



PROGRAM MATERIALS
Program #3091
May 21, 2020

IRS Summons and Other Methods of Obtaining Taxpayer Information, Enforcement, and Defenses

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KOSTELANETZ & FINK

**IRS Summons and Other
Methods of Obtaining
Taxpayer Information,
Enforcement, and Defenses**

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Megan L. Brackney has a distinguished track record of delivering exceptional results for clients facing complicated and difficult tax issues. An expert in the interplay between civil and criminal tax controversies, Ms. Brackney develops innovative strategies to resolve compliance concerns, civil audits, and criminal investigations. Ms. Brackney also advises clients on tax issues that arise in other contexts, such as business and matrimonial disputes, and she represents clients in litigation in the U.S. Tax Court and federal district courts. Ms. Brackney has been recognized by the "New York Super Lawyers" since 2012.

Prior to joining Kostelanetz & Fink in 2004, Ms. Brackney was an Assistant United States Attorney for the Southern District of New York. She also served as an Assistant Attorney General for the State of Missouri.

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Ms. Brackney has previously served as a Council Director for the American Bar Association Section of Taxation, the Chair of the Taxation Committee of the New York County Lawyers' Association, and the Chair of the Individual and Family Taxation Committee of the American Bar Association, Tax Section. She received the American Bar Association Tax Section's John S. Nolan Fellowship for 2008-2009.

Ms. Brackney received her J.D. from the University of Kansas School of Law and her LL.M. in Taxation from New York University, and is a member of the Board of Governors for the University of Kansas School of Law.

RECENT PRESENTATIONS

- "Walking Through the Various States of the Partnership Audit Rule Process, American Law Institute, December 4, 2019
- "Challenges in Representing the Partnership and Partnership Representative," American Law Institute, December 4, 2019
- "Anticipating IRS Audits, Controversies and Litigation Under the Partnership Audit Rules," 78th Institute on Federal Taxation, October 24, 2019
- "Recent Developments in Innocent Spouse Litigation," ABA Section of Taxation, Fall Meeting, October 5, 2019
- "Are Your Secrets Safe? A Discussion Of The Scope, Application And Protection Of Legal Privileges In The US And Abroad," ABA Section of Taxation, May Tax Meeting, May 11, 2019
- "Foreign Information Return Penalties and Defenses," The CPA Academy, Webinar, April 18, 2019
- "Rocks - Partnership Representatives - Hard Places," New York State Bar Association Annual Meeting, New York, NY, January 15, 2019



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Types of Income Tax Examinations

Correspondence examinations

- Generally conducted by Campus operations
- Conducted by mail and fax
- Tax Examiners and Tax Compliance Officers

Office examination

- Generally individual returns
- Limited number of issues
- Conducted in IRS offices
- Tax Compliance Officers

Types of Income Tax Examinations

Field examinations

- Conducted at place of business, home, representatives office, where books and records are kept
- All business returns, some individual returns
- Includes Large Business and International
- All types and sizes of issue
- Revenue Agents

Information Document Requests

Written request for Information and Documents from the IRS to the taxpayer in the audit.

IRS has expansive power to collect information and from taxpayers.

The IDR is not self-enforcing.

IRS can use summons authority to obtain the information and documents if the taxpayer does not comply with the IDR.

IRS Summons Authority

I.R.C. § 7602 authorizes the IRS to issue a summons to taxpayers and third parties to:

- Examine books and records;
- Obtain testimony from the taxpayer; and
- Obtain testimony from third parties who can provide information that may be relevant to determining a taxpayer's liability or ascertaining the correctness of a return.

IRS Summons Authority

Very Broad: **I.R.C. § 7602(a)** provides that a summons may be issued to:

- Ascertain the correctness of any return;
- Make a return where none has been made;
- Determine the liability of any person for any tax; or
- Collect any such liability.

The IRS also may issue a summons to inquire into any offense. **I.R.C. § 7602(b)**.

The IRS cannot issue a summons if a Department of Justice referral is in effect. **I.R.C. § 7602(d)**.

Reach of IRS Summons Authority

- Can reach foreign based taxpayers doing business in the United States. *United States v. Toyota Motor Corp.*, 561 F Supp 354 (C.D. Cal. 1983).
- Can be use in aid of determining or collecting another country's taxes. *United States v. A.L. Burbank & Co., Ltd.*, 525 F.2d 9 (2d Cir. 1975).

Service of Summons

The IRS may serve a summons by:

- Delivery in hand to the person; or
- By leaving the summons at the person's last place of abode.

The IRS may serve a summons on a third party record-keeper by registered or certified mail.

