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Don't Shoot the Messenger: The Expanding Scope of the John Doe Summons

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The John Doe summons is an information-gathering tool that has been available to the IRS for many years, traditionally used to seek information about unknown persons suspected of tax evasion from banks, investment advisors or tax shelter promoters. However, recently authorized John Doe summonses mark a significant development in the manner in which this powerful tool may be wielded. In effect, these summonses are going after the messenger—a development that may well presage much more frequent issuance of John Doe summonses to a variety of entities and raise compelling privacy concerns.

Who is "likely to have records"?

On December 19, 2014, the U.S. Department of Justice (DOJ) announced in a press release that a New York federal judge had authorized the IRS to issue John Doe summonses—not to a tax shelter promoter or investment advisor—but instead to document delivery and money transfer intermediaries including Federal Express, UPS, DHL and Western Union. The summonses seek information on unnamed clients of Sovereign Management & Legal, LTD, a Panamanian offshore services entity alleged to have assisted U.S. taxpayers to unlawfully avoid or evade paying tax. The IRS contends in the supporting documents that the domestic intermediaries, through which Sovereign and its clients corresponded and transferred funds, are "likely to have records" on Sovereign's clients. The summonses direct the intermediaries to produce records identifying U.S. taxpayers who used the intermediaries' services to communicate with Sovereign between 2005 and 2013.

Given the expanding use of John Doe summonses, similarly situated intermediaries should have a basic understanding of such summonses from the perspective of both the recipient of the summons and the targeted class of persons whose identities such summonses seek.

What is a John Doe Summons?

The IRS may examine any books, records, or other data relevant to an investigation of any internal revenue tax liability. INTERNAL REVENUE CODE (IRC) § 7602(a)(1). To obtain this information, the IRS is authorized to serve a summons directly on the subject of the investigation or any third-party record keeper who may possess relevant information. *Id.*

In *United States v. Bisceglia* (420 U.S. 141, 150 (1975)), the United States Supreme Court held that the IRS had authority to issue a summons directing a bank to identify an unnamed individual who had deposited a large amount of unusually deteriorated $100 bills. While the Court recognized that the power to inquire into "the private affairs of bank depositors" with such summonses could be abused, it ultimately held that the IRS had acted within its statutory authority in issuing the summons. *Id.*, at 150-51. In response to *Bisceglia*, Congress passed section 7609(f), expressly codifying the IRS' authority to issue so-called "John Doe" summonses on third-party record keepers for information relating to unidentifiable taxpayers. *See* S. Rep. 94-938(I) at 368-73.

However, Congress was concerned that because third-party record keepers do not have a sufficient interest in protecting the privacy rights of the John Does in question, the IRS would use its summons power to engage in "fishing expeditions" that might impinge upon taxpayer privacy. *Id.* In a typical non-John Doe third-party record keeper summons, the identified targeted taxpayer has a right to intervene in the proceeding and oppose or limit the summons. IRC § 7609(a), (b). In contrast, there is no such identified targeted party in the John Doe summons context. Thus, under section 7609(f), the reviewing court is tasked with protecting the interests of the unidentified target: to "exert[] a restraining influence on the IRS," verify the proper purpose and scope of the John Doe summons, and ensure that the information the IRS is seeking is relevant to a legitimate investigation. *Tiffany Fine Arts, Inc. v. United States*, 469 U.S. 310, 320-21 (1985).

What are the requirements for John Doe Summonses?

If the name of the taxpayer or group of taxpayers is unknown and therefore not identifiable, the IRS may serve a John Doe summons on a third-party that possesses information relating to the unnamed taxpayers. IRC § 7609(f). Prior to serving a John Doe summons, the IRS must obtain approval in federal court, but is permitted to do so without notice or opposition as section 7609(h)(2) provides that the determination shall be made in an *ex parte* proceeding. *Id.* At the proceeding, the IRS must establish the following:[1]

i. The summons relates to the investigation of a particular person or ascertainable group or class of persons;

ii. There is a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provision of any internal revenue law; and

iii. The information sought to be obtained from the examination of the records or testimony (and the identity of the person or persons with respect to whose liability the summons is issued) is not readily available from other sources. IRC § 7609(f).

