

Practice Update

Supreme Court to Decide When Taxpayers Can Obtain an Evidentiary Hearing in a Summons Enforcement Action

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On January 10, 2014, the Supreme Court granted review of an Eleventh Circuit case addressing the circumstances under which a taxpayer can obtain an evidentiary hearing in challenging a summons issued by the Internal Revenue Service. The case, *United States v. Clarke*, 517 Fed. Appx. 689 (11th Cir. 2013), held that a taxpayer is entitled to an evidentiary hearing based solely on an unsupported allegation that IRS issued a summons for an improper purpose. This decision, while in line with the Eleventh Circuit's prior decisions, is at odds with the decisions of every other circuit court that has considered the issue. The importance of the Supreme Court's decision may be amplified in light of the IRS's new mandatory Information Document Request (IDR) enforcement procedure, which became effective on January 2, 2014.

The Internal Revenue Code grants the IRS broad authority to issue summonses to obtain documents and testimony as part of determining a person's tax liability and as part of investigating criminal tax offenses. 26 U.S.C. § 7602. If a person fails to comply with the summons, the government may petition a federal district court for judicial enforcement. 26

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U.S.C. §§ 7402(b), 7604(a). The Supreme Court, in its decision in *United States v. Powell*, 379 U.S. 48 (1964), held that judicial enforcement of a summons requires only that IRS establish that (1) the investigation will be conducted pursuant to a legitimate purpose; (2) the inquiry may be relevant to that purpose; (3) the information sought is not already in IRS's possession; and (4) all necessary administrative steps have been followed.

According to the Supreme Court, satisfying these factors demonstrates "good faith in issuing the summons." *United States v. Stuart*, 489 U.S. 353, 359 (1989). The IRS typically establishes these factors through an affidavit from an IRS agent. Once this showing is made, the taxpayer has the burden of disproving one of these four factors or demonstrating that enforcement would constitute an abuse of the judicial process. A person may defend against a summons, for example, by showing that the information requested is covered by the attorney-client privilege, the tax practitioner privilege or work product immunity, or that responding to the summons would violate the taxpayer's Fifth Amendment rights.

At issue in *Clarke* was whether the district court was required to hold an evidentiary hearing to inquire into the IRS's motive for issuing a summons based solely on the taxpayer's unsubstantiated allegation that the IRS issued in bad faith and for an improper purpose. Nearly every circuit has held that its district courts may—but are not required to—hold such a hearing. In the event of an unsupported allegation of improper purpose, district courts enjoy discretion to summarily rule against the taxpayer and forego an evidentiary hearing at which the issuing agents may be subject to cross examination by the taxpayer. A taxpayer is not entitled to a hearing in order to develop such evidence when the taxpayer possess no such evidence *before* the hearing. The Eleventh Circuit, however, has developed its own interpretation of the *Powell* decision and reiterated in *Clarke* that any allegation

of improper purpose, even if unsubstantiated, triggers a mandatory evidentiary hearing.

On appeal, the government seeks to convince the Supreme Court to adopt the majority view and strike down the Eleventh Circuit decision. It argues in its petition for certiorari that a person receiving a summons should not in every instance be entitled upon request to cross-examine IRS agents for the reasons underlying its issuance. Summons proceedings do not accuse taxpayers of wrongdoing and enforcement of summons does not automatically render the taxpayer guilty of or liable for an illegal tax activity. Instead, the government argues, a summons seeks only to explore the underlying factual circumstances. Requiring an evidentiary hearing upon unsupported allegations of issuance for improper purposes contradicts congressional intent that summons proceedings be resolved expeditiously, hinders the audit and investigatory process, and squanders limited judicial resources. Should district courts wish nevertheless to conduct an evidentiary hearing based only on naked accusations, those decisions should be left to their discretion but should not be mandated by law.

The Supreme Court's decision in *Clarke* is likely to have a significant impact regardless of the outcome. As part of her 2013 Annual Report to Congress, Nina Olson, the National Taxpayer Advocate, listed summons enforcement as one of the top ten tax most litigated tax issues in federal courts. Such litigation is anticipated to increase as a result of the recent directive issued by the Commissioner of the Large Business and International Division (LB&I), which implements mandatory procedures for issuing and enforcing IDRs. Under these procedures, which became effective on January 2, 2014, taxpayers who do not timely respond to an IDR will be issued a delinquency notice. Failure to respond thereafter will lead to a pre-summons letter and ultimately a summons. Since the process "is mandatory and has

no exceptions,” it appears that once an IDR is issued, the examiners have little, if any, discretion to stop the process and many more IDRs will proceed to the issuance of a summons. A decision in Clarke is expected by the end of June.

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