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DAKohn

CC-1997-

May 5, 1997

ACTION ON DECISION

Subject: United States v. Cheng C. Kao and Susan L. Kao,
81 F.3d 114 (9th Cir. 1996)

Issue:

Can the Service issue summonses to compel a taxpayer to sign consent directives which authorize the release of records from unidentified domestic and foreign banks, consistent with the requirements of I.R.C. § 7609?

Discussion:

A revenue agent's investigation into tax liabilities of the Kaos revealed a number of deposits from offshore banks. To obtain information about the deposits, the agent asked the Kaos to voluntarily sign documents known as consent directives, which the Service commonly uses to obtain taxpayer records from foreign banks. The consent directives used in this case covered the release of information from "any bank, financial institution, trust company, foundation, or management company" where the Kaos might have an account. The Kaos declined to sign the consent directives, and the agent issued summonses compelling them to do so. When they refused, the Government petitioned for summons enforcement. The district court ultimately ordered enforcement over the Kaos' objections that the summonses implicated I.R.C. § 7609. The court reasoned that since the summonses were issued to the taxpayers themselves, rather than third parties, and since the Service intended to use the consent directives to obtain information from only overseas banks, I.R.C. § 7609 was not applicable.

The Ninth Circuit reversed, focusing on the fact that the consent directives, on their face, covered as yet unidentified domestic bank accounts. Because domestic bank accounts were implicated and such banks are third-party recordkeepers under I.R.C. § 7609, the Ninth Circuit took the position that the procedure used by the Service violated the statute because it

would permit the Service to obtain account information without providing notice as required by the statute.

Both the district court and the Ninth Circuit recognized that the Service did not intend to rely on the consent directives to obtain information from domestic banks. Moreover, it was within the court's discretion to narrow the scope of the directives to foreign institutions. The Ninth Circuit decided to deny enforcement in toto rather than limit the scope of the consent directives to foreign institutions. Given this approach, the court's determination that the consent directives used in this case could theoretically lead to the Service's receiving taxpayer information from third-party recordkeepers, without notice and in contravention of I.R.C. § 7609, was correct.

The Government's decision to not seek Supreme Court review in this case should be read narrowly. It does not reflect an overall change in the Service's position on the use of either consent directives or summonses for bank records.

The Service does not read the Ninth Circuit's decision as prohibiting the use of consent directives. Under the court's decision, the Service may continue to use consent directives which are either voluntarily signed by taxpayers or are specifically limited to foreign banks. Moreover, the Ninth Circuit's decision does not in any way prevent the Service from using its statutory summons authority to obtain financial information directly from taxpayers. I.R.C. § 7609 provides that notice be given to taxpayers when the Service issues a summons to third-party recordkeepers for taxpayer records. Notice is not required and would be superfluous where the summons for the same financial records is directed to taxpayers themselves. I.R.C. § 7609 was implicated in this case only because: 1) the Service issued summonses, and 2) those summonses could have resulted in release of information from institutions which are domestic third-party recordkeepers. Where these two considerations do not exist simultaneously, the Ninth Circuit's decision will not apply.

In the course of correctly holding that the Service's use of information obtained from a domestic recordkeeper pursuant to the consent directives as drafted in this case would nullify the protections afforded by I.R.C. § 7609, the Ninth Circuit cited Neece v. IRS, 922 F.2d 573 (10th Cir. 1990), with approval. To the extent that this suggests that the Ninth Circuit would not approve production of information effected without the use of a

