IRS Suffers Second Court Loss for Failing to Properly Warn Taxpayers About Third-Party Contacts During Audits

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I. Introduction

The Internal Revenue Service ("IRS") conducts large numbers of audits, the period to complete them is limited, and tax issues are becoming more complex every year. The result is that some Revenue Agents, who are in charge of performing tax audits, employ aggressive tactics to gather data and prepare their initial reports. One example is making so-called third-party contacts ("TPCs"), which essentially means approaching persons, other than the specific taxpayer under audit, for purposes of acquiring information, documentation, and more. There is nothing inherently wrong with making TPCs during an audit; indeed, Code Sec. 7602 expressly allows it. What is problematic, though, is when Revenue Agents disregard legislative history, regulations, and other sources by making TPCs and issuing summonses without first granting the taxpayer a chance to personally provide the relevant data.

After analyzing the relevant background, this article focuses on three recent items that might change the IRS's practices concerning TPCs, including an amendment to Code Sec. 7602, a case of first impression in the Court of Appeals ("COA"), and a case strongly criticizing inappropriate TPCs in 2021.[1]

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II. Filing and Record-Keeping Duties

Any person liable for any tax normally must file a complete, accurate and timely return, using the forms issued by the IRS.[2] Taxpayers also must retain records

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in case the IRS decides to audit them.[3] The regulations dictate that taxpayers "shall keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters" shown on any return.[4] With respect to accessibility and duration, taxpayers must ensure that their substantiation is kept "at all times available for inspection" by the IRS and must retain it for as long as it "may become material in the administration of any internal revenue law."[5]

III. Information-Gathering Tools Used by the IRS

The IRS enjoys broad powers in doing its job. For instance, for purposes of auditing any return, determining the liability of a taxpayer, and collecting such liability, the IRS can (i) examine any books, records or other data that might be relevant or material, and (ii) issue summonses to taxpayers, persons required to perform tax-related acts, persons in possession, custody or control of pertinent data, and "any other person that the [IRS] may deem proper."[6] The IRS often seeks information from persons *other than* the taxpayer during the audit process; these are known as TPCs.

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IV. Statutory Standard Starting in 1998

Various abuses by the IRS came to light in the late 1990s, which led to the enactment of the IRS Restructuring and Reform Act of 1998 ("RRA"). Among other things, the RRA introduced limitations on TPCs made by the IRS. The legislative history contained the following rationale for imposing new restrictions on Revenue Agents conducting audits:

> The [Senate Finance] Committee believes that taxpayers should be notified *before* the IRS contacts third parties regarding examination and collection activities with respect to the taxpayer. Such contacts may have a chilling effect on the taxpayer's business and could damage the taxpayer's reputation in the community. Accordingly, the [Senate Finance] Committee believes that taxpayers should have the opportunity to resolve issues and volunteer information *before* the IRS contacts third parties.[7]

The legislative history contained caveats, of course. It explains that the restrictions on Revenue Agents do not apply in the following situations: criminal tax cases, matters in which the tax liability is in jeopardy of not being assessed or collected, instances where the taxpayer permits the contact, and cases where the IRS determines that disclosure might trigger reprisals on any person.[8]

Code Sec. 7602, as enacted by the RRA, stated that the IRS generally could not contact any person, other than the taxpayer, with respect to the determination or collection of a tax liability, without providing "reasonable notice in advance" to the taxpayer that the IRS might make TPCs as part of the audit.[9]

V. Sample IRS Notices to Taxpayers

Grounded in the portion of legislative history stating that the pre-contact notice could be "part of an existing IRS notice provided to taxpayers," the IRS adopted the position that it adequately informed taxpayers about TPCs by sending them a general document at the beginning of an audit.[10] The document is IRS Publication No. 1 (Your Rights as a Taxpayer), which explains the following:

> Potential Third Party Contacts. Generally, the IRS will deal directly with you or your duly authorized representative. However, we sometimes talk with other persons if we need information that you have been unable to provide, or to verify information we have received. If we do contact other persons, such as a neighbor, bank, employer, or employees, we will generally need to tell them limited information, such as your name. The law prohibits us from disclosing any more information than is necessary to obtain or verify the information we are seeking. Our need to contact other persons may continue as long as there is activity in your case. If we do contact other persons, you have a right to request a list of those contacted. Your request can be made by telephone, in writing, or during a personal interview.[11]

