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No Penalty for Failure to Comply With IRS Summons, but . . .

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Not often have we seen a press release trumpeting a taxpayer's court defeat as a "historic and courageous first step in restoring constitutional order to the administration and enforcement of our nation's tax laws." Even less often have we seen one that hails a per curiam rejection of the taxpayer's appeal as a "dramatic development" that "effectively puts the IRS and DOJ on notice that violations of taxpayer's Due Process Rights will no longer be tolerated." That, however, is how We the People Foundation for Constitutional Education described the opinion of the appeals court affirming the dismissal of Robert L. Schulz v. IRS et al., Dkt. No. 04-0196-cv, Doc 2005-1604, 2005 TNT 17-13 (2d Cir. Jan. 25, 2005). Schulz, chairman of the foundation, had sought an order from the district court quashing administrative summonses the IRS had served on him.

Beating a Dead Horse?

In dismissing the Schulz motions, the district court made the point that, since Reisman v. Caplin, 375 U.S. 440 (1964), injunctive relief against an IRS summons has not been available to taxpayers. The reasoning? Section 7604(b) "provides full opportunity for judicial review before any coercive sanctions may be imposed." Schulz appealed the district court's dismissal, citing two prior Second Circuit decisions in which that appeals court had, in fact, approved applications to vacate an IRS summons in advance of any attempts by the government to seek their judicial enforcement.

The appeals court noted in the unpublished Schulz opinion that the federal courts deal only with actual cases and controversies. Thus, to obtain injunctive relief Schulz would have had to allege some sort of injury that he would sustain that would be traceable to the IRS's allegedly unlawful summonses and that would be ameliorated by the relief he was requesting. The cases on which Schulz relied predated the 1964 Reisman decision and had implicitly been destroyed as precedent by that decision. Comments to that effect had, in fact, appeared over 40 years ago in the appeals court's opinion in United States v. Kulukundis, 329 F.2d 197 (2d Cir. 1964). In Kulukundis, Judge Friendly said:

> Reisman v. Caplin, 375 U.S. 440, 445, 84 S. Ct. 508, 512, 11 L. Ed. 2d 459 (1964), . . . by construing the contempt and punitive provisions of § 7604(b) and § 7210 as applicable only to persons who "wholly made default or contumaciously refused to comply" but not to a witness who "appears and interposes good faith challenges to the summons," seems to destroy the basis underlying decisions of this court which authorized applications to vacate such a summons (and appeals from their denial) in advance of any judicial proceeding by the Government for their enforcement. International Commodities Corp. v. I.R.S., 224 F.2d 882 (2d Cir. 1955); E.g., Application of Colton, 291 F.2d 487 (2d Cir. 1961); and In re Turner, 309 F.2d 69 (2d Cir. 1962) [in which we expressed our willingness to reexamine our prior decisions "if the Government deems that any relevant considerations were overlooked."]. See Application of Howard, 325 F.2d 917 (3d Cir. 1963).

The Schulz opinion noted, therefore, that "we view ourselves today as completing a task begun forty years ago and hold that, absent an effort to seek enforcement through a federal court, IRS summonses apply no force to taxpayers, and no consequences whatever can befall a

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taxpayer who refuses, ignores, or otherwise does not comply with an IRS summons until that summons is backed by a federal court order."[1]

The Sweep of Section 7604(b)

IRS administrative summonses are typically issued under section 7602. Section 7604(a) then provides that the U.S. district court "for the district in which such person resides or is found" has the jurisdiction to compel compliance. Section 7604(b) provides:

> Whenever any person summoned . . . neglects or refuses to obey such summons, or to produce books, papers, records, or other data, or to give testimony, as required, the [IRS] may apply to the judge of the district court or to a United States commissioner for the district . . . for an attachment against him as for a contempt. It shall be the duty of the judge or commissioner to hear the application, and, if a satisfactory proof is made, to issue an attachment directed to some proper officer, for the arrest of such person, and upon his being brought before him to proceed to a hearing of the case; and upon such hearing, the judge or the United States commissioner shall have power to make such order as he shall deem proper, not inconsistent with the law for the punishment of contempts, to enforce obedience to the requirements of the summons and to punish such person for his default or disobedience.

