Supreme Court Allows Taxpayers to Question IRS Agents Regarding Propriety of Summons

Taxpayers may be able to engage in limited challenges to a summons issued by the Internal Revenue Service (IRS) when there is an inference of impropriety regarding the agency's actions. In a unanimous decision on June 19, 2014, the Supreme Court in *United States v. Clarke* held that while no categorical right exists for a taxpayer to question an IRS agent about an issued summons, presentation of some credible evidence supporting a charge of improper agency conduct creates an opportunity for the taxpayer to conduct such an examination. The Court's change in judicial tax procedure may give taxpayers in certain circumstances more leverage in pushing back against summons enforcement proceedings when the taxpayer can show by credible circumstantial evidence that the summons was issued for an improper purpose. The decision in *Clarke* also establishes new standards of appellate review of decisions by federal district courts in summons enforcement proceedings.

Challenging a Summons

The case decided by the Supreme Court involved an IRS investigation and summons filed in the United States District Court for the Southern District of Florida. In its examination of tax returns filed by a limited partnership, the IRS noted that the partnership reported suspicious debt and interest expenses totaling $17,000,000 in 2006 and 2007. On September 24, 2010, the IRS issued five summonses requesting testimony and records regarding the partnership's tax reporting and deductions pursuant to 26 U.S.C.§ 7602, including a summons to the Chief Financial Officer. The summons ordered the company to appear and provide testimony and produce certain books, records, papers and other data. The partnership did not comply with the summons. The IRS then issued a Notice of Final Partnership Administrative Adjustment (FPAA). On February 1, 2011, the partnership filed a Petition for Readjustment of Partnership Items in the U.S. Tax Court challenging the IRS's FPAA determination. Shortly thereafter, the IRS attempted to enforce the summons at issue, alleging that the information it needed was in the partnership's possession.

In order to enforce a summons under the Supreme Court's articulated *Powell* test, the IRS summons must be: (1) issued for a legitimate purpose, (2) seek information relevant to the purpose, (3) seek information that is not already in the IRS's possession and (4) satisfy all administrative steps required by the Internal Revenue Code. The IRS claimed to have satisfied all of these *Powell* requirements by filing the examining agent's sworn declaration of compliance. However, the partnership asserted that the summons was issued in retaliation for not extending the statute of limitations and sought to question the IRS agent about her reasons for issuing the summons. The District Court found that a sworn declaration by the IRS was enough to establish a *prima facie* case for enforcing the summons and that the partnership's "naked assertion" of improper purpose was inadequate to challenge the summons. This decision was vacated and remanded by the Eleventh Circuit Court of Appeals in a *per curiam* opinion issued in April 2013. In construing *Powell*, the Eleventh Circuit stated "that a party opposing a summons is entitled to an adversary hearing before the enforcement is ordered, and that, at the hearing, the opponent 'may challenge the summons on any appropriate ground.'" The circuit court concluded that a respondent to an IRS summons needs only to assert an "allegation of improper purpose" to obtain an adversary hearing in which the respondent can question the IRS official regarding the reasoning behind issuing the summons. The Eleventh Circuit reasoned that requiring taxpayers to provide factual support for allegations of an improper purpose without a meaningful opportunity for the taxpayer "to obtain such facts, saddles the taxpayer with an unreasonable circular burden, creating an impermissible 'Catch 22.'"

The Eleventh Circuit's decision created a split among the circuit courts, as the other appellate courts reviewing lower court decisions regarding taxpayer challenges to IRS summons enforcement proceedings had all held that a taxpayer has no right to examine an IRS agent in order to provide evidence regarding an improper purpose for the summons. Based on this circuit split, the Supreme Court granted the government's petition for certiorari.

Supreme Court Unanimously Favors Limited Right to Examine Summons

In a unanimous opinion for the Court, Justice Elena Kagan settled on a middle road through the dispute, creating new ground in applying tax procedure. The Court dismissed the Eleventh Circuit's rationale that the "bare assertion" of an improper purpose in challenging a summons is sufficient to warrant the right to examine an IRS agent. Rather, the Eleventh Circuit did not adequately assess whether the evidence that the respondent to the summons submitted met the "plausible inference of improper motive standard."

In reaching its decision, the Court weighed the importance of allowing taxpayers to challenge abuses of power by the IRS against the importance of the summons as an investigatory tool, which the Court recognized is a "crucial backstop in a tax system based on self-reporting." Under the Court's view, a taxpayer is allowed to examine an IRS agent when it "can point to specific facts or circumstances plausibly raising an inference of bad faith." This standard requires "some credible evidence supporting" the charge, but the Court also acknowledged that "circumstantial evidence can suffice to meet that burden."

Consequently, the Court also held that in a summons enforcement proceeding, a federal district court's ruling on the matter should be given appropriate deference by an appellate court, but only to the extent that the lower court decision is based on the correct legal standard. This means that district courts must now adequately consider whether a summons challenger has pointed to facts or circumstances that give rise to a plausible inference of the IRS having an improper motive. In addition, a district court's determination is entitled to no deference if it constitutes a question of law, such as legal issues about what counts as an illicit motive.

Key Takeaways

In *Clarke*, the Court clarified that the proper standard to challenge a summons and examine IRS officials concerning improper purpose requires more than a bare assertion by the taxpayer, but also recognized that questioning of an IRS agent is proper in some situations to show evidence that the *Powell* test might not be satisfied. The Court acknowledged that it will be difficult, if not impossible, to show direct evidence of bad faith at the threshold stage, leaving some room for taxpayers to submit circumstantial evidence. Thus, a taxpayer must show that either specific facts exist or the circumstances strongly point to a "plausible inference of improper motive" on the part of the IRS in issuing a summons.

Going forward, taxpayers presented with a summons will now have an opportunity to question an IRS agent about the reasons for its being issued if a credible showing is made that the summons was issued for an improper purpose. The Court's ruling helps provide greater protection of taxpayer rights in a season when the IRS is engaged in aggressive tax enforcement that might at times place those rights in jeopardy.

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