VI. Sample IRS Notices to Third Parties

Let's not overlook the other important part of this equation, the third parties approached by Revenue Agents. For many years, they received a letter, out of the blue, printed on ominous IRS letterhead, enclosing an attachment

describing all the data related to a taxpayer that the IRS is seeking, expressly naming the taxpayer and perhaps others, and stating the following:

> We're requesting your assistance in a pending federal tax matter. Please complete the enclosed information request, and return it to us in the envelope provided by [insert deadline]. Include your telephone number so we can call you if we have any questions about the information you provided. Internal Revenue Code 7602 authorizes us to make this request. By law, we're required to include your name on a list of persons we've contacted. We may send this list [to the taxpayer under audit]. If you believe including your name on the list may cause any person to harm you or any other person, whether that harm is physical, economic, emotional or otherwise, please indicate this on the attachment or call me at the telephone number above by [insert deadline], so we can exclude you from the list. We won't ask you to explain why you believe there's a risk of reprisal or harm to you or another. Thank you for your cooperation.[12]

Notably, the preceding letter fails to mention issues pivotal to third parties, such as the following: Is the IRS auditing me personally? Is the IRS "requesting [my] assistance" or legally obligating me to turn over data? Do I have the right to consult my own legal or tax advisors before deciding how or whether to respond? Will responding to the letter through a professional advisor lead the IRS to suspect me, in addition to the taxpayer? What are the consequences if I do not respond to the letter at all, answer late, or provide only a portion of the materials requested? Can I claim any type of privilege or protection over certain materials? Why is the IRS contacting me specifically? Is the IRS approaching other third parties, too? Why can the IRS not get the data it is seeking directly from the taxpayer instead of involving me? Will the IRS reimburse me for the costs associated with cooperating with the letter? If I supply data to the IRS now, do things end there, or will the IRS later depose me, ask me to submit an affidavit, and/or make me testify at trial? What makes the IRS think that the taxpayer might cause me harm? Does the IRS believe that all taxpayers are prone to vengeance, or is the taxpayer under audit unique in this regard?

VII. Review of the Regulations

After Congress enacts a law, such as the RRA, the IRS interprets and implements it, often by issuing regulations. The procedure normally involves publishing proposed regulations, obtaining written comments from the public, holding a hearing, and then launching final regulations, along with an explanation of why the IRS incorporated or ignored the public input. This is what occurred with respect to Code Sec. 7602, as explained further below.

A. Preamble to Proposed Regulations

The Preamble started with the obvious, which is that the RRA amended Code Sec. 7602 to prohibit the IRS from contacting anybody other than the taxpayer without giving reasonable, advance notice to the taxpayer about the possible TPCs.[13] It then acknowledged that Congress was concerned that TPCs might have a "chilling effect" on a taxpayer's business and damage a taxpayer's reputation, such that the taxpayer should have the chance to resolve issues with, and voluntarily provide information to, the Revenue Agent before he communicates with third parties.[14] Next, the Preamble explained that the proposed law morphed during the legislative process, ultimately requiring the IRS to supply the taxpayer a *general* pre-contact notice (*i.e.*, the IRS might make TPCs during the audit), followed by a *specific* post-contact report (*i.e.*, the IRS actually made certain TPCs).[15] Finally, the Preamble underscored four exceptions, namely, the ability of the IRS to skip the pre-contact notice and post-contact report requirement in criminal tax cases, situations in which the tax liability is in jeopardy of not being assessed or collected, instances where the taxpayer grants permission, and matters where the IRS, in its sole discretion, determines that disclosure of TPCs might result in reprisals to any person.[16]

The IRS concluded in the Preamble that amended Code Sec. 7602 necessitates "an interpretive approach" balancing three distinct considerations: the business and reputational interests of the taxpayer, the privacy interests of third parties, and the responsibility of the IRS to administer the tax laws effectively.[17]

B. Proposed Regulations

Generally, the proposed regulations provide that no IRS employee may contact any person, other than the relevant taxpayer, without providing such taxpayer "reasonable notice in advance" that the IRS might make TPCs, and the IRS must give the taxpayer, upon request, a record of the TPCs.[18]