The Supreme Court's comment on that language, in Reisman v. Caplin, was that "the provision was intended only to cover persons who were summoned and wholly made default or contumaciously refused to comply" with the summons of the hearing officer. Even when that occurs, however, "the witness may assert his objections at the hearing before the court, which is authorized to make such order as it 'shall deem proper.'" We and most tax practitioners with whom we have worked routinely advise clients to respond to requests from the IRS, including the form of request contained in a summons. Response, however, is not the same as supine surrender. If the request is ambiguous or there are valid objections to what the examining agent seeks, or if the request is of doubtful legality, then the response may be to ask for clarification or to assert the objection or illegality. We do not recommend that taxpayers, or anyone else, wholly make default or contumaciously refuse to comply.

There are some who feel otherwise, of course, and who quote the Reisman language that "[i]n such a proceeding only a refusal to comply with an order of the district judge subjects the witness to contempt proceedings." That, they say, justifies ignoring IRS requests, including summonses. We think that is stupid behavior. It gains the taxpayer nothing, antagonizes the IRS people involved, and heightens their suspicion that the taxpayer has something to hide.

The Tax Lawyer and the Special Agent

Taxpayers usually fare poorly when the IRS goes to the district court to enforce a summons. The standards applied are those of United States v. Powell, 379 U.S. 48, 57-58 (1964), which require for the

[1] In a somewhat unusual footnote for a per curiam opinion, which is not intended to function as a citable precedent in other cases, the appeals court panel commented, "This opinion has been circulated to the active members of this Court prior to filing." We assume the other circuit judges were in accord.

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summons to be enforced that the IRS satisfy the district court that (1) the investigation is conducted for a legitimate purpose, (2) the material sought is relevant to that purpose, (3) the IRS is not already in possession of the material sought, and (4) the IRS has complied with the applicable administrative requirements. That burden on the IRS is a slight one, with the IRS normally using an affidavit from the revenue agent to establish its prima facie case and the taxpayer facing the almost impossible task of showing, for example, that the investigation is being conducted for an improper purpose. The district court judge has limited risk that his order enforcing the summons will be reversed on appeal, since the issues are factual and thus the order normally will be disturbed on appeal only if it is clearly in error.

United States v. Charles L. Abrahams, 905 F.2d 1276 (9th Cir. 1990), illustrates how that process works but raises another question -- what are the limits on the authority of the district court judge to go beyond straightforward enforcement of the summons and make modifications to it. Abrahams, a tax attorney, had what Circuit Judge William C. Canby Jr. described as a "routine practice" of filing amended client returns claiming new deductions just before expiration of the three-year statute of limitations for assessing tax liability. An IRS special agent named Darrell G. Henderson was interested in whether Abrahams "advised or aided the filing of false or fraudulent returns, improperly omitted information on original returns so that he could later file amended returns, lacked sufficient factual basis for information submitted on the amended returns, or filed amended returns without informing his clients."

Henderson therefore issued a summons. It sought what Abrahams complained would have been virtually all of his files. Henderson responded by limiting his request to documents used in preparing returns for 39 named clients, allowing an additional 15 days to respond to the summons, and offering clerical assistance. Abrahams nevertheless refused to comply, so Henderson went to the district court to obtain enforcement.

Judicial Due Process

The IRS attorney presented the court with a declaration from Henderson showing that the summons met the Powell requirements. Abrahams responded by asserting that the summons was issued "solely to unearth evidence of criminal conduct." He also alleged that Henderson intended to turn over the information he might obtain to the Justice Department to use against Abrahams and to the IRS audit division to use against Abrahams's clients, and that a major objective was "to harass [him] by disturbing his relationship with his clients." Finally, he contended that the summons was "overbroad and burdensome" and that what was being sought was protected by the attorney-client privilege and the work-product doctrine.

