

DOES *POWELL* OFFER TAXPAYERS MEANINGFUL PROTECTION IN CROSS BORDER E.O.I. REQUESTS?

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INTRODUCTION¹

In *Through the Looking-Glass*, by Lewis Carroll, Humpty Dumpty makes the following point when speaking to Alice:

When I use a word . . . it means just what I choose it to mean – neither more nor less.²

This article addresses the reasons why it is nearly impossible for a U.S. taxpayer to prevent the enforcement of a summons issued by the I.R.S. pursuant to a request for information initiated by a foreign tax authority. It makes no difference whether the foreign tax authority acts in good faith, misrepresents facts, or is motivated by a purpose unrelated to the computation and collection of the appropriate amount of tax. The safeguards designed to prevent the inappropriate use of information in the foreign country making the request simply provide no relief in the U.S. to the person that is the subject of the information exchange. Under the standards adopted in U.S. cases, the language in which those safeguards are couched has no relevance to a U.S. Federal District Court hearing the petition of an aggrieved taxpayer if the acts are perpetrated by a foreign government.

RIGHTS OF TAXPAYERS

The Fourth Amendment to the Constitution provides as follows:

The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized.

¹ The article serves as a companion piece to an article in the last edition of *Insights*, W. Heyvaert and V.S. Mohammad, “Exchanges of Information in Tax Matters and Fundamental Rights of Taxpayers – E.C.J. Delivers Landmark Ruling in the Aftermath of Berlioz,” *Insights* 7, no. 6 (2020): p. 4. The article addressed a landmark European exchange of information case considered by the C.J.E.U. in Joined Cases C-245/19 and C-246/19. There, the C.J.E.U. held that if a taxpayer whose information is requested in an E.U.-to-E.U. cross-border request has indirect remedies available in the country making the request, the Member State fulfilling the information request can deny the taxpayer and third parties the right to a direct judicial remedy preventing the exchange of information from taking place.

² In *Through the Looking-Glass*, by Lewis Carroll (1871), Humpty Dumpty speaks these words to Alice.

In a similar vein, exchange of information provisions in most income tax treaties provide an obligation on the requesting party to keep the information secret and to disclose the information only to persons concerned with the tax assessment and collection process. For example, Article 26 (Exchange of Information) of the O.E.C.D. Model Tax Convention on Income and on Capital ("O.E.C.D. Model") provides as follows:

1. The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant³ for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to the Convention. The exchange of information is not restricted by Articles 1 and 2.
2. Any information received under paragraph 1 by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of, the determination of appeals in relation to the taxes referred to in paragraph 1, or the oversight of the above. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions. Notwithstanding the foregoing, information received by a Contracting State may be used for other purposes when such information may be used for such other purposes under the laws of both States and the competent authority of the supplying State authorises such use.

If these were the only relevant provisions applicable to an exchange of information and they were applied as written, one could assume that an intervening party to a summons is entitled to a fair hearing of all the facts. As often stated, it is dangerous to assume, especially when the I.R.S. power to obtain taxpayer information is broad.

³ Paragraph (5) of the accompanying Commentary elucidates that "[t]he standard of 'foreseeable relevance' is intended to provide for exchange of information in tax matters to the widest possible extent [while clarifying] that Contracting States are not at liberty to engage in 'fishing expeditions'" The Commentary adds, "the standard requires that at the time a request is made there is a reasonable possibility that the requested information will be relevant; whether . . . [it] actually proves to be . . . is immaterial." As an example, paragraphs 5.2 and 8.1 indicate that if a taxpayer is not individually identified by name or address, a request may be a fishing expedition. However, even the Commentary acknowledges such distinction may be ethereal, where it provides Competent Authorities may comply in any event, even if not obligated to do so.

AUTHORITY OF THE I.R.S. TO COLLECT INFORMATION IN THE CONDUCT OF AN EXAMINATION

When it comes to setting forth the I.R.S.'s power to obtain information pertaining to taxpayers' income taxes, Code §7602(a) paints with a broad brush:

For the purpose of ascertaining the correctness of any return, making a return where no return was filed, determining the tax liability of any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the [I.R.S.] is authorized --

- (1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;
- (2) To summon the person liable for tax * * * , or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable * * * , or any other person the Secretary may deem proper, to appear * * * at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and
- (3) Take such testimony * * * as may be relevant or material to such inquiry.