They further state, in terms of pivotal definitions, that a TPC is a communication that is initiated by an IRS employee, made to a person other than the taxpayer, with respect to the determination or collection of a tax liability of the taxpayer, during which the IRS employee discloses

the identity of the taxpayer, as well as the fact that the IRS employee is just that, an IRS employee.[19]

The proposed regulations provide guidance about the general pre-contact notice duty, explaining that the IRS employee can give it orally or in writing, and in the case of the latter, the IRS employee can use any manner that he reasonably believes will result in the taxpayer receiving notice before he makes the TPCs.[20] Creating assumptions favorable to the IRS, the proposed regulations indicate that a written notice is "deemed reasonable" if the IRS employee mails it to the taxpayer's last known address, delivers it in person, or simply leaves it at the taxpayer's dwelling or usual place of business.[21]

As to the specific post-contact reports, the proposed regulations indicate that a taxpayer may request a report "in any manner the [IRS] reasonably permits," ominously followed by the disclaimer that the IRS "may set reasonable limits on how frequently taxpayer requests need to be honored."[22] The proposed regulations reveal that the data the IRS is willing to share might be limited, too. They state the name of the third party or other information that "reasonably identifies" him suffices, the IRS is not obligated to solicit any other data from the third party for purposes of completing the post-contact report, the IRS does not need to specify how many times it interacted with a particular third party, and the IRS is under no obligation to disclose the nature of its inquiry with each third party or the responses by the third parties.[23]

C. Final Regulations

The final regulations were essentially identical to the proposed ones.[24] The Preamble to the final regulations contained some rationales for the IRS's decision to forge ahead without material alterations. As it did earlier in the Preamble to the proposed regulations, the IRS explained that it must balance three considerations, the business and reputational concerns of the taxpayer under audit, the privacy interests of third parties, and the need of the IRS to implement effectively the tax laws.[25] Then, without explaining exactly how, the Preamble suggested that by providing a taxpayer with a general pre-contact notice, followed by a specific post-contact report, a taxpayer is able to come forward with information required by the IRS before it contacts third parties.[26]

VIII. Internal IRS Guidance

The IRS provided *external* guidance to taxpayers and their advisors, by promulgating the regulations under Code Sec. 7602(c), as analyzed above. The next step usually consists of supplying *internal* data to IRS employees, through the Internal Revenue Manual ("IRM"). That is precisely what occurred with respect to TPCs.

The IRM emphasizes that Revenue Agents should not utilize TPCs as a primary auditing tool, but rather they should first grant the taxpayer being audited a chance to personally supply the data sought by the IRS. The IRM makes this clear in several places:

> [Revenue Agents are directed] to give notice to taxpayers, allowing them an opportunity to provide the information, *before* disclosing to a third party that the taxpayer is the subject of an [IRS] action.[27]

> A [TPC] is made when the taxpayer is unable or unwilling to provide the necessary information or when the examiner needs to verify information provided. The examiner should generally request the information on a Form 4564, Information Document Request, *before* making a TPC. Examiners should document the case file to support the need to verify information *already provided* by the taxpayer.[28]

> The intent behind this statute is to provide the taxpayer, in most cases, with the opportunity to produce the information and documents requested *before* the IRS must obtain the information from third parties.[29]

> It is the IRS's practice to obtain information relating to a liability or collectibility determination *directly from the taxpayer whenever possible*. In most cases, it is preferable for the employee *to first try* to obtain the information directly from the taxpayer and/or representative or obtain taxpayer approval to contact third parties …[30]

IX. Past and Present Non-Compliance by the IRS

Setting standards is one thing, but implementing them is another. The information in this segment of the article shows that the IRS has experienced difficulties, historically and presently, in following the letter and spirit of Code Sec. 7602.

