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POINTS TO REMEMBER

Strengthening the John Doe Summons: Where Government Must Turn to Overcome Limited Resources

By Scott M. Klein*

The increase in volume and complexity of modern transactions fosters a need for the government to develop alternative measures to improve compliance outcomes. The purpose of this article is to discuss the progression of methods used by the U.S. Government to gather taxpayer information from individuals doing business overseas. This article draws special attention to the recent proposal for strengthening the John Doe Summons.

Since commercialization of the Internet in 1995, e-commerce and globalization have created opportunities for companies to increase their cross-border investments. Increased access to foreign markets through the touch of a button is shown by the growth in Internet users worldwide from 394 million in 2000 to more than 2.4 billion in 2011. Internet Users Graphs, Market Information and Statistics, International Telecommunications Union, http://www.itu.int/ITU-D/ict/statistics/ (last visited Apr. 9, 2012). Furthermore, the complexity of modern transactions such as cross-border structured financing and reinsurance transactions between cross-border affiliated entities creates compliance risk for foreign tax credit, transfer pricing, and earnings stripping issues, to name a few. While an increase in government resources sufficient to detect worldwide compliance with U.S. tax laws would seem fitting, the recent enactment of the Consolidated Appropriations Act of 2012 reduced the Service's budget by $300 million, causing a reduction in enforcement personnel from 52,000 to 49,000.

Deliberate use of offshore transactions as vehicles to avoid U.S. taxes presents additional compliance risk. According to one allegation, by 2008, up to 19,000 Americans conspired with UBS to avoid paying taxes. Declaration of Daniel Reeves, at 7, *In re United States v. UBS AG*, No. 09-20423 (S.D. Fla. Feb. 6, 2009). In 2009, for example, a Swiss banking executive and an attorney were indicted for advising Americans to form sham entities offshore to conceal assets. *United States v. Schumacher*, No. 09-60210 (S.D. Fla. filed Aug. 20, 2009). In February 2012, allegations surfaced involving a tax evasion conspiracy between U.S. taxpayers and another Swiss bank, Wegelin & Co., to hide $1.2 billion. So it should be no surprise that the government's lack of sufficient

* Ernst & Young LLP, Boca Raton, FL. The views expressed are those of the author and do not necessarily reflect those of Ernst & Young LLP.

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detection resources prompts actions to enact laws that shift the onus onto taxpayers by increasing information reporting requirements.

A brief overview of the new wave of information reporting requirements, such as uncertain tax positions (UTP), foreign bank account reporting (FBAR) and the Foreign Account Tax Compliance Act (FATCA), showcases recent measures to overcome the government's limited resources. UTP, effective for tax years beginning after January 1, 2010, requires certain U.S. corporate taxpayers to report various uncertain tax positions on their tax returns on a separate schedule. This enables the Service to identify and assess compliance risks regarding taxpayers' potentially most vulnerable tax positions. FBAR regulations were issued in final form on February 24, 2011, and require U.S. persons having a financial interest in, or signature authority over, a financial account in a foreign country to disclose such interest to the Service. 31 C.F.R. § 1010.350(a). FATCA was enacted on March 18, 2010, and requires financial institutions (U.S. and foreign) to identify and report the identities and activities of all U.S. account holders, including foreign entities owned by U.S. persons whose account values exceed a minimum threshold. I.R.C. § 1471(c)(1); Prop. Treas. Reg. § 1.1471-4(a).

A fourth such measure, the Stop Tax Haven Abuse Act, is presently being considered by Congress. Stop Tax Haven Abuse Act of 2011, H.R. 2669, 112th Cong., 1st Sess., § 205(a) (2011). The Stop Tax Haven Abuse Act has been in committee since August 2011, but Senator Levin reinstated many of its provisions, including the strengthening of the John Doe summons, into his newly proposed Cut Unjustified Tax (CUT) Loopholes Act, which he introduced in February 2012. CUT Loopholes Act of 2012, S. 2075, 112th Cong., 2d Sess., §§ 102(g), 115 (2012). Part of the proposed Act is aimed at strengthening the John Doe summons under section 7609(f), which gives procedural protections to unidentified (John Doe) taxpayers. *See* Senator Carl Levin, Floor Statement on Introduction of Stop Tax Haven Abuse Act, *available at* http://levin.senate.gov/newsroom/speeches/speech/levin-floor-statement-on-introduction-of-stop-tax-haven-abuse-act (July 12, 2011) (Carl Levin Floor Statement). The current version of section 7609(f) was designed to protect individuals' privacy rights after a decision by the United States Supreme Court, *Bisceglia v. United States*. *See* S. Rep. No. 94-938, pt. 1, at 367–69 (1976).

Bisceglia involved an unidentified taxpayer, "John Doe," who deposited 400 old $100 bills no longer suitable for circulation at a small town bank that had received only 218 of such bills in the 11 preceding months. *United States v. Bisceglia*, 420 U.S. 141, 142–43 (1975). Suspicious that the John Doe might have underreported income, the government issued a John Doe summons on the vice president of the bank to learn the suspect's identity and financial information. *Id.* at 143. The Supreme Court held in favor of issuing the summons, noting that although the Service could conceivably abuse its administrative power by conducting "fishing expeditions" into individuals' private affairs, the suspicious $100 bills presented a legitimate cause for investigation. *Id.* at 150–51.

Shortly after the Supreme Court's decision in *Bisceglia*, Congress enacted section 7609(f) as part of the Tax Reform Act of 1976 to decrease the prospect of excessive power given the Service. Section 7609(f) contains three procedural safeguards the government must satisfy through an *ex parte* judicial proceeding. Then it can serve a John Doe summons on a third-party record-keeper. I.R.C. § 7609(f), (h)(2). The safeguards require that: (1) the summons must relate to the investigation of an identifiable type of person or persons; (2) the government has a reasonable basis to believe the person or persons may fail or have failed to comply with any internal revenue law; and (3) the information the government seeks is not readily available from alternative sources. I.R.C. § 7609(f)(1)-(3).