In short, the I.R.S. may summon any person and request any information in the context of an investigation or audit, including information in the possession of a third party. In addition, the Code provides that the I.R.S. may appeal to Federal courts to compel attendance, testimony, or production and enforce its summons through appropriate process.

U.S. V. POWELL – IMPOSITION OF STANDARDS FOR THE ISSUANCE OF A SUMMONS

In *U.S. v. Powell*,⁴ the Supreme Court examined whether the I.R.S. was required to meet any special showing to compel documents or testimony under Code §7602. The Court looked to prior case law involving the Department of Labor and Federal Trade Commission. In the non-tax case of *Morton Salt*,⁵ issued 15 years prior to *Powell*, Justice Jackson stated the following:

We must not disguise the fact that sometimes, especially early in the history of the federal administrative tribunal, the courts were persuaded to engraft judicial limitations upon the administrative process. The courts could not go fishing, and so it followed neither could anyone else. Administrative investigations fell before the colorful and

⁴ 379 U.S. 48 (1964).

⁵ 338 U.S. 632 (1950).

nostalgic slogan “no fishing expeditions.” It must not be forgotten that the administrative process and its agencies are relative newcomers to the field of law and that it has taken and will continue to take experience and trial and error to fit this process into our system of judicature. More recent views have been more tolerant of it than those which underlay many older decisions. . . .

The only power that is involved here is the power to get information from those who best can give it and who are most interested in not doing so. Because judicial power is reluctant if not unable to summon evidence until it is shown to be relevant to issues in litigation, it does not follow that an administrative agency charged with seeing the laws are enforced may not have and exercise powers of original inquiry. It has a power of inquisition, if one chooses to call it that, which is not derived from the judicial function. It is more analogous to the Grand Jury, which does not depend on a case or controversy for power to get evidence but can investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not. When investigative and accusatory duties are delegated by statute to an administrative body, it, too, may take steps to inform itself as to whether there is probable violation of law.

In *Powell*, the Supreme Court determined that for the I.R.S. had to show four requirements were met before it could issue a valid summons under Code §7602:

- The investigation must be conducted for a legitimate purpose.
- The inquiry may be relevant to that purpose.
- The information sought is not within the I.R.S.’s possession.
- The administrative steps required by the Code have all been met.

At the time the Court heard the case, there existed a circuit split between the U.S. Courts of Appeals as to whether, once seeking in court the “appropriate process” under Code §7602, the I.R.S. was required to meet some more demanding standard, like the probable-cause standard Justice Jackson discussed in *Morton Salt*, which was adopted in the First Circuit – but no other circuit. In short, the requirement posed by the vast majority of circuits was so minimal as almost not to be a standard at all: they referred to it as a “might” standard – *i.e.*, the requested information “might” be relevant to some internal revenue rule.⁶

In the end, the Supreme Court reached a decision in the government’s favor – the Court adopted the four elements listed above, and reasoned that the First Circuit, with its more demanding requirements on the government, misread Code §7605(b), which did not import additional requirements to Code §7602.⁷ Under the four-prong test of *Powell*, the I.R.S. need only demonstrate a “realistic expectation rather than

⁶ See *Foster v. U.S.*, 265 F.2d 183 (2d Cir. 1959); similar approaches were taken in the Third, Fifth, Seventh and Ninth Circuits.

⁷ The original version of Code §7605(b) dated to the 1921 Tax Code, in the early years of the income tax system when the nation’s wealthy and powerful first complained to Congress of “petty annoyances” created by repeat visits of undisciplined lower-echelon revenue agents.

“One consequence of Powell is that if an I.R.S. summons is challenged, the court may simply require the I.R.S. to narrow the scope of the summons.”

an idle hope” that in the course of enforcing the summons, something relevant to income taxes will be discovered.⁸

Once the I.R.S. makes this initial showing – by submitting a simple affidavit sworn by the investigating agent attesting that each of the requirements is met⁹ – the burden shifts to the taxpayer, who must show bad faith on the part of the I.R.S. in order to have the summons dismissed.