Studies show that the IRS has not always met its notification duties. The IRS watchdog, the Treasury Inspector General for Tax Administration ("TIGTA"), concluded that the IRS sometimes does not give any

notice whatsoever to taxpayers about potential TPCs, much less the type of reasonable, pre-contact notice required by Code Sec. 7602.[31] The TIGTA study, which focused on audits in 2016, determined that the IRS failed to issue required notifications 18 percent of the time.[32]

Another interesting fact is that at least some high-level IRS representatives seem unfazed about potential violations of TPC notification duties and they have transmitted this attitude to the field soldiers. A Chief Counsel Advice addressed the question of what would happen, practically speaking, if an IRS employee were to forget to complete the paperwork necessary to record a TPC, address whether an exception applied, *etc*. It concluded that (i) taxpayers have no specific cause of action against the IRS for violating the TPC notice rules, (ii) the IRS has never been sued for breaking such rules, (iii) a violation by the IRS theoretically could trigger a lawsuit by taxpayers under Code Sec. 7433, which allows them to recover damages when an IRS employee takes unauthorized collection actions, but this seems unlikely because "it is unclear what actual, direct economic damages a taxpayer would suffer as a result of a violation of Section 7602(c)."[33]

The final noteworthy item is the manner in which certain Revenue Agents are currently responding to written requests by taxpayers for information about TPCs, submitted in accordance with the regulations. Some Revenue Agents have (i) refused to respond on grounds that taxpayers supposedly can only make requests for TPC data every 90 days, (ii) suggested that a request is utterly null and void if it seeks any information beyond the names of the parties subjected to TPCs, (iii) indicated, in complete contradiction to legislative history, Preambles to the regulations, IRM, and caselaw, that the IRS does not first need to seek data from the audited taxpayer before making TPCs, and (iv) threatened to refer taxpayer representatives to the Office of Professional Responsibility for doing nothing more than occasionally seeking data about TPCs. The excerpts below from actual letters sent by Revenue Agents confirm this practice:

> As you are aware, [Section] 7602(c) imposes no obligation on the IRS to request information from the taxpayer before contacting third parties. We are also not required to coordinate with the taxpayer any efforts to contact third parties.[34]

> The information requested is beyond the scope of what the IRS will provide and is therefore invalid.[35]

> If you send me the same request [for TPC data] again, I will refer you to the Office of Professional Responsibility for ignoring my instructions and delaying the exam.[36]

X. Indicia of Potential Change on the Horizon

Despite previous deficiencies in protecting audited taxpayers from the negativity of improper TPCs, the three items examined below supply hope for future improvement.

A. Statutory Change in 2019

Congress, concerned about TPC issues, modified the applicable law when enacting the Taxpayer First Act in 2019.[37] Readers can clearly see the difference by comparing the old standard, which was in effect from 1998 through 2018, with the new rules, which have governed since 2019.

The *previous* version of Code Sec. 7602(c)(1) dictated the following:

> An officer or employee of the [IRS] may not contact any person other than the taxpayer with respect to the determination or collection of the tax liability of such taxpayer without providing reasonable notice in advance to the taxpayer that contacts with persons other than the taxpayer may be made.

The relevant portion of *amended* Code Sec. 7602(c)(1) provides as follows:

> An officer or employee of the [IRS] may not contact any person other than the taxpayer with respect to the determination or collection of the tax liability of such taxpayer unless such contact occurs during a period (not greater than 1 year) which is specified in a notice which (A) informs the taxpayer that contacts with persons other than the taxpayer are intended to be made during such period, and (B) except as otherwise provided by the [IRS], is provided to the taxpayer not later than 45 days before the beginning of such period.

In simpler terms, the amended law requires IRS employees to give notice to the taxpayer at least 45 days before starting any TPCs, have "present intent" to make TPCs when issuing the pre-contact notice, and specify in the notice the time period, not to exceed one year, within which the IRS plans to make the TPCs.[38]

B. First Case Rebuking the IRS

Code Sec. 7602 lacks an express remedy for aggrieved taxpayers; that is, it does not contain a specific procedure for a taxpayer to challenge the IRS in situations where it violates the general pre-contact notice or post-contact report duties. Consequently, litigation in this area is sparse. The pertinent cases have primarily focused on a taxpayer's ability to "quash," or nullify, a summons issued by the IRS to a third party, when the IRS has not followed all the rules. One such case, *J.B. and P.B.*, is discussed below.[39] The case is important for its analysis of taxpayer protections under Code Sec. 7602(c), even though it dealt with the previous version of the law, in effect from 1998 to 2018.

