Can the IRS Really Do That? Third Party Contacts, Notification Duties, Reprisal Exception, and More

By Hale E. Sheppard*

Hale E. Sheppard examines important issues related to third party contacts made by the IRS during tax audits.

I. Introduction

Getting audited by the Internal Revenue Service ("IRS") is bad enough, but having the IRS tell friends, colleagues, employers, clients and others about it is far worse. The mere fact that the IRS is auditing someone, no matter how routine it might be, can cause serious reputational, business, and financial damage to the person under scrutiny. Unfortunately, the IRS does this on a regular basis, through a process called making third party contacts ("TPCs").

Taxpayers and their advisors often lack sufficient knowledge about TPCs, mandatory advance warnings, exceptions to the general notice requirements, opportunities for taxpayers to supply data to the IRS in an effort to prevent TPCs, and various legal procedures for retrieving data about TPCs from the IRS. This article addresses these critical points, and more.

II. General Filing and Record-Keeping Duties

Any person (both individuals and entities) liable for any tax normally must file a complete return using the forms issued by the IRS.[1] Taxpayers also must retain records in case the IRS decides to audit them.[2] Indeed, 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.[3] 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."[4]

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III. Audits, Notifications, Exceptions—Applicable Law

The IRS enjoys broad powers in doing its job. For instance, for purposes of auditing any return, preparing a return in situations where taxpayers fail to file one, 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."[5] The IRS often seeks information from persons *other than* the taxpayer during the audit process; these are known as TPCs.

Trite though it may be, the reality is that granting any organization, including the IRS, broad powers often triggers abuses. This is what 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.[6]

The legislative history contained caveats, of course. It initially explained that the restrictions on Revenue Agents would not apply in three situations: criminal tax cases, matters in which the tax liability is in jeopardy of not being assessed or collected, and instances where the taxpayer permits the contact.[7] Subsequent legislative history expanded the exceptions, adding a fourth. It stated that the restrictions would have no bearing in cases where the IRS "determines for good cause shown that disclosure may involve reprisal to any person."[8]

The RRA added new aspects to Code Sec. 7602. This provision generally states that IRS may 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 may make TPCs as part of the audit.[9] The exceptions to this rule, evolving from the legislative history described above, clarified that the IRS was not required to provide advance notice of TPCs if it had good cause to believe that such notice would jeopardize tax collection or would trigger reprisals against any person.[10]

IV. Sample IRS Notices

Grounded in the legislative history to Code Sec. 7602(c) stating that the general pre-contact notice could be "part of an existing IRS notice provided to taxpayers," the IRS originally adopted the position that it was adequately informing taxpayers about TPCs by sending them a general document routinely provided at the beginning of an audit.[11] The quintessential document was IRS Publication 1 (Your Rights as a Taxpayer), which explained 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.[12]

Let's not overlook the other important part of this equation, the third parties approached by Revenue Agents. Normally, they receive 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 or reprisal or harm to you or another. Thank you for your cooperation.[13]

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?

V. Away We Go on a Regulatory Journey

After Congress enacts a law, such as the RRA, the IRS interprets and implements it, often by issuing regulations. The procedure normally involves issuing 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 the 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.[14] 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.[15] 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).[16] Finally, the Preamble underscored the 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.[17]

The IRS concluded in the Preamble that amended Code Sec. 7602, as initially introduced and later modified during the legislative process, 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.[18]

The Preamble gave considerable attention to the reprisal exception to the general IRS notification duties. It explained, for instance, that Revenue Agents often do not know the details of the relationship between a third party and the taxpayer when they first make contact, and they generally have no way of knowing whether the potential for reprisals exists without asking. Accordingly, they simply ask the third party if he has any concerns that reprisals might occur, if the taxpayer were to learn of the contact.[19] Importantly, the Preamble admitted that the IRS's experience had been that "few persons expressed a fear of reprisal, even when told that if they feared reprisal their identity would not be reported to the taxpayer."[20] It further recognized that the IRS, in issuing the proposed regulations, prioritized concerns of potential reprisal to third parties above concerns of the taxpayer about his business and reputational interests.[21]