- Third party recordkeepers include banks, consumer reporting agencies, any person extending credit through the use of credit cards, brokers, attorneys, accountants, barter, exchanges or regulated investment companies.
- **I.R.C. § 7603.**

Time and Place for Examination

I.R.C. § 7605 provides that the time and place for responding to a summons must be reasonable and may not be less than ten days after the summons was issued.

Failure to Obey Summons

“Any person who, being duly summoned to appear to testify, or to appear and produce books, accounts, records, memoranda, or other papers, as required under sections 7602, 7603, and 7604(b), neglects to appear or to produce such books, accounts, records, memoranda, or other papers, shall, upon conviction thereof, be fined not more than \$1,000, or imprisoned not more than 1 year, or both, together with costs of prosecution.”

I.R.C. § 7210.

Summons Enforcement

A summons is not self-enforcing.

- The IRS may bring an action in district court compelling a taxpayer or third party to comply with a summons. **I.R.C. § 7604(b)**.
- Note that taxpayer recipient of a summons issued in connection with that taxpayer's own tax liability may not bring a petition to quash the summons because the United States government has not waived its sovereign immunity to allow such petitions. *Abraham v. United States*, 740 F.2d 2 (2d Cir. 1984).
- The IRS must bring suit to enforce the summons, and the individual taxpayer may raise his, her, or its arguments in that proceeding.

Summons Enforcement – The *Powell Factors*

Congress intended for the summons-enforcement proceedings to be “summary in nature.” The purpose of a summons is “not to accuse,” but only “to inquire.”

In order to enforce a contested summons, the IRS must demonstrate that:

1. “The investigation will be conducted pursuant to a legitimate purpose;”
2. “The inquiry may be relevant to the purpose;”
3. “The information sought is not already within the Commissioner’s possession;”
and
4. “The administrative steps required by the [Internal Revenue] Code have been followed.”

This is not a difficult standard to meet, and is usually achieved through an examiner’s affidavit. *United States v. Powell*, 379 U.S. 48, 57-58 (1964).

Improper Purpose Doctrine

“An abuse [of process] would take place if the summons had been issued for an improper purpose, such as to harass the taxpayer or to put pressure on him to settle a collateral dispute or for any other purpose reflecting on the good faith of the particular investigation.”

United States v. Powell, 379 U.S. 48, 58 (1964).

Summons Enforcement – Good Faith

- The government generally satisfies its initial burden of demonstrating that the summons was issued in good faith by filing an affidavit from the investigating agent attesting to the “Powell factors.”
- The court may quash an IRS summons “on any appropriate ground”— including improper purpose.
- The party objecting to the summons, however, is not automatically entitled to an evidentiary hearing.
- The taxpayer has a right to conduct an examination of an IRS official regarding the purpose for issuing a summons if the taxpayer can “point to specific facts or circumstances plausibly raising an inference of bad faith.” *United States v. Clarke*, 573 U.S. 248 (2014)

Relevancy Standard

“As the language of § 7602 clearly indicates, an IRS summons is not to be judged by the relevance standards used in deciding whether to admit evidence in federal court. *Cf.* Fed. Rule Evid. 401. The language ‘may be’ reflects Congress’ express intention to allow the IRS to obtain items of even potential relevance to an ongoing investigation, without reference to its admissibility.”

United States v. Arthur Young & Co., 465 US 805, 814 (1984).

Special Rules for Third Party Summons – Right to Notice of Third-Party Contacts

- **IRC § 7602(c)** provides that an IRS agent may not contact any person other than the taxpayer with respect to the determination of the tax liability of such taxpayer without providing reasonable notice in advance to the taxpayer that contacts other than the taxpayer may be made.
- The IRS shall periodically provide the taxpayer a record of persons contacted and shall provide the record on request to the taxpayer.
- IRS may provide notice in advance that third parties may be contacted.

Notice of Third Party Contacts – Taxpayer First Act of 2019

(1) General notice. An officer or employee of the Internal Revenue Service may not contact any person other than the taxpayer with respect to the determination or collection of the tax liability of such taxpayer unless such contact occurs during a period (not greater than 1 year) which is specified in a notice which--

(A) informs the taxpayer that contacts with persons other than the taxpayer are intended to be made during such period; and

(B) except as otherwise provided by the Secretary, is provided to the taxpayer not later than 45 days before the beginning of such period.

“Nothing in the preceding sentence shall prevent the issuance of notices to the same taxpayer with respect to the same tax liability with periods specified therein that, in the aggregate, exceed 1 year. A notice shall not be issued under this paragraph unless there is an intent at the time such notice is issued to contact persons other than the taxpayer during the period specified in such notice. The preceding sentence shall not prevent the issuance of a notice if the requirement of such sentence is met on the basis of the assumption that the information sought to be obtained by such contact will not be obtained by other means before such contact.”

