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U.S. Supreme Court To Address the IRS's Summons Authority

By Jeremy H. Temkin

The current U.S. Supreme Court term promises to be an especially important one for tax practitioners. In addition to the recent arguments in *Bittner v. United States*, No. 21-1195 (argued Nov. 2, 2022) (addressing the penalties that can be imposed for non-willful FBAR violations) and *In re Grand Jury*, No. 21-1397 (argued Jan. 9, 2023) (addressing the application of the attorney-client privilege to communications that include tax-preparation advice), on Dec. 9, 2022, the court granted a writ of certiorari in *Polselli v. IRS*, No. 21-1599, to address a two-decade old Circuit split regarding the scope of the Internal Revenue Service's obligation to provide notice when it seeks records in connection with its efforts to collect past due taxes. This column discusses the approaches taken by different Circuit Courts of Appeals and the Supreme Court's decision to resolve the circuit split.

Background Regarding Summonses

Section 7602 of the Internal Revenue Code gives the IRS broad authority to issue summonses "[f]or the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability." Section 7609 sets forth the procedures to be applied when the IRS serves summonses on third-party recordkeepers. In general, within three days of serving a summons on a third-party, the IRS must provide a copy of the summons to the person whose financial records are being sought. That person may then challenge the summons in court.

Section 7209(c)(2) sets forth certain exceptions to this notice requirement, including summonses "(D) issued in aid of the collection of" either "(i) an assessment made or judgment rendered against the person with respect to whose liability the summons is issued" or "(ii) the liability … of any transferee or fiduciary" of such person. At issue in *Polselli* is a split between the Ninth Circuit on the one hand and the Sixth, Seventh and Tenth Circuits on the other with respect to the scope of this exception from the notice requirement when the IRS summonses the financial records of individuals other than a person liable for the taxes.


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'Ip v. United States'

Ip v. United States, 205 F.3d 1168 (9th Cir. 2000), arose out of an assessment of taxes against a Hong Kong corporation, Diamond Trade Limited (Diamond Trade). Following the assessment, the

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IRS issued summonses to two banks requesting records of accounts held by Shiela Ip, the fiancée of Diamond Trade's agent, and others. Although the IRS did not notify Ip that it had summonsed her account records, she learned of the summons and filed a petition in district court seeking to quash it. The district court granted the government's motion to dismiss the petition for lack of standing because, in the district court's view, Ip was not entitled to notice because the summonses were issued "in the aid of the collection of" Diamond Trade's tax liability.

On appeal, Ip argued that the district court had read the exception currently found in §7609(c)(2)(D)(i) too narrowly. In reversing, the U.S. Court of Appeals for the Ninth Circuit noted that other courts to address the issue—including the Seventh Circuit in *Barmes v. United States*, 199 F.3d 386 (7th Cir. 1999)—had held that the exception to the notice requirement applied whenever a "third-party summons is issued to aid in the collection of any assessed tax." The court, however, found that the statutory language was ambiguous and, after reviewing the relevant legislative history and assessing Congress's intent, concluded that the literal language of Section 7609(c)(2)(D)(i) would "render[] totally meaningless the explicit language in [Section 7609(c)(2)(D)(ii)] which suspends notice when the summons is in aid of collection of 'the liability … of any transferee or fiduciary of any person referred to in clause (i).'" The court reasoned that, if the exception set forth in clause (i) barred notice to any person regardless of their ownership interest in the account, there would be no need for clause (ii) to specify that a transferee or fiduciary is also not entitled to notice. The court further found that such a broad reading of the exception would "vitiate[] completely the legislative purpose" because it would permit the IRS to avoid notice in virtually every situation following an assessment against a taxpayer. Refusing to apply "a strictly semantic approach," the court concluded "that the notice exception set forth in [Section 7609(c)(2)(D)] applies only where the assessed taxpayer 'has a recognizable [legal] interest in the records summoned.'" Because the assessed taxpayer, Diamond Trade, did not have any legal interest in Ip's bank account, and because the IRS had not established that Ip was a transferee or fiduciary of Diamond Trade, the exception to the notice requirement did not apply, and Ip had standing to challenge the summons.

'Polselli v. IRS'

In *Polselli*, the taxpayer—Remo Polselli—had over $2 million in tax liabilities. The IRS suspected that Polselli was avoiding the assessment by using his wife's bank accounts and that his lawyers had financial records that might reveal, among other things, the source of Polselli's funds and additional bank accounts. To determine whether Polselli was, in fact, concealing his assets, the IRS issued summonses to three banks seeking records of accounts held by Mrs. Polselli and the lawyers (collectively, Petitioners).

