



Tax Talk

by Anson H. Asbury

Bare Allegations, Naked Assertions, and Improper Purposes: Supreme Court to Hear Arguments in Summons Enforcement Matter

On Jan. 10, 2014, the U.S. Supreme Court granted

the United States' petition seeking *certiorari* in *United States v. Clarke*,¹ an Internal Revenue Service (IRS) summons enforcement action. The government sought *certiorari* from an unpublished opinion of the Eleventh Circuit Court of Appeals reversing and remanding an unpublished order of the U.S. District Court for the Southern District of Florida. The petition was filed on the grounds that the appellate decision created a split in the circuits over the rights of a summons opponent and the obligations of the government in summons enforcement. *Clarke* asks whether a summons opponent can trigger an evidentiary hearing with a naked assertion of improper purpose on the part of the IRS.

The IRS issues thousands of summonses each year,² and enforcement has been a regularly litigated issue for more than a decade.³ The Large Business and International (LB&I) division of the IRS has placed a priority on the issuance and enforcement of summonses for taxpayers who do not respond to requests for information during an examination. In 2013, LB&I issued two policy directives on the topic⁴ and completed mandatory training for revenue agents on updated summons procedures.⁵ LB&I's new enforcement procedures went into effect on March, 3, 2014.⁶ The current emphasis on summons enforcement only highlights the importance of the *Clarke* petition.

The IRS has the authority under Section 7601 to investigate all persons "who may be liable to pay any internal revenue tax."⁷ Section 7602(a)(2) gives the secretary of internal revenue the authority to summons persons liable for a tax, or otherwise possessing information about a tax, to appear, produce books and records, and give testimony under oath.

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 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, and

- Collect any such liability.⁸

The purpose of the summons also may include an inquiry into "any offense connected with the administration or enforcement of the internal revenue laws" (e.g., criminal or civil fraud).⁹

A summons is not self-enforcing. A summons generally is issued only after a party has failed to respond to a formal request for documents or other information. An IRS officer, such as a revenue agent, a special agent, or a large case specialist, may issue a summons with the signature of a territory manager.¹⁰ The face of a summons identifies the tax matter and the summoned party and requests that the party appear at a specific day, time, and place. If the summoned party does not appear, the summons does not expire. Rather, it becomes ripe for enforcement. Enforcement occurs when an action to compel a response from the summoned party is filed in a U.S. district court.¹¹

The U.S. Supreme Court set forth a four-pronged test for summons enforcement in *U.S. v. Powell*.¹² To enforce a summons, the government must show that it (1) is issued for a legitimate purpose; (2) seeks information that may be relevant to that purpose; (3) seeks information that is not already within the possession of the IRS; and (4) satisfies all the administrative requirements of the Internal Revenue Code.¹³

The Examination

The IRS examined the tax returns of Dynamo Holdings Limited Partnership (DHLP) for the tax years 2005 to 2007. Twice during the examination, DHLP voluntarily agreed to extend the statute of limitations. About five months before the extended limitations period was set to close, the IRS presented (but did not issue) a signed Final Partnership Administrative Adjustment (FPAA) for the 2005 to 2007 period to DHLP.¹⁴

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After presenting the FPAA, the IRS again asked DHLP to extend the statute of limitations so that it might continue its examination. DHLP declined. Shortly thereafter, the revenue agent issued six separate summonses requesting production of documents and testimony about DHLP's 2005 to 2007 tax returns.¹⁵ Four of those subject to the summonses declined to comply and ultimately became the respondents in *United States v. Clarke*.¹⁶

On Dec. 28, 2010, with three days remaining on the extended statute of limitations, the IRS formally issued the FPAA that previously had been presented to the taxpayers. On Feb. 1, 2011, DHLP challenged the FPAA by filing a petition for readjustment in the U.S. Tax Court.¹⁷

Summons Enforcement—The District Court

On April 28, 2011, almost three months after DHLP commenced its suit in tax court and six months after the return date for most of the summonses, the IRS initiated a proceeding in U.S. district court to enforce the summonses.¹⁸ In support of each petition for enforcement, the United States attached a declaration of the revenue agent who issued the summonses, attesting to satisfaction of the *Powell* factors.

The respondents moved to quash, arguing that the summonses were issued for an improper purpose under *Powell*. They requested an evidentiary hearing to question the issuing revenue agent and also asked for prehearing discovery.