(2) Notice of specific contacts. The Secretary shall periodically provide to a taxpayer a record of persons contacted during such period by the Secretary with respect to the determination or collection of the tax liability of such taxpayer. Such record shall also be provided upon request of the taxpayer.

I.R.C. § 7602(c).

Notice of Third Party Contacts – Taxpayer First Act of 2019

- (c)(3) Exceptions.** This subsection shall not apply--
- (A)** to any contact which the taxpayer has authorized;
 - (B)** if the Secretary determines for good cause shown that such notice would jeopardize collection of any tax or such notice may involve reprisal against any person; or
 - (C)** with respect to any pending criminal investigation.

Right to Privacy During Third Party Contacts and Interviews

The taxpayer's right to privacy will be protected when contacting third parties for information.

- Information will be collected, to the greatest extent practicable, directly from the taxpayer to whom it relates.
- Third party contacts will be made with the taxpayer is unable to provide necessary information or when the examiner needs to verify information provided.
- Information about taxpayers collected from third parties will be verified to the extent practicable with the taxpayer before action is taken.

Internal Revenue Manual 4.10.3.3.2, 4.11.3.21, 4.11.57.3

IRS employees may make investigative disclosures to the extent 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. **I.R.C. § 6103(k)(6).**

Right to Move to Quash Third-Party Summons

- Taxpayer may move to quash a summons issued to a third-party under **I.R.C. § 7609**.
- An action to quash must be brought within 20 days after notice of the summons is given to the identified party, and a copy of the moving party's petition must be sent both to the summoned party and to the Service by registered or certified mail. **I.R.C. § 7609(b)(2)(B)**.

Potential Defenses to Enforcement of a Summons

- The summons was issued for an improper purpose.
- The summoned information is not relevant to the audit of the taxpayer.
- The IRS already has the information summoned.
- The IRS did not follow the necessary administrative steps for issuing and enforcing a summons.
- The documents sought do not exist.
- The summonsed party does not have possession, custody, or control of the documents or information sought.
- The summoned information is privileged.
- There is a Department of Justice referral in effect.
- **I.R.C. § 7602(d).**

Possession, Custody, or Control

- A legal or physical inability to produce the documents is a complete defense justifying noncompliance with an IRS summons.
- One must, however, make an exhaustive search for missing documents and must make sincere attempts to regain possession over documents taken by third parties. *United States v. Bryan*, 339 U.S. 323, 330-331 (1950); *United States v. O'Henry's Film Works*, 598 F.2d 313 (2d Cir. 1979).

Potential Privileges

- Attorney client privilege, including the *Kovel* privilege.
- Tax practitioner privilege under **I.R.C. § 7525**.
- Work product doctrine.
- 5th Amendment privilege.
- Spousal Privilege.

Attorney-Client Privilege

- Where legal advice of any kind is sought
- From a professional legal advisor in his capacity
- The communication relating to that purpose
- Made in confidence
- By the client
- Are at his instance permanently protected
- From disclosure by himself or by the legal advisor
- Except if the protection be waived

Waiver of Attorney-Client Privilege

- Express Waiver
 - Caused by intentionally (or inadvertently) revealing privileged communications to a third party.
- Implied Waiver
- Caused by putting otherwise-privileged topics into controversy –
 - Reliance on advice of counsel.
 - Reasonable cause and good faith (e.g., **I.R.C. § 6664(c)(1)**).
 - *AD Investment 2000 Fund LLC v. Comm’r*, 142 T.C. No. 13 (2014) (“by placing the partnerships’ legal knowledge and understanding into issue in an attempt to establish the partnerships’ reasonable legal beliefs in good faith arrived at (a good-faith and state-of-mind defense), petitioners forfeit the partnerships’ privilege protecting attorney-client communications relevant to the content and the formation of their legal knowledge, understanding, and beliefs”)

Attorney-Client Privilege: *Kovel*

- Extension of attorney-client privilege to an accountant (or other agent of the attorney).
- The key is that the “the presence of the accountant is necessary, or at least highly useful, for the effective consultation between the client and the lawyer which the privilege is designed to permit.”
United States v. Kovel, 296 F.2d 918 (2d Cir. 1961).