One consequence of *Powell* is that if an I.R.S. summons is challenged, the court may simply require the I.R.S. to narrow the scope of the summons.¹⁰ This can be a lengthy game of snakes and ladders if the I.R.S. does not carefully follow its own administrative requirements.¹¹ If the taxpayer loses at the level of the trial court, the summons will be enforced unless the trial court issues a stay of enforcement pending appeal. In the event the trial court fails to issue a stay of enforcement, an application for a stay may be submitted to the relevant U.S. Circuit Court of Appeals.¹²

Powell has been described as a low bar for the I.R.S. to overcome. It is even lower when a summons is issued in the context of an exchange of information under an income tax treaty.

EXCHANGE-OF-INFORMATION REQUESTS

Tax treaties contain exchange-of-information (“E.O.I.”) provisions which are intended to facilitate sharing of information by revenue agencies. For example, Article 27 of the France-U.S. Income Tax Treaty, provides that the competent authorities of the U.S. and France may exchange information that is relevant to carrying out the provisions of the treaty. In pertinent part, the treaty provides as follows:

1. The competent authorities of the Contracting States shall exchange such information as may be relevant for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws concerning taxes of every kind and description imposed on behalf of the Contracting States, insofar as taxation thereunder is not contrary to the Convention. The exchange of information is not restricted by Articles 1 (Personal Scope) and 2 (Taxes Covered).
2. Any information received under this Article by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection or administration of, the enforcement or prosecution

⁸ *U.S. v. Goldman*, 637 F.2d 664, 677 (9th Cir. 1980).

⁹ *U.S. v. Clarke*, 573 U.S. 248 (2014), citing the U.S. Supreme Court’s 1989 decision in *Stuart*, discussed below.

¹⁰ Ninth Circuit examples include *Goldman*, cited *supra*, and *U.S. v. Kersting*, 891 F.2d 1407, 1412 (9th Cir. 1989), *cert den.* 498 U.S. 812 (1990).

¹¹ See for example *Larson v. United States*, 1992 WL 104791 (D. Montana 1992).

¹² See 15A Fed. Prac. & Proc. Juris § 3954 (5th ed.) (Motion for a Stay or Injunction). Also see *Methvin v. United States*, 1999 WL 458976 (1999).



in respect of, the determination of appeals in relation to the taxes referred to in paragraph 1 , or the oversight of the above. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions.

3. In no case shall the provisions of paragraphs 1 and 2 be construed so as to impose on a Contracting State the obligation:
 - a. to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;
 - b. to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;
 - c. to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy (“ordre public”) * * *¹³

The Treasury Technical Explanation to the 2009 protocol,¹⁴ which modified the language of the information exchange provisions, provides the following explanation:

New paragraph 1 authorizes the competent authorities to exchange information as may be relevant for carrying out the provisions of the Convention or to the administration or enforcement of the domestic laws concerning taxes imposed by the Contracting States, insofar as the taxation under those domestic laws is not contrary to the Convention. New paragraph 1 uses the phrase “may be relevant”, which is used in the U.S. Model, to clarify that the rule incorporates the standard in Code section 7602 which authorizes the Internal Revenue Service to examine “any books, papers, records, or other data which may be relevant or material.” (Emphasis added.) In *United States v. Arthur Young & Co.*, 465 U.S. 805, 814 (1984), the Supreme Court stated that “the language ‘may be’ reflects Congress’s express intention to allow the Internal Revenue Service to obtain ‘items of even potential relevance to an ongoing investigation, without reference to its admissibility.’” (Emphasis in original.) However, the language “may be” would not support a request in which a Contracting State simply asked for information regarding all bank accounts maintained by residents of that Contracting State in the other Contracting State, or even all accounts maintained by its residents with respect to a particular bank.¹⁵

¹³ The treaty language in the text is not unique to the France-U.S. Income Tax Treaty. The 2016 U.S. Model Treaty includes a comparable provision.

¹⁴ Signed by the U.S. and France on January 13, 2009 and entered into force on 12/23/2009. The relevant provision is Article XI of the protocol.

¹⁵ This was prior to the entry into the Intergovernmental Agreement between the U.S. and France in 2013 related to F.A.T.C.A.