The burden to establish the above requirements is slight, and may be satisfied through a written declaration from an IRS revenue agent. *United States v. Samuels, Kramer and Co.*, 712 F.2d 1342, 1345 (9th Cir. 1983). If the court finds that these requirements have been satisfied—which it almost invariably

[1] If the IRS seeks a "dual purpose" summons—that is, a summons that seeks both information from an identified taxpayer and information about unnamed parties related to the investigation of the identified taxpayer—the IRS does not need to comply with the requirements of section 7609(f).

will, given the deference afforded to the IRS declarations—the court will issue an order authorizing the IRS to issue the John Doe summons to the third-party recipient.

What can the recipient of a John Doe summons do?

Once a John Doe summons has been ordered, a third-party recipient may not refute the court's finding that the three requirements of section 7609(f) have been satisfied. *Samuels, Kramer and Co.,* 712 F.2d at 1346. With the recent Sovereign summonses, for example, the recipients could not dispute that the identifying information on Sovereign's clients is not readily available from other sources. The recipients of a John Doe summons may, however, assert the defenses generally available to persons served with an IRS summons.

A recipient may challenge the John Doe summons under the *Powell* factors.

If the recipient fails to comply with the John Doe summons, the IRS may bring an enforcement proceeding. IRC § 7604(b). In an enforcement proceeding, the recipient may oppose the John Doe summons on the same grounds as a traditional summons, using what are known as the *Powell* factors. *Tiffany Fine Arts*, 469 U.S. at 321. As held in *United States v. Powell* (379 U.S. 48, 57-58 (1964)), the four threshold requirements the government must show to enforce a summons are:

i. The investigation was conducted for a legitimate purpose;[2]

ii. The information sought was relevant to the purpose;

iii. The IRS must not already possess the information; and

iv. All required administrative steps have been taken.

The burden for the IRS to show these requirements is minimal and may be satisfied via written declaration. After the IRS has established these prerequisites to enforcement, the recipient may still "challenge the summons on any appropriate grounds." *Powell*, 379 U.S. at 58.

Recipients of a John Doe summons may, for example, make Fourth Amendment objections that the summons is overbroad or indefinite, though these objections are rarely successful.[3] Where applicable, a recipient may also assert that specified summoned documents are protected by the attorney-client privilege. Procedurally, the recipient may argue that the summons relates to tax years that have already been closed, or, in the case of foreign institutions, that the IRS lacks personal jurisdiction over the summoned records.[4]

Generally, because of the deference afforded to agent declarations, a recipient is unlikely to prevail in enforcement proceedings on any grounds. For example, between June 2013 and May 2014 the IRS litigated 102 summons enforcement cases; taxpayers reportedly were successful in only two.[5]

[2] An "improper purpose" includes harassing the taxpayer, pressuring the taxpayer to settle a collateral dispute, or any other purpose reflecting negatively on the good faith of the particular investigation. *Powell*, 379 U.S. at 58.

[3] *See* George Johnson and Marvin Friedlander, "Exempt Organizations: Summons and Enforcement," Jul. 31, 2012; available here.

[4] Note that the IRS has successfully avoided this objection with respect to foreign financial institutions by serving the John Doe summons on a domestic correspondent bank. See, e.g., Department of Justice Press Release, "Court Authorizes IRS To Seek Records From UBS Relating To U.S. Taxpayers With Swiss Bank Accounts," Jan. 28, 2013; available here.

[5] *See* "Most Litigated Issues – Summons Enforcement Under IRC §§ 7602, 7604, and 7609," 2014 Annual Report to Congress, Taxpayer Advocate Service; available here.

A recipient may notify and involve the John Doe targets.

While the *Powell* defenses are available to recipients, a significant concern in the John Doe context is that the recipient may be unlikely or unmotivated to assert such defenses. Practically speaking, it is the targeted class—not the recipient—that has an interest in raising the defenses. However, it is equally unlikely that the targeted class will be aware of the summonses because the requirements to provide notice to targets of third-party summonses expressly do not apply to John Doe summonses. IRC § 7609(c)(3). Nevertheless, there is nothing precluding a recipient of a John Doe summons from notifying its affected customer account holders or users of its services that it has been served with a John Doe summonses requesting information relating to the affected customers. Indeed, recipients concerned about privacy-related actions following disclosure of customer information should consider providing such notice, and allow the customers to communicate any grounds for defenses in response to the summonses.