The district court held a hearing and then ordered partial compliance. Abrahams was to submit the documentation used in his preparation of 20 "representative" returns of his choosing for the six years in question. Further, said the court, the IRS was not to interview any of Abrahams's clients unless Abrahams was present in his capacity as their attorney. The court also modified the summons to prohibit the agents investigating Abrahams from releasing any information acquired under the summons to agents that might be involved in cases in which Abrahams was representing his clients before the Tax Court or Court of Federal Claims. Finally, the court in its enforcement order stated that the IRS could not demand any material already furnished to the IRS, such as Forms 1040, 1099, or W-2.

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Both the IRS and Abrahams appealed that order. In an unpublished case, United States v. Abrahams, 833 F.2d 1017 (9th Cir. 1987), the court of appeals reversed and remanded for a limited evidentiary hearing on Abrahams's allegations of bad faith and harassment. At that hearing, Abrahams finally had a chance to examine Henderson and three other agents involved in investigating Abrahams's clients. When he finished, the district court concluded that Abrahams had not substantiated his charges. The court reissued its prior order, and both Abrahams and the IRS appealed. The appeals court denied Abrahams's appeal in full; it vacated the two points in the district court's order from which the IRS appealed, those being the 20 returns per year limitation and the requirement that Abrahams be present at IRS interviews with his clients. Some of its discussion should be of particular interest to practitioners.

Civil vs. Criminal Investigatory Purpose

Abrahams had objected that the summons was improper because the IRS was interested solely in investigating his possible criminal conduct. In 1964 the Supreme Court had noted in Reisman v. Caplin that one of the grounds for holding a summons to be unenforceable was "that the material is sought for the improper purpose of obtaining evidence for use in a criminal prosecution." Many taxpayers and some tax practitioners still believe that the possibility that the material being sought might be used in a criminal prosecution is a valid defense to a summons.

In 1982, however, section 7602, giving the IRS authority to examine books, papers, and witnesses and to issue summons for that purpose, was broadened by adding section 7602(b) to allow the IRS to inquire into "any offense connected with the administration or enforcement of the internal revenue laws." Thus, under current law, the only restriction regarding criminal matters is that of section 7602(d), also added in 1982 (as 7602(c)), prohibiting an administrative summons when there has been a Justice Department referral in a criminal matter.

The Senate explained its understanding of what it was doing in adding sections 7602(b) and (c):

> Many tax investigations by the Internal Revenue Service have both civil and criminal aspects. The committee believes that a clear definition of when the power to issue an administrative summons exists and when it does not exist in cases with a criminal aspect will simplify administration of the laws without prejudicing the rights of taxpayers. . . . Under the bill, the Secretary may not issue any summons or commence any action to enforce a summons if a Justice Department referral is in effect with respect to the person whose tax liability is in issue. A Justice Department referral is in effect with respect to any person if the Secretary recommends to the Attorney General (1) a grand jury investigation, or (2) criminal prosecution of such person for any offense connected with the internal revenue laws, or (3) the Attorney General . . . makes a written request to the Secretary for return of or return information relating to a taxpayer which request sets forth the need for disclosure for tax administration purposes. . . . The Secretary may issue a summons for one taxable year even if a Justice Department referral is in effect with respect to the taxpayer for another taxable year.

District Court Discretion in Modifying Summons

In Abrahams the district court judge had narrowed the scope of the IRS summons and imposed conditions on the manner of its enforcement. The appeals court reversed those actions. Judge Canby explained that under the court's prior cases, "denials and exclusions followed determinations

that the summonses in question called for production of irrelevant or privileged material." He found no precedent in his court's decisions, or in any others, for refusing to enforce an IRS summons that met the Powell requirements and sought only relevant and unprivileged documents.

