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TAX LITIGATION ISSUES

Expert Analysis

IRS Summonses: No Reasonable Basis Required

By
Jeremy H. Temkin

Section 7602 of the Internal Revenue Code grants the Internal Revenue Service broad authority to examine "any books, papers, records, or other data which may be relevant or material to [an] inquiry." The IRS exercises this authority by issuing summonses in the course of administrative investigations of either a taxpayer's civil liability or possible criminal conduct. As this column has recounted, 26 U.S.C. §7609(f) authorizes the IRS to obtain "John Doe summonses" directing a third party to provide information relating to a class of otherwise unidentified individuals. See Jeremy H. Temkin, "John Doe Summonses: Procedural Hurdles With Limited Review," N.Y.L.J. (Nov. 14, 2019).

A recent decision by the United States Court of Appeals for the Sixth Circuit highlights differences between the low threshold that courts apply in deciding motions to quash summonses addressed to third parties, and the more rigorous standard applied in deciding whether a John Doe summons should be issued. While the court rejected the taxpayer's attempt to invoke the higher standard applied in the John Doe summons setting, its decision reflects both the difficulties faced by counsel representing taxpayers challenging third-party summonses and the value of constantly considering new lines of attack.

Applicable Standards Of Review

In *United States v. Powell*, the Supreme Court noted that the IRS "can investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not." 379 U.S. 48, 57 (1964) (quoting *United States v. Morton Salt Co.*, 338 U.S. 632, 642-43 (1950)). Recognizing the breadth of the IRS's authority, the court established a relatively low threshold for assessing the validity of summonses—first, to establish a prima facie case for enforcement, the government must demonstrate that: (1) the investigation has a legitimate purpose; (2) the summons seeks information relevant to that purpose; (3) the information sought is not already in the IRS's possession; and (4) all administrative steps required by the Internal Revenue Code have been followed. Once the IRS makes this prima facie showing, the party resisting enforcement must either disprove at least one of the *Powell* factors or establish an affirmative defense,

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JEREMY H. TEMKIN *is a principal in Morvillo Abramowitz Grand Iason & Anello P.C.* THADDEUS R. KLECKLEY, *an associate at the firm, assisted in the preparation of this article.*

such as: (1) a Constitutional and common-law privilege; (2) that the summons is overbroad, vague or burdensome; (3) that it does not have responsive documents in its possession; or (4) that the IRS issued the summons in bad faith or for an improper purpose, such as to harass a witness or impose pressure to settle a collateral dispute.

By contrast, to get authorization to issue a John Doe summons, the IRS must establish in an ex parte proceeding that: (1) the summons relates to the investigation of a particular person or ascertainable class of persons; (2) it has a "reasonable basis for believing that such persons or group or class of persons may have failed to comply with" the Internal Revenue Code; (3) the information sought, including the identity of the person or persons suspected of having violated the Internal Revenue Code, is not readily available from other sources; and (4) the summons "is narrowly tailored to information that pertains to the failure (or potential failure) of the [relevant] person or group or class of persons … to comply with one or more provisions" of the Internal Revenue Code. Given the nature of the application and the absence of a specifically identified taxpayer, the reviewing court "takes the place of the affected taxpayer … and exerts a restraining influence on the IRS." *Tiffany Fine Arts v. United States*, 469 U.S. 310, 321 (1985); Jeremy H. Temkin, "Tax Enforcement, John Doe Summonses and Digital Currency," N.Y.L.J. (Jan. 19, 2017).