The taxpayers in *J.B. and P.B.* were randomly selected for audit, the IRS issued a summons to the California Supreme Court seeking various employment-related documents, and the taxpayers filed a so-called Motion to Quash the Summons with the District Court. One of the taxpayers was an attorney who accepted appointments from the California Supreme Court to represent indigent criminal defendants in capital cases, so the IRS was seeking copies of billing statements, invoices, and other documents about compensation paid.

The IRS tried to justify its actions, arguing that giving the taxpayers a copy of IRS Publication No. 1 at the start of the audit sufficed to meet its TPC notification duty. The District Court was not impressed. It held in favor of the taxpayers, determining that the IRS had violated Code Sec. 7602(c)(1) by not providing sufficient advance notice to the taxpayers that it would seek data from a third party, *i.e.*, the California Supreme Court.

The District Court evaluated the Motion to Quash the Summons filed by the taxpayers under the standards previously established by the Supreme Court many years ago, in *Powell*. According to that famous case, courts will not uphold a summons, unless the IRS establishes a prima facie case that (i) the underlying investigation is for a legitimate purpose, (ii) the information requested is relevant to that purpose, (iii) the information sought is not already in the IRS's possession, custody, or control, *and* (iv) the IRS followed all administrative requirements.[40] The District Court in *J.B. and P.B.* held that the IRS failed the fourth requirement because it violated Code Sec. 7602.

The COA for the Ninth Circuit affirmed the earlier decision by the District Court in *J.B. and P.B.*, expansively interpreting Code Sec. 7602 in favor of taxpayers in various ways. First, the COA set the following high standard in terms of what "reasonable notice in advance" means:

> [N]otice reasonably calculated, under all the relevant circumstances, to apprise interested parties of the possibility that the IRS may contact third parties, and that *affords interested parties a meaningful opportunity to resolve issues and voluntary information before third-party contacts are made [by the IRS]*.

Second, the COA confirmed that Code Sec. 7602, as a whole, should be construed to safeguard taxpayers given the need for confidentiality and protection of reputational interests:

> As an exception of the general rule that taxpayer records are to be kept confidential, we construe [Section] 7602(a) narrowly in favor of the taxpayer and [Section] 7602(c) broadly as a protective measure.

Third, the COA underscored the disparity in taxpayer protections and participation rights in connection with various information-gathering methods used by the IRS:

> While [Section] 7609 gives the taxpayer an opportunity to quash the summons in a federal district court, [Section] 7602(c)(1), in comparison, protects the taxpayer's reputational interest. It gives the taxpayer a meaningful opportunity to resolve issues and volunteer information before the IRS seeks information from third parties, which would be unnecessary if the relevant information is provided by the taxpayer himself.

Fourth, the COA explained that the entirety of Code Sec. 7602 indicates that the IRS must offer taxpayers a meaningful chance to personally supply all requested data before the IRS resorts to bugging others for it:

> We cannot ignore the text of a statute that hinges the adequacy of notice on a determination of reasonableness. Nor can we ignore the congressional mandate to provide taxpayers faced with a potential third-party summons with a meaningful opportunity to respond with the relevant information themselves so as to maintain their privacy and avoid the potential embarrassment of IRS contact with third parties, such as their employers.
>
> A reasonable notice must provide the taxpayer with a meaningful opportunity to volunteer records on his own, so that third-party contacts may be avoided if the taxpayer complies with the IRS's demand.

Finally, the COA concluded that the summons issued to the California Supreme Court seeking employment

records of one of the taxpayers in *J.B. and P.B.* was improper because the IRS failed to meet its general pre-contact notice duty under Code Sec. 7602(c)(1). The COA clarified the following standard for the IRS:

> Drawing on our case law in this area, we conclude that the IRS does *not* satisfy the pre-contact notice requirement … unless it provides notice reasonably calculated, under all relevant circumstances, to apprise interested parties of the possibility that the IRS may contact third parties, *and* that affords interested parties a meaningful opportunity to resolve issues and volunteer information *before* those third-party contacts are made.

C. Most Recent Case Rebuking the IRS

Demonstrating that *J.B. and P.B.* was not an aberration, another case, decided in August 2021, held that the IRS crossed the line when it comes to pre-contact notice for taxpayers about TPCs.