A recipient may attempt to limit the scope of the John Doe summons.

If the recipient of a John Doe summons is unable to assert or prevail on any of the above grounds, the recipient may attempt to limit the scope of the summons. In the past, certain recipients of John Doe summonses have been able to successfully enter into agreements with the IRS to significantly limit the volume of information the IRS was attempting force the recipient to disclose.[6]

What can the targets of a John Doe summons do?

The recourse available for targets of John Doe summonses is, if anything, more limited than for recipients. Indeed, because of the *ex parte* nature of the proceeding and the inapplicability of the notice provisions, in many instances the targets may be unaware that the summons has been issued. If the recipient of the summons decides to produce the information without opposition through an enforcement proceeding—raising precisely the privacy concerns Congress sought to avoid by enacting section 7609(f)—a John Doe target may never have the opportunity to oppose disclosure of his or her personal information.

A potential large class of John Does should have a forum to raise privacy concerns that might otherwise never be heard. Depending on the facts and circumstances, such concerns may be significant, particularly where the summons is overly broad or where the connection between the targets and unlawful tax avoidance is not readily demonstrable.

Putting aside the conundrum that targets seeking to retain their anonymity may not be inclined to openly intervene in an enforcement proceeding, John Does who are aware of a summons targeting their information may not have standing to intervene even if they wanted to. On one hand, only parties that are entitled to notice of a summons under section 7609(b) have standing to oppose enforcement, and John Does are not parties so entitled. IRC § 7609(c)(3). But in other contexts, parties are permitted to appear through their counsel without disclosing their identity such as where anonymity is necessary to preserve privacy in matters of a sensitive or highly personal nature, or where the anonymous party would be compelled to admit illegal conduct thereby risking criminal prosecution. *Does I thru XXIII v. Advanced Textile Corp.,* 214 F.3d 1058, 1068 (9th Cir. 2000). Although the statute provides that only parties entitled to notice have standing to oppose or quash a summons, any taxpayer able to assert a justifiable expectation of privacy should have a sufficiently protectable interest to warrant intervention in an enforcement proceeding. *United States v. Coopers and Lybrand*, 413 F.Supp. 942, 944 (D. Col. 1975); see

[6] For example, in 2009 the IRS served a John Doe summons on UBS, initially seeking records relating to over 50,000 John Does. UBS was able to limit the ultimate production to 4,000 John Does records after intensive negotiations relying on the limitations in the U.S./Swiss Tax Treaty exchange-of- information provisions, which at present permit exchanges only in cases of "fraud or the like." *See* "Agreement between the United States of America and the Swiss Confederation," Aug. 19, 2009 at Article 26; available here.

also *United States v. McEgliot*, 2015 TNT 67-10, No. 3:14-cv-05383, (N.D. Cal. Apr. 6, 2015) [holding that in order to determine whether a taxpayer should be permitted to intervene in a third-party summons proceeding, the court must engage in a balancing of the equities, including whether the taxpayer's privileges are adequately protected by the third party].

What are the lessons for intermediaries likely to have records?

The IRS possesses broad authority to gather information from individuals and third-parties during an investigation. While traditionally the third-party recipients of John Doe summonses have been banks or financial services institutions, the IRS' most recent targeting of shipping and monetary intermediaries marks a significant change, perhaps reflecting the increasingly international nature of tax evasion investigations. Furthermore, using the same reasoning as accepted by the court in the Sovereign summons, the IRS could, for example, seek to serve John Doe summonses on Internet Service Providers to obtain the identities of persons electronically communicating with entities suspected of aiding and abetting tax evasion. Such a use could have significant privacy implications, particularly as the individual John Doe taxpayers are left without a mechanism to protect their privacy and Sixth Amendment right to counsel. This convergence of issues raises compelling concerns for any entity that collects, retains, or transmits personally identifiable information. As the use of John Doe summonses proliferates in this era of "Big Data," the courts and Congress should take note of, and perhaps revisit, the almost unquestioned deference afforded to the IRS, which leaves both recipients and targets with little to no recourse once a John Doe summons has issued.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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