High Threshold for Taxpayers

While there is no record of how often courts reject ex parte applications for John Doe summonses, the *Powell* standard has proved to be a heavy burden for taxpayers seeking to avoid the production of information in response to third-party summonses. Thus, *Powell* made clear that the IRS "need not meet any standard of probable cause to obtain enforcement of his summons." And while the court expressly envisioned that taxpayers would be entitled to a meaningful "adversary hearing … before enforcement is ordered," *Powell*, 379 U.S. at 57-58, and that courts would be entitled to "inquire into the underlying reasons for the examination," *id*. at 58, in practice, courts give great deference to affidavits submitted by IRS agents and commonly reject challenges to summonses. *See, e.g.*, *United States v. AS Holdings Grp.*, 521 F. App'x 405, 409 (6th Cir. 2013) ("The IRS may meet this 'minimal burden' by submitting an affidavit from the agent issuing the summons."); *United States v. Dynavac,* 6 F.3d 1407, 1414 (9th Cir. 1993) ("The government's burden is a slight one, and may be satisfied by a declaration from the investigating agent that the *Powell* requirements have been met."); *Alphin v. United States*, 809 F.2d 236, 238 (4th Cir. 1987) ("The government's burden is fairly slight" and satisfied "by an affidavit of an agent involved in the investigation averring the *Powell* good faith elements."). Indeed, courts rarely refuse to enforce IRS summonses, and several courts have concluded that the government can satisfy *Powell's* "legitimate purpose" prong through an agent's affidavit stating broadly that she was "ascertaining the [target's] tax liability." *See, e.g.*, *Canatella v. United States*, No. 10-CV-05970, 2011 U.S. Dist. LEXIS 39901, at *6 (N.D. Cal. Apr. 5, 2011); *United States v. Samango*, No. 15-CV-6260, 2016 U.S. Dist. LEXIS 48761, at *3 (E.D. Pa. Apr. 12, 2016) (same).

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'Byers v. United States'

It is against this backdrop that the Sixth Circuit decided *Byers v. United States*, 963 F.3d 548 on

June 26, 2020. *Byers* arose out of an IRS investigation into whether Andrea Byers was subject to penalties under 26 U.S.C. §§6700 and 6701, based on her promotion of abusive tax shelters. After Byers refused either to produce documents voluntarily or to submit to an interview, the agent issued summonses to four banks with which Byers had a relationship. After receiving notice of the summonses, Byers exercised her right to intervene and filed a petition to quash.

In the district court, Byers argued that the IRS was required to satisfy the "reasonable basis" standard applicable to John Doe summonses issued under 26 U.S.C. §7609(f) in all situations when it seeks information from third parties; that it had failed to satisfy three of the four *Powell* criteria; and that enforcement of the summonses would constitute an abuse of the district court's process. The district court summarily rejected Byers's arguments without issuing an opinion, and Byers appealed.

On appeal, Byers argued that while section 7609(f) imposes "procedural requirements" for the issuance of John Doe summonses "when the identity of the person under investigation is unknown," the procedures governing the enforcement of both John Doe summonses and third party summonses with respect to named taxpayers "serve to protect the same substantive privacy interests." *Byers v. United States*, No. 19-1893, *Brief for the Appellant*, Dkt. No. 15, at 11 (6th Cir. 2020). According to Byers, the fact that the government does not know the identity of the person under investigation when it issues a John Doe summons "is no reason to confine the 'reasonable basis' requirement to the 'John Doe' setting." *Id*. at 12. To support this argument, Byers pointed to *Tiffany Fine Arts*, which she viewed as "impl[ying] that known taxpayers are entitled to the same substantive protections section 7609(f) affords to unknown taxpayers." *Id*. at 13.

In an opinion for a unanimous panel, Judge Karen Nelson Moore described the question of "whether the IRS must demonstrate a 'reasonable basis' for believing that a named taxpayer has violated or may violate the internal revenue laws before the district court may enforce a third-party summons seeking information about this taxpayer" as a "novel issue." Notwithstanding its novelty, the court rejected Byers' arguments and found that *Tiffany Fine Arts* did not "hold, let alone insinuate, any of" the standards Byers sought to invoke, and concluded that her argument was premised on dicta, as the Supreme Court's holding was both straightforward and inapposite to appellant's arguments. *Id*.

Ultimately, the court noted that there was "no shortage of reasons to reject Byers' argument," but nonetheless acknowledged that it had "intuitive appeal" and merited a fulsome response. However, while acknowledging that the question that Byers had raised—"Shouldn't the government have to give a reason why it wants my information?"—was a "a colorable policy argument," it failed as a legal argument since "[s]imply stated, the IRS is not required to comply with the 'John Doe summons' requirements, where the summons relates to a named party."

Conclusion

As the Sixth Circuit recognized, Byers' argument is intrinsically logical, even if it is not cognizable under case law or the relevant statutes. Practitioners representing taxpayers in administrative investigations are all too familiar with the IRS's expansive powers when it seeks information. Counsel, however, need to continue to think creatively about potential objections that they can raise on behalf of their clients.