To the dismay of many taxpayers and tax professionals, the Preamble explained that (i) the concept of "reprisal" encompasses not only physical harm, but also emotional and/or economic harm to a third party, (ii) a mere statement, without any substantiation whatsoever, by a third party that harm might occur "against any person" constitutes "good cause" for the IRS to invoke the reprisal exception, (iii) the IRS is not required to investigate any statement by a third party and "must be permitted" to rely on the third party because he is better situated to evaluate his relationship with the taxpayer, (iv) forcing the IRS to investigate and confirm claims of potential reprisals would divert resources from tax audits, place a heavy administrative burden on the IRS, intrude into the affairs of third parties, and obligate IRS employees to make judgments "that they are not well positioned to make," and (v) information from *any* source, not only the third party himself, may constitute "good cause" to anticipate future reprisals.[22]

B. Content of the Proposed Regulations

Generally, the proposed regulations provide that no IRS employee may contact any person, other than the relevant taxpayer, with respect to a determination or collection of a tax liability, 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.[23]

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.[24]

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.[25] 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.[26]

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."[27] 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.[28]

The proposed regulations give considerable attention to the reprisal exception. They explain, among other things, that the IRS is not required to provide the taxpayer with a general pre-contact notice or a specific post-contact report if the IRS employee making a TPC has "good cause" to believe that doing so might "cause any person to harm any other person in any way, whether the harm is physical, economic, emotional or otherwise."[29] The proposed regulations go on to explain that a mere statement by the third party that harm might occur against any person constitutes "good cause" for the IRS employee to believe that reprisal might occur, and such employee is not obligated to further question the third party or make any further inquiries about the validity of the statement.[30] The proposed regulations feature several examples about the functioning of the reprisal exception. The first involves a situation where a third party merely claims, without any substantiation or historical grounds, that he subjectively fears that a family member might cause him harm:

> An IRS employee seeking to collect unpaid taxes is told by the taxpayer that all the money in his and his brother's joint bank account belongs to the brother. The IRS employee contacts the brother to verify this information. The brother refuses to confirm or deny the taxpayer's statement … [T]he brother states that he fears harm from the taxpayer should the taxpayer learn of the contact, even though the brother gave no information. This contact is excepted from [the general TPC notice rules] because the third party has expressed a fear of reprisal. The IRS employee is not required to make further inquiry into the nature of the brothers' relationship or otherwise question the brother's fear of reprisal.[31]

Another example highlights the ability of IRS employees to decide, completely on their own, that depriving audited taxpayers about the occurrence of TPCs is acceptable:

> An IRS employee is examining a joint return of a husband and wife, who recently divorced. From reading the court divorce file, the IRS employee learns that the divorce was acrimonious and that the ex-husband once violated a restraining order issued to protect the ex-wife. This information provides good cause for the IRS employee to believe that reporting contacts which might disclose the ex-wife's location may cause reprisal against any person. Therefore, when the IRS employee contacts the ex-wife's new employer to verify salary information provided by the ex-wife, the IRS employee has good cause not to report that contact to the ex-husband, regardless of whether the new employer expresses concern about reprisal against it or its employees.[32]

C. Criticisms of the Proposed Regulations

The IRS received two written comments to the proposed regulations, only one of which is relevant to this article.[33] It focused on the reprisal exception. The author of the comment began by underscoring that Congress enacted Code Sec. 7602(c) for purposes of protecting taxpayers, not the IRS, and not third parties. However, the reprisal exception in the proposed regulations seemingly prioritizes the wellbeing of third parties over that of taxpayers, which is inconsistent with the origin of Code Sec. 7602(c). According to the author, "[w]hile it can be reasonably argued that Congress intended to imbue the third party witnesses with certain rights, it cannot be reasonably argued that Congress intended any such rights to be superior to those of the taxpayers."

The author of the comment also attacked the "good cause" standard at length, highlighting that (i) a Revenue Agent has no obligation to evaluate the veracity of a claim of potential reprisal, (ii) no peers, supervisors, IRS attorneys, or others are required to approve a reprisal-related decision, (iii) it is the Revenue Agent, not the third party, who almost always broaches the topic of possible reprisals, and (iv) the threshold is offensive when one takes into account the ordinary practice by Revenue Agents of informing third parties, before asking any substantive questions, that the existence of any degree of concern about reprisals will prevent disclosure of their names.

The author identified other criticisms of the proposed regulations, too. For instance, he rhetorically asked how "information from any source" could possibly constitute "good cause" to damage the business and reputational interests of a taxpayer, how an IRS employee, with absolutely no education or training in the field, could competently evaluate "emotional harm" to a third party, and how the IRS intends to fairly and uniformly apply the rules to all taxpayers when the determinations are subjective? The author additionally pointed out that the proposed regulations actually backfire, causing the taxpayer, not third parties, to suffer reprisals, with little or no ability to set the record straight:

> Assume that the [third party] witness made untruthful statements to the IRS. This untruthfulness will be presumed truthful by the IRS employee. This belief on the part of the IRS employee will likely cause the examination of the taxpayer to become expanded, horizontally or vertically. This will likely result in additional representation costs to the taxpayer. It may also cause anxiety, manifested in various ways, in the taxpayer. Ironically, the [proposed] regulations allow third parties to do reprisals, when they are supposedly designed to prevent taxpayers from taking reprisals.