The facts and procedural history in *Vaught et al.* are complicated, but here are the essentials.[41] The IRS started an audit of Mr. Crow in November 2015 to determine whether the installment sales transactions with which he was somehow involved were "tax shelters" subject to special disclosure requirements, whether he or his company, S. Crow Collateral Corporation ("SCCC"), had "promoted" such transactions, and whether he had made false statements about alleged tax benefits of such transactions. The IRS gave Mr. Crow a copy of Publication No. 1 on the first day of the audit, which, as explained earlier in this article, contains general information about TPCs. Approximately two months later, in December 2015, Revenue Agents initially met with Mr. Crow and supposedly told him, orally, that they might make TPCs. The IRS audited Mr. Crow and SCCC for nearly six years. During that period, the IRS made at least 16 TPCs and issued multiple summonses to third parties.

In 2018, the IRS issued two summonses to Mr. Vaught, in his role as an executive of two companies that served as lenders or escrow agents for SCCC in connection with the installment sale transactions under scrutiny ("Vaught Summonses"). Mr. Vaught did not comply, so the IRS filed a petition with the District Court asking it to enforce the Vaught Summonses. Mr. Vaught opposed the Petition, and Mr. Crow and SCCC, as intervenors, did the same. Mr. Vaught, Mr. Crow and SCCC argued that the District Court should quash the Vaught Summonses for several reasons, the primary one being that the IRS violated the pre-contact notice requirements in Code Sec. 7602.

Before the District Court could render a decision in *Vaught et al.*, the COA for the Ninth Circuit issued the taxpayer-favorable ruling in *J.B. and P.B.*, discussed above. Accordingly, the District Court borrowed heavily from the analysis of the COA.

The District Court began by reciting and exploring the relevant standards for upholding a summons under *Powell*. It then noted that the only standard in dispute was the fourth; that is, whether the IRS had obeyed the administrative procedures related to Code Sec. 7602.

The IRS contended that it met the requirements by notifying Mr. Crow of possible TPCs three times. First, the IRS maintained that it gave Mr. Crow a copy of Publication No. 1 when the audit began. The District Court, citing the reasoning in *J.B. and P.B.*, held that merely providing Publication No. 1 is insufficient. It also pointed out that the IRS issued the Vaught Summonses 26 months after it supplied Mr. Crow with Publication No. 1. Grounded in this extended passage of time, the District Court said that it "cannot find the IRS satisfied its administrative duty of giving Crow a meaningful opportunity to provide the relevant documents involving [companies run by Mr. Vaught] by generally informing Crow, over two years before, that it 'may talk with other persons' in the course of its investigation." The District Court added that the willingness of the IRS to wait more than two years before issuing the Vaught Summonses shows a "lack of urgency" of the audit and illustrates that the IRS's interest in obtaining the data would not have been compromised by providing Mr. Crow with additional pre-contact notice.

Second, the IRS underscored that two Revenue Agents met with Mr. Crow in December 2015 and orally notified him, again, of possible TPCs. The District Court challenged this stance, emphasizing that the IRS failed to provide any specific details about the supposed oral notice. The District Court presented the following rhetorical questions to fortify its point: What did the Revenue Agents say about TPCs on that date? Did the Revenue Agents mention any specific third parties or types of businesses they might contact if Mr. Crow would not or could not personally provide all data sought by the IRS? Did the Revenue Agent provide any hint to Mr. Crow that he needed to produce documents involving lenders or escrow companies?

Third, the IRS contended that it discussed possible TPCs with Mr. Crow in April 2017. The District Court pointed out that such discussions only occurred after Mr. Crow had sent the IRS a letter complaining that it had failed to give him pre-contact notices already. Apparently, in response to the letter, the Revenue Agents called Mr. Crow's attorney, stated that they previously gave

Mr. Crow a copy of Publication No. 1, and that sufficed. The intransigence of the IRS did not escape the District Court, which summarized the IRS's position as follows: "The government cites a conversation in which the IRS refused to provide notice other than Publication 1 as an example of the IRS providing reasonable advance notice." The District Court rejected the argument that one phone call, after the IRS had already made many TPCs, in which the IRS announced that it would do nothing more, constituted adequate notice.

