of a mediation involving a dispute between taxpayers and two states concluded that confidentiality was one of the primary reasons why the particular mediation was success-

ful.⁴⁸ Each participant to the mediation “signed a strict confidentiality agreement, confirming that all discussions would be held in confidence.”⁴⁹ As a result, “all parties were willing to openly discuss all risks and issues regarding the law, equity, and facts [of] the litigation.”⁵⁰

Further, states may be willing to protect the confidentiality of a taxpayer’s trade secrets, even if the particular document is not otherwise protected from disclosure. Because all documents filed during the course of litigation become public record, clients routinely enter confidentiality orders regarding trade secrets and other proprietary information. Revenue departments can do the same regarding that information in an administrative settlement.

For example, Iowa requires that all final orders, decisions, and opinions involving the Revenue Department be “available for public inspection” and indexed by name and subject.⁵¹ Despite that requirement, the statute also provides that any trade secrets in such a document “will be deleted upon a proper showing by the person requesting such deletion.”⁵² Accordingly, it is possible that trade secrets in a tax settlement agreement may be confidential, even if the agreement as a whole is not.

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Public policy also could affect the confidentiality of a settlement agreement. Courts in some states have declared that public policy prevents settlement agreements between the government and private parties from being confidential. The Tennessee Court of Appeals, for example, has held that a “governmental entity cannot enter into confidentiality agreements with regard to public records.”⁵³ The court determined that a settlement agreement between a city and a private party was a public record and thus had to be disclosed by the city on request.⁵⁴

⁴⁸Steve Young et al., “An MTC Mediation Success Story,” *State Tax Notes*, Dec. 1, 2008, p. 561, *Doc 2008-22172*, or *2008 STT 232-2*.

⁴⁹*Id.*

⁵⁰*Id.*

⁵¹Iowa Admin. Code 701 -- 6.2 (17A).

⁵²*Id.*

⁵³*Tennessean v. City of Lebanon*, 2004 WL 290705, at *5 (Tenn. Ct. App. 2004).

⁵⁴*Id.* See also *State ex rel. Sun Newspapers v. Westlake Bd. of Educ.*, 601 N.E.2d 173, 175 (Ohio Ct. App. 1991) (“A public entity cannot enter into enforceable promises of confidentiality with respect to public records.”) (internal quotation marks

(Footnote continued on next page.)

⁴²Texas Gov’t Code Ann. section 552.022(b) (emphasis supplied).

⁴³Texas Gov’t Code Ann. section 552.001(b).

⁴⁴Dave Wasson, “Idaho Senate Panel Asks Tax Commission to Comply With Reforms,” *State Tax Notes*, Feb. 2, 2009, p. 305, *Doc 2009-1541*, or *2009 STT 14-7*.

⁴⁵*Id.*

⁴⁶*Id.*

⁴⁷La. Admin. Code 61:III:329(A).

Finally, when a settlement agreement contains an explicit confidentiality provision, and one party violates it, the other party must determine whether it is still obligated to perform under the agreement. Contract law generally provides the necessary guidance in that situation. The majority rule is that the nonbreaching party is no longer obligated to perform if the confidentiality provision was material to the agreement.⁵⁵ Some courts have affirmed that confidentiality provisions *can* be material to settlement agreements.⁵⁶ However, if the confidentiality provision was not material, the only remedy is an action for damages against the breaching party under a breach of contract theory.⁵⁷ The nonbreaching party must still perform under the agreement.⁵⁸

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This issue could arise in settlement agreement negotiations between a state revenue department

omitted); *Newspaper Holdings, Inc. v. New Castle Area Sch. Dist.*, 911 A.2d 644, 648 (Pa. Commw. Ct. 2006) (holding that when a “settlement agreement fixes the personal or property rights of the parties or calls for the payment of money involving the disbursement of public funds, it is subject to disclosure” under the state’s freedom of information act).

⁵⁵See Restatement (Second) Contracts section 237 (stating that “it is a condition of each party’s remaining duties to render performances . . . that there be no uncured material failure by the other party to render any such performance due at an earlier time”).

⁵⁶See, e.g., *Thomas v. HUD*, 124 F.3d 1439 (Fed. Cir. 1997) (holding that confidentiality was material to a settlement agreement that provided that employee would resign in exchange for employer’s keeping details of his employment history confidential).

⁵⁷*Ackerman v. McMillan*, 442 S.E.2d 618, 620 (S.C. Ct. App. 1994) (“where the breach is not so material as to defeat the purpose of the contract, the nonbreaching party is compensated by damages”) (citations omitted).

⁵⁸*Id.* (“In order to warrant a repudiation, a breach must be so fundamental and substantial as to defeat the purpose of the contract.”) (citations omitted).

and a taxpayer. The revenue department could, for example, threaten to renege if the taxpayer violates the agreement’s two-way confidentiality provision. So far, there are no reported cases or rulings of a revenue department attempting to take that position. However, it is likely that the above contract principles would be equally applicable in that context, resulting in the revenue department’s action failing if confidentiality was not material to the agreement, but possibly prevailing if indeed confidentiality was a material part of the contract.

Conclusion

Standardized settlement agreements are becoming more prevalent and often include two-way confidentiality agreements. To understand the enforceability and propriety of those agreements, it is necessary to understand how a state’s laws affect the confidentiality of tax settlement agreements. However, the lack of direct legal guidance in many states can make it difficult for taxpayers to determine whether tax settlement agreements with a state will be confidential and protected from disclosure. The framework that we have suggested focusing on the three primary provisions affecting the confidentiality of settlement agreements can assist taxpayers in making an initial determination. ☆

Audit + Beyond, a column on state tax audits and the resolution of disagreements between business taxpayers and state revenue departments, is written by members of the Alston & Bird LLP state and local tax group. Mary T. Benton is a partner and Michael M. Giovannini is an associate in the firm’s Atlanta office.