D. Final Regulations

The IRS disregarded the public comments, and it had no epiphanies on its own, such that the final regulations were essentially identical to the proposed ones.[34] 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.[35] 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.[36]

The Preamble referenced the public comments about the proposed regulations, which criticized various aspects of the reprisal exception. The IRS largely dismissed these, summarizing the author's position as "the scope of what would be considered reprisal is too broad and the determination of when reprisal would be considered to exist is too lenient."[37] In defending its definitions, standards, and procedures, the IRS took the position in the Preamble that the existence of the reprisal exception reflects a decision by Congress that "a taxpayer's right to know whom the IRS has contacted is outweighed by a third party's right to be free from any reprisal."[38] The Preamble went on to explain that the best plan is to simply take a third party at his word

about reprisals because he is in the best position to draw this conclusion, and because forcing Revenue Agents to evaluate the validity of a claim or seek supervisory approval would create a significant administrative burden, require Revenue Agents to make judgments for which they are not trained, and "intrude into the third party's affairs."[39] The Preamble also pointed out that Congress contemplated broad applicability of the reprisal exception when it indicated that the potential reprisal could be directed at "any person," not just the third party.[40] Finally, in justifying its expansive definition of reprisal, the Preamble stated that limiting the reprisal exception to physical harm only would be inconsistent with the notion that third parties remain free from all adverse consequences associated with being contacted by the IRS about a taxpayer's liability. Taking this one step further, the Preamble said that Congress did not expressly define or restrict the kind of reprisal situations about which it was concerned, such that the IRS was warranted in including physical, economic, emotional and other types of possible harm.[41]

VI. Internal IRS Guidance

The IRS provided *external* guidance, to taxpayers and their advisors, by promulgating regulations regarding 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.

Getting audited by the Internal Revenue Service ("IRS") is bad enough, but having the IRS tell friends, colleagues, employers, clients and others about it is far worse. The mere fact that the IRS is auditing someone, no matter how routine it might be, can cause serious reputational, business, and financial damage to the person under scrutiny.

The IRM emphasizes that Revenue Agents should not utilize TPCs as a primary auditing tool, but rather they should first grant the taxpayer under audit 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.[42]

> 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.[43]

> 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.[44]

> 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 ….[45]

The IRM contains a significant amount of information about the reprisal exception. It explains, for instance, who has authority to make decisions about potential reprisals. Pursuant to the relevant Delegation Order, many categories of IRS employees are empowered "[t]o determine for good cause shown that providing the taxpayer with general notice or notice of specific [TPCs] may involve reprisal against any person."[46] These include, but are not limited to, Revenue Agents, Audit Accounting Aides, Examination Aides, Tax Auditors, Appeals Officers, Settlement Officers, Tax Compliance Officers, Bankruptcy Specialists, Correspondence Examination Technicians, Collection Representatives, and Tax Resolution Representatives.[47] Such an expansive roster might make one question who is *not* authorized, with no specific training required, to make crucial decisions about potential reprisals, and thus about the rights of audited taxpayers?

The IRM broadly defines the concept of reprisal as "an act of revenge or retaliation against any person" or a belief that the taxpayer "will harm any other person in any way (physical, economic, emotional or otherwise)."[48] It also

offers the following "suggested language" or "reprisal script" for IRS employees to use when making TPCs:

> By law I am required to include your name on a list of parties we have contacted. This list will be sent to (taxpayer's name). If you believe that including your name on the list may result in reprisal against any person, we can exclude you from the list. Do you have any reason to believe that reprisal against any person may occur?[49]

The IRM, consistent with regulations stating that IRS employees are not supposed to make any effort whatsoever to confirm the veracity of a statement by a third party, explains that "[a]ny concern raised by the third party with respect to reprisal will be taken at face value."[50]

If IRS employees determine, unilaterally or through statements by a third party or any other person, that the potential for reprisal exists, they must complete a Form 12175 (*Third Party Contact Report Form*), check the "reprisal box," and take other steps necessary to ensure that the IRS can access and utilize the data provided by the third party, while maintaining secret from the taxpayer the existence of the contact, the identity of the third party, the nature of the inquiry, and the information obtained.[51]