Photo: Patrick Semansky/AP

A sign is displayed outside the Internal Revenue Service building May 4, 2021, in Washington.

The IRS did not notify Petitioners of these summonses, but the banks did, which prompted Petitioners to file petitions in the Eastern District of Michigan seeking to quash the summonses. The IRS moved to dismiss the petitions arguing that, because Petitioners were not entitled to notice of the summonses that were issued to aid the collection of assessments against Polselli, their claims was barred by the doctrine of sovereign immunity.

The district court agreed, finding that the "plain language" of Section 7609(c)(2)(D)(i) provides that notice is not required so long as a summons is issued in connection with an attempt to collect an assessment. See *Polselli v. United States*, 2020 WL 12688176 (E.D. Mich. Nov. 16, 2020). In so holding, the district court rejected the Ninth Circuit's reasoning in *Ip* and instead adopted the approach taken by the Seventh Circuit in *Barmes* and the Tenth Circuit in *Davidson*

v. United States, 1998 WL 339541 (June 9, 1998). The court reasoned that, in addition to the plain language of the statute, a narrow construction of the exception is consistent with the requirement that waivers of sovereign immunity be construed strictly.

Petitioners appealed the district court's decision to the Sixth Circuit which affirmed in a 2-1 decision. In doing so, the court concluded that the summonses at issue fell "squarely within the exception listed in §7609(c)(2)(D)(i)" because that section "unequivocally provides" that notice is not required so long as a summons was issued "in aid of the collection" of an assessment made or judgment entered against a delinquent taxpayer. In other words, the IRS was not required to give notice because it had issued the summonses to locate Polselli's assets to satisfy his assessed tax liability (rather than to determine additional federal tax liabilities of the non-assessed individuals). Because Petitioners were not entitled to notice, the district court lacked subject-matter jurisdiction to quash the summonses.

In *Polselli*, the Sixth Circuit expressly rejected the Ninth Circuit's view that the government's expansive reading of clause (i) would render clause (ii) meaningless, noting that transferee and fiduciary liability is governed by state law, while the IRS determines the liability of taxpayers. Moreover, the court reasoned that even if its interpretation of the statute would lead to some redundancy, it would not give the court license to add limiting statutory language. The Sixth Circuit deemed the apparent redundancy a "belt and suspenders approach" by Congress to clarify that the IRS need not give notice when it issues summonses in aid of the collection of the liability of a transferee or fiduciary of an assessed taxpayer.

Finally, the Sixth Circuit rejected the concerns raised by Petitioners and the dissent that the court's interpretation would result in a significant intrusion upon the privacy of blameless account holders. In doing so, the court concluded that it is "Congress's prerogative to prioritize the IRS's collection efforts over taxpayer privacy" and the court must honor the IRS's expansive authority to gather information in pursuit of its collection efforts.

'Polselli' and Beyond

Although the circuit split on the correct interpretation of Section 7609(c)(2)(D)(i) persisted for nearly a quarter century, the Sixth Circuit's recent adoption of the Seventh and Tenth Circuits' approach has drawn the Supreme Court's attention. Given that a majority of the current Justices are avowed textualists, the Court may have agreed to hear *Polselli* in order to address the conflict between the Sixth, Seventh, and Tenth Circuits' focus on the literal statutory language and the Ninth Circuit's recognition that a literal reading is at odds with the legislative intent and would render part of the statute meaningless. In resolving this conflict, it is hard to envision the Court adopting the Ninth Circuit's assertion that "the masters of the American legal tradition have warned us not to become strict literalists in construing the language of statutes."

Alternatively, textualism is not the Court's sole concern—or as Justice Kagan put it, "the current Court is textualist only when being so suits it"—and the Justices may have been motivated to hear *Polselli* to address privacy concerns raised in both the cert petition and an amicus brief filed on behalf of the Center for Taxpayer Rights. Specifically, the Court may well be concerned that adopting the broad interpretation of the exemption from notice applied by the majority of circuits will give the IRS broad and unchecked access to the financial records of third parties in connection with tax collection efforts.

Regardless of its motivation for agreeing to hear the case, *Polselli* is an opportunity for the Court both to address an important issue regarding the scope of the IRS's summons authority and procedures and to further develop the overarching jurisprudence governing statutory interpretation.