The authority to exchange information granted by paragraph 1 is not restricted by Article 1 (Personal Scope) or Article 2 (Taxes Covered), and thus need not relate solely to persons or taxes otherwise covered by the Convention. For purposes of Article 27, the taxes covered by the Convention constitute a broader category of taxes than those referred to in Article 2 (Taxes Covered). Exchange of information is authorized with respect to taxes of every kind imposed by a Contracting State at the national level. Accordingly, information may be exchanged with respect to U.S. estate and gift taxes, excise taxes or, with respect to France, value added taxes. In this regard, paragraph 1 is broader than paragraph 1 of Article 27 of the 2004 Convention. Article 27 does not apply to taxes imposed by political subdivisions or local authorities of the Contracting States.

This raises the following question. If a treaty partner jurisdiction makes an E.O.I. request to the I.R.S. and the request is challenged in U.S. Federal District Court by the subject individual, should the court look to the purpose of the treaty partner tax administration or the purpose of the I.R.S. when applying the *Powell* standards? Under the cases, the answer is simple – all that matters under *Powell* is the good faith purpose of the I.R.S. in responding to the request. The good faith of the treaty partner is irrelevant.

“If a treaty partner jurisdiction makes an E.O.I. request to the I.R.S. and the request is challenged in U.S. Federal District Court by the subject individual, should the court look to the purpose of the treaty partner tax administration or the purpose of the I.R.S. when applying the Powell standards?”

STANDARD ADOPTED IN *U.S. v. STUART*

The seminal case in this area is *U.S. v. Stuart*,¹⁶ concerning a request for bank statements under the Canada-U.S. Income Tax Treaty. In *Stuart*, the I.R.S. served a summons on a bank regarding information related to the subject individual’s U.S. account. The taxpayer challenged the request in U.S. Federal District Court based on the contention that the Canadian Revenue Agency investigation had proceeded to a stage that was analogous to a U.S. Department of Justice criminal investigation. By analogy to the rule of Code §7602(c), which prohibited issuances of civil summonses in such situations, the taxpayer moved to quash the summons.¹⁷ The Supreme Court found that Code §7602(c) was inapplicable in the cross-border context, stating as follows:

The concerns that prompted Congress to enact Code §7602(c) – particularly that of preventing the IRS from encroaching upon the rights of potential criminal defendants – are not present when the I.R.S. issues summonses at the request of foreign governments conducting investigations into possible violations of their own tax laws. This is especially so where none of the countries, including Canada, with whom the United States has tax treaties providing for exchanges of information employ grand juries and criminal discovery procedures differ considerably among those countries.

¹⁶ 489 U.S. 353 (1989).

¹⁷ Introduced by the Tax Equity and Fiscal Responsibility Act of 1982, this rule has since been relocated to Code §7602(d) and provides that “[n]o summons may be issued under this title, and the Secretary may not begin any action under [Code §]7604 to enforce any summons, with respect to any person if a Justice Department referral is in effect with respect to such person.”

In U.S. Federal District Court, the holding in *Stuart* is routinely cited by U.S. government attorneys for the proposition that treaty E.O.I. requests are presumptively valid under *Powell*, at least with respect to the legitimate purpose prong. Here are several examples.

*Mazurek v. U.S.*¹⁸ involved a taxpayer's motion to quash a summons to provide information requested by the French revenue agency. The matter was referred to a magistrate judge who, after hearing from both parties, issued a Report and Recommendation. In it, the magistrate judge concluded that discovery and a full evidentiary hearing were not necessary, and the summons should be enforced based on the evidence in the pleadings. The district court adopted the recommendation, and the decision was affirmed by the Fifth Circuit Court of Appeal.¹⁹ In its opinion, the appellate court reasoned as follows:

. . . the information [Mr. Mazurek] sought to procure through discovery and to present during an evidentiary hearing relates to the propriety of the FTA's investigation under French civil tax law. His document requests reflect this same focus. Producing evidence that may demonstrate the bad faith of a French tax agency purely as a matter of French civil tax law is irrelevant to the only good faith issue under *Powell*, *i.e.*, the good faith of the IRS in honoring the French request. And, Mazurek does not seek to discover, or allege that he needs to discover, information that would impugn the good faith of the IRS in issuing the summons or enforcing it in compliance with the FTA's request.²⁰

*Lidas, Inc. v. U.S.*²¹ involves a request by the French government for information regarding U.S. bank accounts of certain individuals and a corporation. The individuals contended that they were not residents of France and challenged the enforcement

¹⁸ 271 F.3d 226 (5th Cir 2001).

