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Supreme Court Clarifies Standard to Challenge IRS Summons

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On June 19, 2014, the U.S. Supreme Court in *United States v. Clarke*[1] held that a taxpayer has a right to conduct an examination of IRS officials regarding their reasons for issuing an administrative summons when the taxpayer points to specific facts or circumstances plausibly raising an inference of bad faith. In light of procedures recently adopted by the IRS to enforce information document requests (IDRs), which may cause more summonses to be issued, the standard adopted in *Clarke* raises the importance of documenting discussions with IRS agents regarding the scope and purpose of IDRs.[2]

The IRS has broad statutory authority to obtain documents and testimony when examining tax returns. Typically, the IRS requests information through IDRs, but it also has the authority to issue administrative summonses. When the summoned party (which can include the taxpayer, current or former officers or employees of the taxpayers, attorneys, accountants or other advisers, and third parties) does not comply with the summons, the IRS may bring an enforcement action in district court. The Supreme Court long ago held that the IRS can meet its *prima facie* case in such a case by establishing, typically through an affidavit from a revenue agent, "that the investigation will be conducted pursuant to a legitimate purpose, that the inquiry may be relevant to the purpose, that the information sought is not already within the [IRS's] possession, and that the administrative steps required by the Code have been followed."[3]

In *Clarke*, the taxpayer agreed to two extensions of the statute of limitations on assessment, but declined the IRS's request for a third extension. Shortly thereafter, the IRS issued the summonses in dispute, and then concluded the examination and asserted adjustments. The summoned parties did not respond to the summonses, and the taxpayer petitioned the U.S. Tax Court to challenge the IRS's examination changes. The IRS then began a summons enforcement proceeding in district court. In response, the summoned parties asserted that the IRS issued the summonses to "punish" the taxpayer for refusing to extend the statute of limitations, and that the IRS was using the summonses to circumvent the Tax Court discovery process. The district court denied the summoned parties' request for an evidentiary hearing on whether the IRS had issued the summonses with an improper purpose. On appeal, the 11th Circuit Court of Appeals reversed, holding that a bare allegation of improper purpose was sufficient to justify an evidentiary hearing. That holding conflicted with the position of every other circuit court of appeals.

Vacating the 11th Circuit's decision, the Supreme Court held that "as part of the adversarial process concerning a summons's validity, the taxpayer is entitled to examine an IRS agent when he can point to specific facts or circumstances plausibly raising an inference of bad faith. Naked allegations of improper purpose are not enough: The taxpayer must offer some credible evidence to support his charge. But circumstantial

1 *U.S. v. Clarke*, 573 U.S. ___ (2014), *vacating and remanding*, 517 Fed. Appx. 689 (11th Cir. 2013).

2 *See* "IRS Announces New IDR Enforcement Process," *available at*: http://www.skadden.com/sites/default/files/publications/IRS_Announces_New_IDR_Enforcement_Process.pdf.

3 *U.S. v. Powell*, 379 U.S. 48, 57-58 (1964).

evidence can suffice to meet that burden … ." The Supreme Court noted that both parties, in oral argument, agreed to this standard.

The Supreme Court also reaffirmed that a district court's decision to grant or deny an evidentiary hearing under this rule is subject to review by an appellate court for an abuse of discretion, so long as the district court was applying the appropriate legal standard.

The Supreme Court made clear it was not deciding two legal issues: (i) whether the district court was correct in holding that the claim that the IRS was trying circumvent Tax Court discovery was irrelevant, on the grounds the summonses were issued before the Tax Court case began; and (ii) whether issuing a summons because a taxpayer declined to extend the statute of limitations was an improper purpose. Both questions may be considered by the 11th Circuit upon remand.

The summons enforcement authorities frequently address *Clarke*'s fact pattern: a statute is about to close; the IRS issues summonses, closes the audit and asserts a deficiency; the taxpayer goes to Tax Court; and the IRS pursues summons enforcement in a district court. Further opinions in *Clarke* on the remaining legal issues, therefore, will be worth watching. This is especially true because the recently adopted IDR enforcement procedures require revenue agents to issue summonses when a taxpayer does not timely comply in full with an IDR, and summons enforcement proceedings are likely to become more prevalent under this new regime.