The District Court acknowledged that the IRS is not obligated to give audited taxpayers a separate notice before each TPC. It clarified, however, that (i) the IRS must still provide taxpayers with "sufficient notice to allow them to respond with the relevant information themselves so as to maintain their privacy and avoid the potential embarrassment of IRS contact with third parties," and (ii) the IRS failed to show how the general information in Publication No. 1 and an oral reminder by Revenue Agents in December 2015 gave Mr. Crow this opportunity.

The District Court expanded on the shortcomings of the IRS, identifying several "reasonable steps" that the IRS could have taken to provide Mr. Crow with adequate pre-contact notice. For instance, the IRS could have renewed its request for data directly from Mr. Crow in 2018, before issuing the Vaught Summonses. At that time, the IRS could have advised Mr. Crow that, if he were unwilling or unable to provide the data personally, the IRS would be forced to make TPCs. Moreover, explained the District Court, the IRS could have better informed Mr. Crow about what data was still missing, after Mr. Crow had responded to all IDRs issued to him, supplied materials in response to all summonses issued to him, and asked the Revenue Agents to enlist the involvement of the IRS National Office. It appears that the Revenue Agents simply took what Mr. Crow provided, ignored his request for help from IRS superiors, ceased communicating with him for many months, and then launched the Vaught Summonses. The District Court presented a better course of action: "If the IRS was dissatisfied with the documents Crow had already produced, it could have requested additional documents in the nine months between its last contact with Crow, and its decision to [issue the Vaught Summonses] in 2018."

Lastly, the District Court stated that the IRS's own internal records suggest that it intentionally deprived Mr. Crow of adequate pre-contact notice. As part of the dispute with the IRS, Mr. Crow filed a request for audit-related materials pursuant to the Freedom of Information Act. He obtained, among other things, a copy of the "Case Activity Report" maintained by the Revenue Agents. It revealed that the Revenue Agents had concluded, perhaps erroneously, that Mr. Vaught and the related companies were not "third parties" for purposes of Code Sec. 7602, such that the IRS was not required to give Mr. Crow pre-contact notice about potential interactions with them.

Because the IRS failed to meet the fourth standard in *Powell* (*i.e.*, it did not satisfy the pre-contact notice duties under Code Sec. 7602), the District Court quashed the Vaught Summonses.

XI. Conclusion

It is clear that some changes will occur. The recent amendment to Code Sec. 7602 obligates Revenue Agents to give audited taxpayers notice of TPCs at least 45 days before starting them and to specify the period, of not more than one year, during which they will occur. Moreover, the IRS has recently advised its personnel that merely handing taxpayers a copy of Publication No. 1 at the start of an audit will no longer constitute adequate warning about TPCs.[42] What remains uncertain, though, is whether Revenue Agents, consistent with *J.B. and P.B.* and *Vaught et al.*, will give audited taxpayers a reasonable opportunity to personally provide data *before* resorting to TPCs. Taxpayers under audit, potential third parties, and their tax professionals should be following this important issue closely.

ENDNOTES

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1 This article supplements a recent one by the same author. *See* Hale E. Sheppard, *Can the IRS Really Do That? Third Party Contacts, Notification Duties, Reprisal Exception, and More*, J. TAX PRAC. PROC., June 2021, at 33.

2 Code Sec. 6011(a); Reg. §1.6011-1(a).

3 Code Sec. 6001.

4 Reg. §1.6011-1(a).

5 Reg. §1.6011-1(a).

6 Code Sec. 7602(a); Reg. §301.7602-1(a).

7 U.S. Senate, Committee on Finance. Internal Revenue Service Restructuring and Reform Act of 1998. 105th Congress, 2nd Session, Report 105-174 (Apr. 22, 1998), p. 77.

8 U.S. Senate, Committee on Finance. Internal Revenue Service Restructuring and Reform Act of 1998. 105th Congress, 2nd Session, Report 105-174 (Apr. 22, 1998), p. 77; U.S. House of Representatives, Conference Report. Internal Revenue Service Restructuring and Reform Act of 1998. 105th Congress, 2nd Session, Report 105-599 (June 24, 1998), p. 277. Internal Revenue Service Restructuring and Reform Act of 1998 (July 22), P.L. 105-206, §3417. *See* Code Sec. 7602(c)(1).