¹⁹ The Fifth Circuit Court of Appeals noted the taxpayer's "arguments and requests for information inappropriately focused on the legitimacy and bad faith of the FTA in requesting the summons rather than on the good faith of the I.R.S. in seeking to comply with that request under the Treaty." 271 F.3d 226, 229 (5th Cir. 2001). It's worth noting that the District Court in *Mazurek* initially granted a temporary stay in response to the I.R.S.'s information request pending re a determination of the taxpayer's residency by a French tribunal; thereafter once the foreign tribunal determined that French residency existed the stay was vacated. 2001-1 U.S.T.C. ¶50,304 (E.D. La. 2001); 2001-1 U.S.T.C. ¶50,415 (E.D. La. 2001).

²⁰ In a purely domestic context, courts have considered the I.R.S.'s good faith in a variety of contexts, and precedents for quashing summons based on the I.R.S.'s improper purpose may continue to be grounds for relief; see for example *United States v. Coinbase, Inc.*, 120 A.F.T.R. 2d 2017-5239 (2017), in which the Court granted one John Doe defendant the right to be substituted for two others, based on an argument that the I.R.S.'s request for extensive information on owners of cryptocurrency was akin to requesting bank records for every single U.S. customer from every single U.S. bank branch based on an argument that "tax liabilities are under reported in general, and such records might turn up tax liabilities[.]" and hence an abuse of the court's process.

²¹ 238 F.3d 1076 (9th Cir. 2001).

“While refusing to grant a stay pending its resolution of the matter, the Court entertained the case on the basis that if the taxpayer prevailed, the I.R.S. would ask S.A.T. to return the materials and destroy any copies.”

of the summons through the filing of a motion to quash. In affirming the grant of summary judgment in favor of the U.S. Government., the court stated the following:

The [Individuals] also contend that the district court erred in granting summary judgment in favor of the United States enforcing the summons. To obtain enforcement of an administrative summons issued pursuant to 26 U.S.C. section 7602(2) (sic), the IRS need only demonstrate “good faith” in issuing the summons. The IRS’s *prima facie* showing of good faith is based on the four-part test formulated in *United States v. Powell*, 379 U.S. 48 (1964). The IRS must show that: (1) the investigation will be conducted for a legitimate purpose; (2) the inquiry will be relevant to such purpose; (3) the information sought is not already within the Commissioner’s possession; and (4) the administrative steps required by the Internal Revenue Code have been followed. See *id.* at 57-58.

The same test applies where the IRS issues a summons at the request of a tax treaty partner. See *United States v. Stuart*, 489 U.S. 353 (1989). In such case, the IRS need not establish the good faith of the requesting nation. “So long as the IRS itself acts in good faith [under *Powell*] . . . and complies [pg. 2001-805] with applicable statutes, it is entitled to enforcement of its summons.” *Id.* at 370.

Once the IRS establishes a *prima facie* case for enforcement of its summons under *Powell*, the burden shifts to the taxpayer, who “may challenge the summons on any appropriate ground,” including failure to meet the *Powell* requirements. See *Powell*, 379 U.S. at 58. Nevertheless, the taxpayer bears a “heavy burden” to rebut the presumption of good faith. *United States v. Jose*, 131 F.3d 1325, 1328 (9th Cir. 1997) (*en banc*).

*Villareal v. U.S.*²² involves a taxpayer who alleged that the treaty request for records from a third-party bank was made for the improper purpose of harassment. The taxpayer provided an affidavit stating S.A.T. could not obtain the information under Mexican law. While refusing to grant a stay pending its resolution of the matter, the Court entertained the case on the basis that if the taxpayer prevailed, the I.R.S. would ask S.A.T. to return the materials and destroy any copies. Citing *Stuart*, the Tenth Circuit ultimately determined that the Mexican authority’s good faith was irrelevant to the matter, and only the I.R.S.’s good faith in issuing the summons was in issue.

In a wholly domestic context, some Circuit Courts of Appeals will permit a taxpayer to examine I.R.S. officials regarding their reasons for issuing a summons, assuming sufficient facts are alleged up front in the form of a signed affidavit. This approach is irrelevant in the cross-border context.