Federally-Authorized Tax Practitioner Privilege

- **I.R.C. § 7525:** “[C]ommunication between a taxpayer and any federally authorized tax practitioner [is privileged] to the extent the communication would be ... privileged ... if it were between a taxpayer and an attorney.”
- Limited to noncriminal tax matters where the U.S. is a party (i.e., not recognized in state courts or non-tax controversies).
- Limited to tax advice.
- Does not apply to tax shelter advice.

Work Product Privilege

Fed. R. Civ. P. 26(b)(3).

(A) *Documents and Tangible Things.* Ordinarily, a party may not discover documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative (including the other party's attorney, consultant, surety, indemnitor, insurer, or agent). But, subject to Rule 26(b)(4), those materials may be discovered if:

- (i) they are otherwise discoverable under Rule 26(b)(1); and
- (ii) the party shows that it has substantial need for the materials to prepare its case and cannot, without undue hardship, obtain their substantial equivalent by other means.

(B) *Protection Against Disclosure.* If the court orders discovery of those materials, it must protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of a party's attorney or other representative concerning the litigation.

Work Product Privilege, Cont.

- Meaning of “in anticipation of litigation:”
 - “[D]ocuments should be deemed prepared ‘in anticipation of litigation,’ . . . if ‘in light of the nature of the document and the factual situation in the particular case, the document can fairly be said to have been prepared *because of* the prospect of litigation.’”
 - “Where a document is created because of the prospect of litigation, analyzing the likely outcome of that litigation, it does not lose protection under this formulation merely because it is created in order to assist with a business decision.”

United States v. Adlman, 134 F.3d 1194, 1202 (2d Cir. 1998).

Fifth Amendment Privilege

“No person shall be compelled in any criminal case to be a witness against himself.”

U.S. Const., Amend. V.

- Privilege can be invoked in civil and criminal proceedings (but can give rise to adverse inference in civil case).
- A communication is incriminating under the Fifth Amendment not only when it directly yields evidence to support a criminal conviction, but when it “includes information which would furnish a link in the chain of evidence that could lead to prosecution, as well as evidence which an individual reasonably believes could be used against him in a criminal prosecution.” *Maness v. Meyers*, 419 U.S. 449 (1975).

Spousal Privileges

- **Marital Communications Privilege**
 - Information privately disclosed between husband and wife in the confidence of the marital relationship.
 - Either spouse may invoke (witness or non-witness spouse).
 - Applies even after the marriage has dissolved.
 - Applies in all kinds of proceedings.
- **Spousal Testimonial Privilege**
 - Applies to any adverse testimony, not just confidential communications.
 - Limited to criminal cases.
 - Applies only during the marriage.
 - Only the witness-spouse can invoke.

John Doe Summons

The government must obtain a court order (*ex parte*) after establishing that:

1. The summons relates to the investigation of a particular person or ascertainable group or class of persons;
2. There is a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provision of any internal revenue law; and
3. The information sought to be obtained from the examination of the records or testimony (and the identity of the person or persons with respect to whose liability the summons is issued) is not readily available from other sources.

This procedure is *ex parte* and based “solely on the petition and supporting affidavits” of the government.

I.R.C. § 7609(f).

John Doe Summons, Cont.

The Taxpayer First Act provides a new requirement in **I.R.C. § 7609(f)**:

- “The Secretary shall not issue any summons described in the preceding sentence unless the information sought to be obtained is narrowly tailored to information that pertains to the failure (or potential failure) of the person or group or class of persons referred to in paragraph (2) to comply with one or more provisions of the internal revenue law which have been identified for purposes of such paragraph.”

Dual Purpose Summons

- The IRS does not have to use the John Doe summons procedure when it serves a summons on a particular taxpayer with the “dual purpose” of investigating that taxpayer’s tax liability and unidentified parties’ tax liabilities.
- A dual-purpose summons does not constitute a John Doe summons and that the IRS did not have to comply with Code Sec. 7609(f) “as long as all the information sought is relevant to a legitimate investigation of the summoned taxpayer.” The IRS, however, cannot issue a summons to a specific taxpayer as a pretext for avoiding the John Doe summons requirements.

Tiffany Fine Arts v. United States, 469 U.S. 310 (1985).

Challenging John Doe Summons

- Government's application for authority to issue a John Doe summons is made *ex parte*, and the summoned party cannot intervene in the proceeding or move to quash a John Doe summons.
- The remedy for a party who has been served with a John Doe summons is to raise any challenges after the government has brought an action against that party for enforcement of the John Doe Summons. However, in that enforcement proceeding, the summoned party cannot challenge the summons on the ground that the government failed to comply with the requirements of I.R.C. § 7609(f).
- Rather, the summoned party is limited to challenging the summons based on the government's failure to comply with the *Powell* requirements or bad faith or abuse of process.