VII. Congress Demands Tighter Notice Starting in 2019

Congress, concerned about TPCs and the related notices provided to affected taxpayers, modified the law when enacting the Taxpayer First Act in 2019.[52] The differences are best seen by comparing the old standard, in effect from 1998 to 2019, with the new rules, governing from 2019 forward:

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 advance notice, and specify in the notice the time period, not to exceed one year, within which the IRS plans to make the TPCs.[53]

VIII. Cases Interpreting Code Sec. 7602

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.[54] The case is important not so much for its holdings, but its analysis and clarification of taxpayer protections under Code Sec. 7602(c).

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 simply giving the taxpayers a copy of IRS Publication 1 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 filed by the taxpayers under the standards previously established by the Supreme Court many years ago, in *Powell*.[55] According to that famous case, courts will not uphold a Summons, unless the IRS establishes a *prima facie* case of good faith by showing 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.[56] The District Court in *J.B. and P.B.* held that the IRS failed the fourth requirement because it violated Code Sec. 7602.

The Court of Appeals ("COA") 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:

> [Section] 7602 is an exception to the general rule that the IRS must keep taxpayer records confidential …. 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:

> [Section] 7602(c)(1)'s notice requirement also complements other notice requirements in the Internal Revenue Code, including [Section] 7609(a)(1), which instructs the IRS to provide the taxpayer with a copy of any summons it serves on a third party. 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:

> The exceptions to … notice requirement further demonstrate that Congress meant for the advance notice provision to provide the taxpayer with a meaningful opportunity to produce information to avoid third-party contacts. [Section] 7602(c)(3) waives the advance notice requirement [in three situations]. These exceptions demonstrate that Congress intended [the] advance notice requirement to give the taxpayer a meaningful opportunity to respond to the IRS's request; it is only if the taxpayer knows who the IRS plans to contact or the documents that the IRS plans to request that the taxpayer may authorize the contact, or more cynically, impede the contact by jeopardizing tax collection efforts, retaliating against third parties, or interfering in a pending criminal investigation.
>
> 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, [Section] 7602(c)(1), 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.

IX. Rules Versus Reality

The information described thus far in this article is available to anyone who has the gumption to analyze the pertinent laws, regulations, IRM, and cases. There are other facts that are more obscure and, perhaps, more interesting. A few are addressed below.

A. Past IRS Performance

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, advance notice required by Code Sec. 7602.[57] The TIGTA study, which focused on audits in 2016, determined that the IRS failed to issue required notifications 18 percent of the time when taxpayer documents were sent to an IRS employee for verification, which often involved making TPCs.[58]

B. Little Fear of Retribution by Affected Taxpayers

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 the reprisal exception applied, etc. The response, published by the IRS for the entire world to see, was that (i) the IRS employee should complete Form 12175 as soon as possible, (ii) taxpayers have no specific cause of action against the IRS for violating the TPC notice rules, (iii) the IRS has never been sued for breaking such rules, (iv) a violation by the IRS theoretically could trigger a lawsuit by a taxpayer under Code Sec. 7433, which allows taxpayers 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)."[59]

Taxpayers are entitled to data about TPCs thanks to the FOIA, Code Sec. 6103, and the recent Transparency Memorandum, yet certain IRS employees have recently taken actions contrary to these authorities, which hinder a taxpayer's ability to obtain data necessary to defend himself.

C. Apparent Disregard for Applicable Law and IRS Directives

The final noteworthy fact concerns various avenues for taxpayers to receive audit-related files from the IRS, including data about TPCs. Taxpayers have three main ways to obtain such data. First, they can submit a request pursuant to the Freedom of Information Act ("FOIA").[60] Second, taxpayers can seek materials pursuant to Code Sec. 6103, which states that the IRS generally will disclose to taxpayers and/or their representatives "returns" and "return information," provided that doing so "would not seriously impair federal tax administration."[61] The concept of "return information" reaches TPCs, as it encompasses the following:

> [A] taxpayer's identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments, whether the taxpayer's return was, is being, or will be examined or subject to other investigation or processing, *or any other data, received by, recorded by, prepared by, furnished to, or collected by the [IRS] with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense*.[62]