THIRD PARTY SUMMONS

Assume the I.R.S. requests information and the taxpayer refuses. Suppose the I.R.S. then seeks the information from third parties in whose possession such

²² 524 Fed. Appx. 419 (10th Cir. 2013).

information may naturally exist – perhaps the taxpayer’s bank. Code §7609(a) poses three distinct procedural hoops that must be overcome in such cases:

- Within three days of the service of process to the third party, and in all events no later than the 23rd day before the date fixed in the summons on which records in the third party’s possession are to be examined or provided, the I.R.S. must notify the taxpayer identified in the summons of the third-party request.
- The notice to the taxpayer must meet the requirements of Code §7603, which includes the situation where the I.R.S. serves the notice via certified or registered mail to the taxpayer’s last known address on record.
- The notice must be accompanied by a copy of the summons and contain an explanation of the right to bring a proceeding to quash.

If the taxpayer intervenes under Code §7609 to quash, a case must be brought in the U.S. Federal District Court where the taxpayer resides (if an individual) or is registered for business (if a corporation or L.L.C.). This can be a lengthy game of snakes and ladders if one or both sides are not fully compliant with the requirements of the Code and the Service’s own administrative requirements. If the I.R.S. fails to give the taxpayer proper notice and the third-party fails to stop and ask whether the information may legitimately be given, how will the taxpayer prevent irreparable damage? There is a Circuit split on the question of whether third-party notice requirements of Code §7609 must be strictly construed under *Powell*.²³ In addition, the Taxpayer First Act of 2019²⁴ amended Code §7602(c) to provide that, if the I.R.S. issues third-party summons on or after August 17, 2019, it must give notice in writing to the affected taxpayer.

WHERE INFORMATION IS MISUSED BY THE FOREIGN TAX AUTHORITY

In light of the holding in *Stuart*, what remedy is realistically available to a person whose information has been obtained by the I.R.S. under the exercise of its summons power, transferred to the tax authority of a treaty partner country, and used for an improper purpose? The answer is that limited retroactive relief may be obtained in the form of damages.

In *Aloe Vera of America, Inc. v. United States*, the taxpayer sought civil damages under Code §6103 for an allegedly unauthorized disclosure of certain confidential return information to the National Tax Administration (“N.T.A.”) in Japan. Paragraph 1 of Article 26 of the relevant income tax treaty provided standard limitations on the disclosure of information by the treaty partner country making the request. In pertinent part, it provided as follows:

²³ See *Jewell v. United States*, 749 F.3d 1295 (10th Cir. 2014), discussing four other circuit’s approach to Code §7609, treating it as a “soft” requirement under *Powell*, prong 4, and reasons for which the Tenth Circuit considered it necessary for the I.R.S. to fully observe the administrative requirements of this provision.

²⁴ Pub. L. No. 116-25.

Any information so exchanged shall be treated as secret and shall not be disclosed to any persons other than those (including a court or administrative body) concerned with assessment, collection, enforcement, or prosecution in respect of the taxes which are the subject of this Convention.

The taxpayer argued that the I.R.S. knew or should have known that Japan's N.T.A. routinely failed to abide by secrecy provisions when it requested information under an E.O.I. provision of income tax treaties. The taxpayers requested actual and proximate damages for the N.T.A.'s inappropriate use in the vicinity of \$52 million,²⁵ based on the harmful effects of the N.T.A.'s negative press conference. The I.R.S. claimed that, under the convention, the duty to maintain secrecy applied solely to the N.T.A., but the court concluded that Code §6103 protections were applicable, nevertheless. Unfortunately for the taxpayer, the court awarded only statutory damages of \$1,000 to each of three plaintiffs, holding that actual and punitive damages requested were inapplicable where the taxpayers failed to show that the N.T.A. commenced its simultaneous examination because of the information provided by the I.R.S.²⁶

²⁵ The taxpayers cited *Jones v. U.S.*, 9 F. Supp. 2d 1119 (D. Neb. 1998), which awarded \$4,500,000 in damages to a taxpayer whose information was provided by the I.R.S. to an informant, who then publicly disclosed the information received.