The respondents alleged that the summonses had been issued in retribution for DHLP's refusal to allow another extension of the statute of limitations and to circumvent the tax court restrictions on discovery.¹⁹ They offered several specific exhibits in support of their position.²⁰

The U.S. District Court for the Southern District of Florida denied the motions to quash and ordered enforcement of the summonses. It found that respondents failed to rebut the United States' *prima facie* case for enforcement under *Powell*. The court acknowledged that the respondent is entitled to an adversarial hearing but denied respondents' requests for an evidentiary hearing and discovery. The court noted that establishing an improper purpose requires more than a naked assertion.²¹ The district court explained that the respondents made "no meaningful allegations of improper purpose," and a court is not required to hold an evidentiary hearing "upon a mere allegation of improper purpose."²² It further held, as a matter of law, that the use of the summons process to avoid the limitations of tax court discovery was not grounds for quashing a summons²³ and dismissed the claim of retaliation as having "no bearing" on whether the summonses should be enforced.

The Appeal—The Eleventh Circuit Court of Appeals

The Eleventh Circuit Court of Appeals reversed the ruling in part in an unpublished, *per curiam* decision. It held that the lower court abused its discretion by declining to hold a limited evidentiary hearing to establish whether the IRS may have issued the summonses for an improper purpose. Relying on its own recent precedent in *Nero Trading, LLC v. U.S. Dep't of Treasury*,²⁴ the appellate court held that respondents were "entitled to a hearing to explore their allegation of an improper purpose" and "to ascertain whether the [IRS] issued a given summons for an improper purpose."²⁵ The court also noted that "in situations such as this, requiring the taxpayer to provide factual support for an allegation



of an improper purpose, without giving the taxpayer a meaningful opportunity to obtain such facts, saddles the taxpayer with an unreasonable circular burden, creating an impermissible 'Catch 22.'²⁶ The court, however, did agree with the district court that the respondents were not entitled to discovery.

Petition for Writ of Certiorari

The government sought *certiorari* on the grounds that the Eleventh Circuit's decision conflicted with the authority of all the other circuits and that the issue was recurring and important. It framed the question for the high court as:

Whether an unsupported allegation that the Internal Revenue Service (IRS) issued a summons for an improper purpose entitles an opponent of the summons to an evidentiary hearing to question IRS officials about their reasons for issuing the summons.²⁷

The government argued that the Eleventh Circuit's holding would allow a summons opponent to nullify its good faith demonstration of the *Powell* factors with a bare allegation of IRS impropriety.²⁸ It further maintained that such a rule would be inconsistent with effective enforcement of federal tax laws and could be a substantial impairment to summons enforcement in the Eleventh Circuit.²⁹

Respondent's Brief in Opposition of Certiorari

The respondents disputed the government's core claims and enlisted the aid of a former solicitor general³⁰ in their response. They maintained that the appellate decision did not represent a departure from the law of the other circuits and that the fact-bound holding of the Eleventh Circuit was not appropriate for review by the high court.

The respondents argued that the Eleventh Circuit's reliance on its own precedent *Nero Trading* was consistent with the Supreme Court's precedent in *Powell* and the decisions of the other courts of appeals.³¹ They maintained that district courts in every circuit have the discretion to require the IRS to justify enforcement of a summons at an evidentiary hearing. They maintained that the government's problem with the Eleventh Circuit's decision was that it simply had ordered the trial court to hold such a hearing. The

respondents maintained that the factual dispute between the two lower courts did not warrant review by the high court. Respondents also suggested that the evidence the IRS was using in the summons action to subvert the tax court's discovery rules complicated the question presented by the government and made the case an inappropriate vehicle for consideration.³²

The Supreme Court Grants *Certiorari*

The Supreme Court apparently found the respondents' call for restraint unpersuasive in light of the issue framed by the government's petition. Whether *Clarke* will herald a new era in summons enforcement or further bolster this substantial information-gathering tool in the hands of the government remains to be seen. Oral arguments were heard on April 23, 2014. ☉

Endnotes

¹*United States v. Clarke*, 517 Fed. Appx. 689 (11th Cir. Fla. April 18, 2013) (No. 12-13190) *cert. granted*, 134 S. Ct. 895, 82 U.S.L.W. 3131 (U.S. Jan. 10, 2014) (No. 13-301).

²"The IRS issues thousands of summonses every year, including hundreds in the Eleventh Circuit." Petition for a *Writ of Certiorari*, at 19, *United States v. Clarke*, 517 Fed. Appx. 689 (11th Cir. Fla. April 18, 2013) (No. 12-13190).