Third, based on recent guidance by IRS officials, taxpayers should be able to get audit-related data,

including information about TPCs, directly from Revenue Agents. The Chief Privacy Officer at the IRS issued a Memorandum in March 2019 to the heads of all audit divisions ("Transparency Memorandum").[63] It widely announced that the IRS is committed to "openness in government." The Transparency Memorandum then revealed the following specific guidance:

> Under the FOIA, we have 20 business days to respond to a requester. This statutory responsibility is shared by all IRS employees and we are committed to meeting this obligation. *We need you and your staff to give FOIA requests a high priority by responding timely and providing requested documents on a "rolling production" schedule (as they become available and until all documents are delivered)*.
>
> *You can and should make the following categories of records available without requiring [the taxpayer to make] a formal FOIA request*, to the extent their release does not seriously impair tax administration, compromise privacy interests, or fall within a FOIA statutory exemption.
>
> *Open compliance files should be made available to taxpayers or their authorized representatives without directing them to the FOIA. Under [Section 6103(e), taxpayers have the right to receive copies of these files to the extent their release will not impair tax administration*.
>
> In addition to the proactive disclosure requirements mandated by FOIA … other opportunities exist to efficiently make records publicly available that otherwise might be sought through FOIA requests. *Under [the Department of Justice's] directive, agencies [including the IRS] should exercise their discretion to make a broader range of records available beyond the minimum required by statute*.

Even though taxpayers are entitled to data about TPCs under FOIA and Code Sec. 6103, and despite express mandates in the Transparency Memorandum to provide taxpayers with "open compliance files," to make a "broader range of records available," to not obligate taxpayers to submit official FOIA requests, and to supply materials on a "rolling production schedule," some Revenue Agents seem hell-bent on depriving taxpayers of pivotal data. Specifically, in response to periodic written requests for data about TPCs, certain Revenue Agents have (i) refused to respond on grounds that taxpayers supposedly can only make requests every 90 days, (ii) suggested that a request is utterly null and void if it seeks any information beyond the names of those receiving 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. Lest one suspect sour grapes here, actual excerpts from recent letters from Revenue Agents are set forth below:

> 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.[64]
>
> Pursuant to Treas. Reg. §301.7602-2(e)(1), we have determined that a periodic request for [TPCs] every ninety (90) days is reasonable. Any requests for [TPCs] that are delivered before 90 days have passed since the most recent request will be ignored.[65]
>
> The information requested is beyond the scope of what the IRS will provide and is therefore invalid.[66]
>
> 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.[67]

X. Conclusion

This article underscores the following: (i) Taxpayers generally must file tax returns and maintain all relevant records; (ii) The IRS has the right to audit taxpayers, using various tools, including TPCs, when appropriate; (iii) Congress intended for taxpayers to have the first opportunity to provide requested data to the IRS *before* it resorts to TPCs, because making them often causes reputational damage to the taxpayer; (iv) The IRS must provide taxpayers with general pre-contact notices and specific post-contact reports, but exceptions exist, such as when there is a possibility of reprisals; (v) The IRS often sends Letter 1995 to third parties "requesting [their] assistance" with an audit, which many third parties consider threatening, which fail to answer a long

list of logical questions that third parties would have, and which arguably damage the taxpayer's reputation from the outset by announcing that he is under audit and implying that he might retaliate against those who cooperate; (vi) The IRS, through its issuance of regulations, has construed the concept of "reprisal" in an ultra-broad manner, to encompass physical, emotional, economic, or other harm, to any person, based on any unverified statement by a third party or any other person, or based on a unilateral decision by an IRS employee; and (vii) Taxpayers are entitled to data about TPCs thanks to the FOIA, Code Sec. 6103, and the recent Transparency Memorandum, yet certain IRS employees have recently taken actions contrary to these authorities, which hinder a taxpayer's ability to obtain data necessary to defend himself.

Taxpayers facing IRS audits should be aware of these realities. More importantly, they should hire professionals, steeped in tax disputes and complicated IRS procedures, to overcome them in the most effective way possible.

ENDNOTES

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

2 Code Sec. 6001.

3 Reg. §1.6011-1(a).

4 Reg. §1.6011-1(e).

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

6 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), at 77.

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), at 77.

8 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), at 277.

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

10 P.L. 105-206, Internal Revenue Service Restructuring and Reform Act of 1998 (July 22, 1998), Section 3417. *See* Section 7602(c)(3) of the Internal Revenue Code.

11 66 FR 77 (Jan. 2, 2001); REG-104906-99, Preamble.