²⁶ The case wound its way up and down through the Federal courts for nearly 20 years. The initial case was prompted by an I.R.S. audit of the taxpayers' tax liabilities in May of 1995 after an I.R.S. examiner recommended disallowing certain deductions for commissions paid on sales of Aloe Vera gel exceeding \$32 million. Thereafter, the I.R.S. proposed a joint examination to N.T.A., and both agencies ultimately assessed deficiencies, including penalties and interest. The N.T.A. was notorious for leaking information to shame large or famous tax evaders. When a Japanese subsidiary's tax information was leaked, the taxpayers brought a suit for damages based on a disclosure of a baseless estimate by the I.R.S. agent. In District Court, the taxpayers asserted that the U.S. disclosed information to the N.T.A. which it knew or should have known the N.T.A. would not keep confidential. The initial decision was *Aloe Vera of Am., Inc. v. U.S.*, 128 F. Supp. 2d 1235 (D. Ariz. 2000). After three successive amendments to the taxpayers' complaint, the District Court determined in 2007 that the plaintiffs had failed to establish the existence of a genuine issue of material fact; see 2007 U.S. Dist. LEXIS 8103 (D. Ariz. 2007). On appeal, the Ninth Circuit Court of Appeals remanded for a determination of subject matter jurisdiction based on the statute of limitations. See 580 F.3d 867 (9th Cir. 2009). Subsequently, the District Court found it had jurisdiction over some claims but reaffirmed its partial award of summary judgment to the I.R.S. on other claims for reasons stated in the prior ruling. See 730 F. Supp. 2d 1020 (D. Ariz. 2010). On a second-round appeal, the Ninth Circuit affirmed in part and reversed in part, holding genuine issues of material fact existed, as discussed in 699 F.3d 1153 (9th Cir. 2012). On remand the District Court denied a motion for partial summary judgment, at 2013 U.S. Dist. LEXIS 179559 (D. Ariz. 2013). During the litigation, the U.S. waived sovereign immunity specifically with respect to the statements its agents had made to the N.T.A., and after a final bench trial, the District Court found that "considering all of the evidence, . . . [the N.T.A.] leaked information to the Japanese media," and awarded statutory damages but not actual or punitive damages requested by the taxpayers. See *Aloe Vera of Am., Inc. v. U.S.*, No. CV-99-01794-PHX-JAT, at *11 (D. Ariz. 2015); *aff'd in part, rev'd and rem'd in part, by unpub. op.*, No. 15-15672 (9th Cir. 2017), *amended by unpub. op. denying pet. for reh'g and reh'g en banc*, No. 15-15672 (9th Cir. 2017).

“Unfortunately for the taxpayer, the court awarded only statutory damages of \$1,000 to each of three plaintiffs, holding that actual and punitive damages requested were inapplicable. . .”

CONCLUSION

When a U.S. person files an action to quash an I.R.S. summons that has been issued in response to an E.O.I. request, answer of the I.R.S. is predictable. It takes the form of a motion to dismiss based on the argument that *Powell's* requirements are automatically met. While legal arguments and case citations are cited by the attorneys for the U.S. Government, should keep in mind that if the proffered argument is based on the protections granted in the E.O.I. article of a treaty, it should expect a decision based on the words uttered by Humpty Dumpty to Alice. The mandatory purpose for exchanging information and the recipient's obligation to keep the information secret are words that impose no burden on the tax authority making the request. Under the cases, those words likely mean that the foreign government wants the information and is obligated to use the information as it pleases. And, if upon obtaining the information from the I.R.S., the treaty partner revenue agency leaks protected return information to the public, in the best-case scenario the U.S. taxpayer's recourse may be limited to nominal damages plus attorney fees.²⁷

Similar to E.U. taxpayers addressed by Messrs. Heyvaert and Mohammed in their article in the last edition of *Insights* and cited at n.1, the taxpayer's only effective route may be to take the matter up directly with the courts of the foreign jurisdiction originating the request, where prospects for meaningful relief may be slim.



²⁷

Recent U.S. Supreme Court opinions on First and Second Amendment cases such as *Uzuegbunam v. Preczewski* have addressed taxpayer's entitlement to bring suit for nominal damages, though Justice Kavanaugh speculated during oral argument that claims for nominal damages may be driven by attorney fee awards. An example can be found in [Adam Liptak, Citing Taylor Swift, Supreme Court Seems Set to Back Nominal Damages Suits](#), Jan. 12, 2021.