See, e.g., United States v. Coinbase, Inc., 2017 WL 6890052 (N.D. Cal. 2017).

John Doe Summonses – Statute of Limitations

- The statute of limitations on civil assessment of tax and criminal prosecution for tax offenses for the person’s whose tax liability is at issue is suspended if the summoned party does not timely comply with the John Doe summons. **I.R.C. § 7609(e)(2)** provides as follows:
 - “In the absence of the resolution of the summoned party’s response to the summons, the running of any period of limitations under section 6501 or under section 6531 with respect to any person with respect to whose liability the summons is issued (other than a person taking action as provided in subsection (b)) shall be suspended for the period — beginning on the date which is 6 months after the service of such summons, and ending with the final resolution of such response.”

Formal Document Requests (“FDR’s”)

During an exam, if foreign-based documentation requested by an IDR is not sufficiently provided, the IRS can issue an FDR.

If FDR is not substantially complied with and the taxpayer did not have reasonable cause for failure to comply, the foreign-based documentation requested is not admissible in court.

I.R.C. § 982.

Other IRS Methods of Gathering Offshore Information

- DHS' Treasury Enforcement and Communication System ("T.E.C.S."). *See generally*, I.R.M. Sec. 5.1.18.
- T.E.C.S gives revenue officers the ability to access taxpayer information from multiple law enforcement agencies.
- T.E.C.S also provides a method for revenue officers to communicate messages to federal and state law enforcement.
- Revenue officers can research a taxpayer's historical travel information. *See* I.R.M. Sec. 5.1.18.14.7.
- T.E.C.S gives revenue officers access to various treasury filings (e.g., FinCEN Form 104 (currency transaction reports) and Form TD F 90-22.47 (suspicious activity reports)). *See* I.R.M. Sec. 9.4.2.4.2.

Other IRS Methods of Gathering Offshore Information

IRS/DOJ DATA MINING

- OVDP submissions
- FATCA reports
- Data obtained through the DOJ amnesty program for Swiss banks

FinCEN and tax return information

- FBARs filed by taxpayers that identify foreign accounts
- Other information returns regarding foreign assets (e.g., IRS Form 5471 (foreign corporations), IRS Form 3520 (foreign trusts), IRS Form 8938 (foreign-based assets))

Treaty and Tax Information Exchange Agreement (“TIEA”) requests. *See* I.R.M. Sec. 5.21.2.2.

- Revenue Officers may request information from foreign tax authorities through the U.S., Competent Authority Office (the Tax Attaché).

Other IRS Methods of Gathering Offshore Information, Cont.

Questioning at the border

- Once a Revenue Officer enters taxpayer information into T.E.C.S the taxpayer is placed on the DHS lookout indicator list
- Applies to citizen and non-citizen taxpayers
- Customs officials can question taxpayers at the border about their tax liability, their assets, the purpose/duration of travel, etc.

Circular 230 Requirements for Practitioners – Information to Be Furnished to the IRS - 31 C.F.R. 10.20(a)

1. A practitioner must, on a proper and lawful request by a duly authorized officer or employee of the Internal Revenue Service, promptly submit records or information in any matter before the Internal Revenue Service unless the practitioner believes in good faith and on reasonable grounds that the records or information are privileged.
2. Where the requested records or information are not in the possession of, or subject to the control of, the practitioner or the practitioner's client, the practitioner must promptly notify the requesting Internal Revenue Service officer or employee and the practitioner must provide any information that the practitioner has regarding the identity of any person who the practitioner believes may have possession or control of the requested records or information. The practitioner must make reasonable inquiry of his or her client regarding the identity of any person who may have possession or control of the requested records or information, but the practitioner is not required to make inquiry of any other person or independently verify any information provided by the practitioner's client regarding the identity of such persons.

Circular 230 Requirements for Practitioners – Information to Be Furnished to the IRS - 31 C.F.R. 10.20(a), Cont.

3. When a proper and lawful request is made by a duly authorized officer or employee of the Internal Revenue Service, concerning an inquiry into an alleged violation of the regulations in this part, a practitioner must provide any information the practitioner has concerning the alleged violation and testify regarding this information in any proceeding instituted under this part, unless the practitioner believes in good faith and on reasonable grounds that the information is privileged.

Circular 230 Requirements for Practitioners – Interference with a proper and lawful request for records or information - 31 C.F.R. 10.20(b)

- A practitioner may not interfere, or attempt to interfere, with any proper and lawful effort by the Internal Revenue Service, its officers or employees, to obtain any record or information unless the practitioner believes in good faith and on reasonable grounds that the record or information is privileged.

Thank you