9 Internal Revenue Service Restructuring and Reform Act of 1998 (July 22), P.L. 105-206, §3417. *See* Code Sec. 7602(c)(1).

10 66 Fed. Reg. 77 (Jan. 2, 2001); REG-104906-99, Preamble.

11 IRS Publication No. 1 (Your Rights as a Taxpayer) (Rev. 9-2017); *See also* IRS Publication No. 556

(Examination of Returns, Appeal Rights, and Claims for Refund) (Rev. 9-2013), p. 3.

[12] IRS Letter 1995 (Rev. 3-2017), Catalog Number 62794I.

[13] 66 Fed. Reg. 77 (Jan. 2, 2001); REG-104906-99, Preamble.

[14] 66 Fed. Reg. 77 (Jan. 2, 2001); REG-104906-99, Preamble.

[15] 66 Fed. Reg. 77 (Jan. 2, 2001); REG-104906-99, Preamble.

[16] 66 Fed. Reg. 77 (Jan. 2, 2001); REG-104906-99, Preamble.

[17] 66 Fed. Reg. 77 (Jan. 2, 2001); REG-104906-99, Preamble.

[18] Reg. §301.7602-2(a).

[19] Reg. §301.7602-2(b).

[20] Reg. §301.7602-2(d)(1).

[21] Reg. §301.7602-2(d)(1).

[22] Reg. §301.7602-2(e)(1).

[23] Reg. §301.7602-2(e)(2)(i).

[24] T.D. 9028, Dec. 17, 2002.

[25] T.D. 9028, Dec. 17, 2002, Preamble.

[26] T.D. 9028, Dec. 17, 2002, Preamble.

[27] IRM §4.11.57.1 (May 26, 2017).

[28] IRM §4.11.57.2 (May 26, 2017).

[29] IRM §4.11.57.2 (May 26, 2017).

[30] IRM §25.27.1.3 (Oct. 19, 2017).

[31] Treasury Inspector General for Tax Administration. *Some Tax Returns Selected for Fraud Screening Did Not Have Refunds Held and Required Notifications Were Not Always Sent to Taxpayers*. Reference Number 2018-40-024 (Mar. 27, 2018).

[32] Treasury Inspector General for Tax Administration. *Some Tax Returns Selected for Fraud Screening Did Not Have Refunds Held and Required Notifications Were Not Always Sent to Taxpayers*. Reference Number 2018-40-024 (Mar. 27, 2018), p. 6.

[33] Chief Counsel Advice 201330036 (July 26, 2013).

[34] Letter from Revenue Agent J. Whittington Tindall dated March 18, 2021. Letter on file with author.

[35] Letter from Revenue Agent Justin L. Yarnell dated February 25, 2021. Letter on file with author.

[36] Letter from Revenue Agent Justin L. Yarnell dated February 25, 2021. Letter on file with author.

[37] P.L. 116-25 (July 1, 2019). The change was featured in the Title of the Taxpayer First Act called "Putting Taxpayers First," with a Subtitle of "Sensible Enforcement."

[38] IRM §4.11.51.1 (July 20, 2020); U.S. Joint Committee on Taxation. Description of H.R. 1957, the Taxpayer First Act of 2019. JCX-15-19. April 1, 2019, p. 17.

[39] *J.B. and P.B.*, 123 AFTR 2d 2019-859 (Feb. 26, 2019).

[40] *Powell*, SCt, 64-2 USTC ¶9858, 379 US 48, 57–58, 85 SCt 248.

[41] *Vaught et al.*, 128 AFTR 2d 2021-XXXX (Aug. 16, 2021); *See also* Emily L. Foster, *IRS's Notice of Third-Party Summonses Doesn't Pass Muster*, 2021 Tax Notes Today Federal 159-1 (Aug. 16, 2021).

[42] *See* IRS Memorandum SBSE-04-0719-0034 (July 26, 2019), Attachment 3, Sample Letter 3164-X; Alberotanza and March, *Collection: IRS Third Party Contacts in 2020 and Beyond*, J. Tax Prac. Proc., December 2019/January 2020, at 15; IRM §25.27.1.3.1 (Apr. 7, 2021).

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