12 IRS Publication 1 (Your Rights as a Taxpayer) (Rev. 9-2017); *See also* Publication 556 (Examination of Returns, Appeal Rights, and Claims for Refund) (Rev. 9-2013), at 3. Various court losses about the adequacy of notices and the passage of additional legislation caused the IRS to change its philosophy. The mere delivery of Publication 1 to taxpayers under audit would no longer suffice as of August 2019. From that point forward, IRS employees were told to use the appropriate version of Letter 3164. *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*, Journal Of Tax Practice & Procedure, Dec. 2019/Jan. 2020, at 15; IRM 25.27.1.3.1 (Apr. 7, 2021).

13 IRS Letter 1995 (Rev. 3-2017), Catalog Number 62794I.

14 66 FR 77 (Jan. 2, 2001); REG-104906-99, Preamble.

15 66 FR 77 (Jan. 2, 2001); REG-104906-99, Preamble.

16 66 FR 77 (Jan. 2, 2001); REG-104906-99, Preamble.

17 66 FR 77 (Jan. 2, 2001); REG-104906-99, Preamble.

18 66 FR 77 (Jan. 2, 2001); REG-104906-99, Preamble.

19 66 FR 77 (Jan. 2, 2001); REG-104906-99, Preamble.

20 66 FR 77 (Jan. 2, 2001); REG-104906-99, Preamble.

21 66 FR 77 (Jan. 2, 2001); REG-104906-99, Preamble.

22 66 FR 77 (Jan. 2, 2001); REG-104906-99, Preamble.

23 Reg. §301.7602-2(a).

24 Reg. §301.7602-2(b).

25 Reg. §301.7602-2(d)(1).

26 Reg. §301.7602-2(d)(1).

27 Reg. §301.7602-2(e)(1).

28 Reg. §301.7602-2(e)(2)(i).

29 Reg. §301.7602-2(f)(3)(i).

30 Reg. §301.7602-2(f)(3)(i).

31 Reg. §301.7602-2(f)(3)(ii) Example 1 and Example 2.

32 Reg. §301.7602-2(f)(3)(ii) Example 3.

33 Letter to the IRS by Paul J. Dee, Jr. of Truelove & Dee, LLP, dated March 29, 2001.

34 T.D. 9028 (Dec. 17, 2002).

35 T.D. 9028 (Dec. 17, 2002), Preamble.

36 T.D. 9028 (Dec. 17, 2002), Preamble.

37 T.D. 9028 (Dec. 17, 2002), Preamble.

38 T.D. 9028 (Dec. 17, 2002), Preamble.

39 T.D. 9028 (Dec. 17, 2002), Preamble.

40 T.D. 9028 (Dec. 17, 2002), Preamble.

41 T.D. 9028 (Dec. 17, 2002), Preamble.

42 IRM 4.11.57.1 (May 26, 2017).

43 IRM 4.11.57.2 (May 26, 2017).

44 IRM 4.11.57.2 (May 26, 2017).

45 IRM 25.27.1.3 (Oct. 19, 2017).

46 IRM 1.2.2.14.12 (May 22, 2009) (referencing Delegation Order 25-12).

47 IRM 1.2.2.14.12 (May 22, 2009).

48 IRM 25.27.1.3.2 (Oct. 19, 2017); IRM 25.27.1.3.3 (Oct. 19, 2017).

49 IRM 25.27.1.3.5 (Oct. 19, 2017).

50 IRM 25.27.1.3.5 (Oct. 19, 2017).

51 IRM 25.27.1.3.3 (Oct. 19, 2017); IRM 25.27.1.3.5 (Oct. 19, 2017); IRM 4.11.57.4.2.3 (July 20, 2020).

52 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."

53 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, at 17.

54 *J.B. and P.B.*, No. 16-15999, Opinion, 9th Circuit Court of Appeals (Feb. 26, 2019).

55 *Powell*, SCt, 64-2 USTC ¶9858, 379 US 48, 85 SCt 248.

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

57 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).

58 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), at 6.

59 Chief Counsel Advice 201330036 (July 26, 2013).

60 5 USC §552; IRS Policy Statement 11-13; Reg. §601.702.

61 Code Sec. 6103(c); Code Sec. 6103(e)(7); IRM 11.3.2.2 (Sept. 17, 2020); IRM 11.3.2.3 (Sept. 17, 2020).

62 Code Sec. 6103(b)(2)(A) (emphasis added).

63 *IRS Issues Memo on FOIA Obligations, Transparency*, 2019 Tax Notes Today 54–36 (Mar. 7, 2019).

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

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

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

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