Further, said Judge Canby, restricting the IRS's ability to interview Abrahams's clients to situations in which Abrahams was present constituted "an abuse of the court's 'considerable discretion' in setting the terms of the order of enforcement." The proceeding dealt with granting or denying enforcement of the terms of the specific summons. "As the product of such a proceeding, the district court's order should have been correspondingly narrow: terms dealing with aspects of the summons itself were permissible, but those dealing with elements of the IRS investigation not directly related to the summons were not." How the IRS conducted its interviews while investigating Abrahams was beyond the scope of the proceeding.

In United States et al. v. Laddie F. Jose, Trustee of Jose Business Trust and Jose Family Trust, 121 F.3d 531, Doc 97-34272, 97 TNT 246-25 (9th Cir. 1997) (en banc), the Ninth Circuit returned again to the question of the ability of a district court to impose conditions on enforcement of a summons. Revenue Agent Leslie M. Nishimura had sought to review some trust documents, which Jose submitted to him on condition that he neither photocopy them nor disclose their contents to anyone else without his permission. Nishimura at first agreed to those conditions, but then returned the documents because he found it impossible to complete his work within those restrictions. The IRS then served Jose with two summonses for testimony and the production of documents. Jose refused to comply and the IRS sought enforcement. At the district court hearing, Jose voiced his concern that the documents would ultimately be used for criminal prosecution and asked the magistrate judge handling the proceeding for an equitable order stating that the IRS could not turn the documents over to the U.S. attorney's office without Jose first being notified. The order that was issued went even further. It required the IRS to notify Jose five days before circulating, transferring, or copying the summoned documents to any other division of the IRS, including the Criminal Investigation Division. Asked Circuit Judge Cynthia Holcomb Hall, writing for the divided en banc appeals court: "May the district court conditionally enforce IRS summonses, or is it limited to enforcing or denying summonses?"

Judge Hall quoted from United States v. Barrett, 837 F.2d 1341, 1350-51 (5th Cir. 1988) (en banc), cert. denied, 492 U.S. 926 (1989), that "[t]he sole purpose of the enforcement proceeding is to ensure that the IRS has issued the summons for proper purpose and in good faith." She reversed the district court and held "that the district court is strictly limited to enforcing or denying the IRS summonses." To the extent that prior decisions of the Ninth Circuit authorized conditional enforcement, she added, "they are overruled."

Conclusion

The IRS has not had the power in and of itself to mete out fines or imprisonment or to seize property. The courts stand between the taxpayer (and the tax practitioner) and the government, and the system generally works reasonably well for those who use the system and play by the rules. One CPA queried us (and other tax lawyers) about the Schulz case, asking, "Does this case actually signify a breakthrough for the tax protest movement as the advocates claim or are there reasons why this case may not have the import that it is alleged to have?" Our answer to him was to quote from our "IRS Summons Power and the Tax Court," Tax Notes, May 20, 2002, p. 1205:

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> If the hearing officer rejects the summoned party's challenge [to the IRS summons] and the witness nevertheless refuses to produce the documents sought or to testify, the hearing officer is without power to enforce compliance or to impose sanctions for noncompliance. To compel compliance with the summons, the IRS officer must get the IRS attorneys to bring suit in U.S. district court. At this point, and not before, the summoned party may mount a judicial challenge to the summons. If the district court orders compliance, only then might noncompliance result in the imposition of penalties under section 7210 or 7604(b).

We might have written the same thing in other articles in earlier years, as well. We may have to write it again in the future. The We the People press release on Schulz implies that the Second Circuit's reiteration of a rule that is at least 40 years old makes the IRS into a toothless tiger. In that, We the People demonstrate its lack of understanding of the system against which it makes its living protesting. The system is designed to give due process to those who take advantage of that opportunity. At the same time, the IRS power, even with the taxpayer's ability to obtain judicial oversight of its exercise, is formidable. When the IRS seeks court enforcement of a summons, there is some, but very little, likelihood that the court will refuse to grant it. Taxpayers who wish to incur the expense and aggravation of testing that truth are welcome to proceed. It is their money. For our part, we find it is usually more effective to work with the IRS. When we do decline to furnish something, we do so respectfully, as one professional to another, and explain our reasons.

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