The legislative history identifies appropriate uses of John Doe summonses in circumstances like those in *Bisceglia*, where the Service has knowledge of particular transactions that may affect compliance with U.S. tax laws. *See* S. Rep. No. 94-938, pt. 1, at 372–73 (1976). But both the House and Senate's versions of the Tax Reform Act of 1976 express that authorization to issue a John Doe summons should be given only upon showing "specific facts concerning a specific situation to present to the court." *Id.* at 373.

A recent case in the Eastern District of California, *In re Does*, illustrates the resources needed by the Service to comply with section 7609(f). *In re Does,* No. 2:10-mc-00130, 2011 U.S. Dist. Lexis 55650 (E.D. Cal. May 23, 2011). The government sought information from a state agency regarding a particular class of California residents. They included parents and children involved in transfers of real property for little or no consideration between 2005 and 2010. Hence, since the class of John Does was

readily identifiable, the government satisfied the first requirement. The government satisfied the second requirement of section 7609(f) by constructing a survey and producing the results that showed between 50% and 90% of the class failed to file gift and generation skipping transfer tax returns. The government, however, failed to satisfy the third requirement. The court considered alternative sources from which the government could have obtained the information. The court contemplated attempts to contact each of California's 58 counties rather than the single state agency to which the government sought to issue a summons. The court granted permission to issue the summons after the government revised its petition to show attempts to contact the 58 counties, many of which did not maintain the information sought by the government.

Under the proposed Stop Tax Haven Abuse Act, the government could gather U.S. taxpayers' information from non-FATCA institutions without the need to satisfy section 7609(f). Stop Tax Haven Abuse Act of 2011, § 205(a). Non-FATCA institutions will include foreign institutions that elect not to comply with the FATCA reporting requirements, which obligate the institutions to identify all clients who are U.S. persons. I.R.C. § 1471(c).

The former version of the Stop Tax Haven Abuse Act, introduced in March 2009, listed, as the subjects of the strengthened John Doe summons, institutions organized under the laws of 34 countries deemed offshore secrecy jurisdictions. That list included entities organized under the laws of Anguilla, Antigua and Barbuda, Aruba, Bahamas, Barbados, Belize, Bermuda, British Virgin Islands, Cayman Islands, Cook Islands, Costa Rica, Cyprus, Dominica, Gibraltar, Grenada, Guernsey/Sark/Alderney, Hong Kong, Isle of Man, Jersey, Latvia, Liechtenstein, Luxembourg, Malta, Naura, Netherlands Antilles, Panama, Samoa, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Singapore, Switzerland, Turks and Caicos, and Vanuatu. Stop Tax Haven Abuse Act of 2009, H.R. 1265, 111th Cong., 1st Sess., § 101(b) (2009).

The present version of the bill, however, simply identifies the subjects of the strengthened John Doe summons as non-FATCA institutions. Stop Tax Haven Abuse Act of 2011, § 205(a). Senator Carl Levin, a chief proponent of the Stop Tax Haven Abuse Act, expects this effort to collect billions of tax dollars that escape the U.S. Treasury annually as a result of offshore tax abuses. Carl Levin Floor Statement, *supra.* In his introductory remarks on the Senate floor, Senator Levin emphasized the inefficiencies of the current version of section 7609(f) as applied to offshore secrecy jurisdictions. He cited the need for the Service to establish the same proof that transactions in these jurisdictions raise a significant likelihood of tax evasion. Senator Levin explained that the presumption of noncompliance would counter "the obvious fact that accounts at non-FATCA institutions raise tax compliance issues."

One countervailing argument is that law-abiding taxpayers regularly transact with institutions in foreign jurisdictions for lawful purposes. As presidential candidate Mitt Romney announced regarding his own financial affairs at a debate during the 2012 Florida primary, diversifying one's portfolio in foreign banks and brokerage accounts can offer solid financial strategy. Enhancing creditor protection, investing in foreign currency markets, and owning shares in foreign businesses illustrate additional rationales. After enactment of the proposed Stop Tax Haven Abuse Act, these individuals would face a presumption of noncompliance, potentially enabling the Service to review their financial records.

Moreover, additional presumptions within the proposed Stop Tax Haven Abuse Act pose potential burdens on U.S. taxpayers should they possess insufficient records to substantiate the source of funds for their transactions. Section 102(g) of the proposed Act provides a presumption that transferors to non-FATCA compliant accounts exercised control over the property transferred. This could subject such transferors to nondisclosure penalties under FBAR. Furthermore, all amounts transferred will be presumed to be unreported income to the transferor. Then the presumption can be overcome only by a showing of clear and convincing evidence otherwise. Stop Tax Haven Abuse Act of 2011, § 102(g). Government officials and practitioners may counter that these individuals should not be concerned if they are indeed tax-compliant. However, such an argument arguably frustrates the legislative purpose behind enacting section 7609(f), which is to protect the privacy of U.S. taxpayers from unfocused Service investigations into their financial affairs.

In summary, recent statements by Service spokesperson Michelle Eldridge, expressing concerns that insufficient resources for Service enforcement will have a negative "lasting impact on the nation's voluntary tax compliance," likely foreshadow future measures to address noncompliance. Lisa Rein, *Budget Cuts Hurt IRS, Watchdog Says*, Washington Post, Jan. 13, 2012, at A18. Where the government's efforts to improve compliance are hampered by limited resources in an environment with increased volume and complexity of transactions, expect more laws and regulations requiring taxpayer transparency and providing the Service more access to taxpayer information. ■