³National Taxpayer Advocate, 2013 Report to Congress, at 322 available at www.taxpayeradvocate.irs.gov/userfiles/file/2013_FullReport/Most-Litigated-Issues.pdf. Summons enforcement has been identified among the most litigated issues in the National Taxpayer Advocates' Report to Congress since 2002.

⁴*Id.*, see also, Large Business and International Dir., (June 18, 2013), (guidance to LB&I revenue agents to follow when issuing Information Document Requests (IDRs) during the information-gathering phase of an examination).

⁵Large Business and International Dir. on Information Document Request Enforcement Process, LB&I Control No: LB&I-04-1113-009 (Nov. 4, 2013).

⁶Large Business and International Dir. on Information Document Request Enforcement Process, LB&I Control No: LB&I-04-0214-004 (Feb. 28, 2014).

⁷All section references are to the Internal Revenue Code of 1986, as amended.

⁸I.R.C. § 7602(a).

⁹*Id.* § 7602(b).

¹⁰Internal Revenue Manual 25.5.5.

¹¹See I.R.C. § 7402 (authorizing U.S. district courts to hear summons enforcement proceedings).

¹²379 U.S. 48 (1964).

¹³*Id.* at 57-58.

¹⁴The distinction between the presentation and issuance of an FPAA is important. Issuance triggers the taxpayer's right to seek judicial review of the IRS's adjustments in the U.S. tax court. I.R.C. § § 6221-6223, see e.g., *Sealy Power, Ltd. v. Commissioner*, 46 F.3d 382, 385-386 (5th Cir. 1995) (the FPAA notifies "affected taxpayers that the Commissioner has made a final administrative determination of their liability for particular tax years.>").

¹⁵Six summonses were issued to five individuals. Two summonses were issued to Michael Clarke, one in his capacity as chief financial officer of Beekman Vista, Inc., and another in his role as chief financial officer of Dynamo GP, Inc.

¹⁶The fifth summoned individual ultimately complied and was interviewed in September 2011. She is not among the respondents to the Supreme Court case. The respondents in the matter before the high court include the four parties representing the five noncomplying summonses and DHL, which was permitted to intervene in the initial summons enforcement proceeding.

¹⁷See *DHLP v. Commissioner*, No. 2685-11 (T.C. Feb. 1, 2011).

¹⁸*United States v. Clarke*, No. 9:11-mc-80456-KLR, 111 A.F.T.R.2d 2013-1697 (S.D. Fla. Apr. 17, 2012) (order denying motions to quash).

¹⁹The tax court imposes significant limitations on the scope of discovery and treats nonconsensual deposition as "an extraordinary method of discovery." Tax Court 74(c)(B).

²⁰Many of the exhibits produced by respondents alleged use of the summons as a means to circumvent tax court discovery. Interesting among those exhibits was "a declaration from attorney Richard Sapinski, who represented Christine Moog when she appeared in compliance with her IRS summons, and who stated that Moog's interview by the IRS was conducted exclusively by the two attorneys representing the IRS in the Tax Court proceeding and that [summons issuing] Agent Fierfelder did not even attend." Respondent's Brief in Opposition at 6-7, *United States v. Clarke*, No. 12-13190, 517 Fed. Appx. 689 (11th Cir. Fla. April 18, 2013).

²¹*Id.* at 5 (citing *United States v. Millman*, 765 F.2d 27, 29 (2d Cir. 1985)).

²²*United States v. Clarke*, No. 9:11-mc-80456-KLR, 111 A.F.T.R.2d 2013-1697, order at 9 (S.D. Fla. April 17, 2012).

²³*Id.* at 6 (citing *PAA Mgmt., Ltd. v. United States*, 962 F.2d 212, 219 (2nd Cir. 1992)) (the government's power to enforce a summons does not terminate merely because a tax court proceeding has begun).

²⁴570 F.3d 1244, 1249 (11th Cir. 2009).

²⁵*Id.*

²⁶*Id.* at 1250.

²⁷Petition for *Writ of Certiorari*, at I, *United States v. Clarke*, 517 Fed. Appx. 689 (11th Cir. Fla. April 18, 2013) (No. 12-13190).

²⁸*Id.* at 8.

²⁹*Id.* at 9.

³⁰Seth Waxman, 41st solicitor general of the United States, 1997-2001, currently chair, appellate and Supreme Court litigation practice group, WilmerHale, Washington, D.C.

³¹Respondent's Brief in Opposition at 2, *United States v. Clarke*, 517 Fed. Appx. 689 (11th Cir. Fla. April 18, 2013) (No. 12-13190).

³²*Id.*

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