Industrial Electric Sales & Service, Inc. v. Commissioner, 65 T. C. 844 (1976)

In tax court proceedings, third-party statements must be produced for discovery, but production can be delayed until after the petitioner responds to requests for admissions to preserve their impeachment value.

Summary

In Industrial Electric Sales & Service, Inc. v. Commissioner, the Tax Court addressed the discovery of third-party statements taken during an IRS investigation. The petitioners sought these statements to aid their defense against allegations of unreported income. The Commissioner objected, citing potential use for impeachment. The court ruled that the statements must be produced, but delayed the production until after the petitioners responded to the Commissioner's requests for admissions. This decision balances the petitioners' right to discovery with the need to preserve the effectiveness of cross-examination, illustrating the court's discretion in managing discovery to ensure a fair trial.

Facts

Industrial Electric Sales & Service, Inc. (Industrial) and its president, E. B. Hale, were under investigation for unreported income from scrap metal sales. The IRS interviewed several individuals, including Industrial's employees and alleged scrap metal buyers. Industrial requested the production of statements and summaries from these interviews. The Commissioner initially refused, arguing that the statements could be used for impeachment purposes.

Procedural History

Industrial filed a motion for the production of the third-party statements. After a hearing, the Commissioner agreed to produce certain reports but objected to the third-party statements. The Tax Court then considered the motion, leading to the decision to order production but delay it until after Industrial responded to the Commissioner's requests for admissions.

Issue(s)

1. Whether the Tax Court should order the production of third-party statements taken by the Commissioner's agents.

2. Whether the production of such statements should be delayed until after the petitioner responds to the Commissioner's requests for admissions.

Holding

1. Yes, because the court found that the Commissioner failed to demonstrate that the statements were primarily for impeachment purposes, and the petitioners had a

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right to discovery.

2. Yes, because delaying production until after the petitioners respond to requests for admissions would preserve the impeachment value of the statements without denying discovery.

Court’s Reasoning

The court applied Rule 72 of the Tax Court Rules of Practice and Procedure, which governs discovery. It rejected the Commissioner’s argument that the statements should be withheld due to their potential impeachment value, citing previous cases where mere possibility of tailoring testimony was insufficient to deny discovery. The court emphasized that the Commissioner bore the burden of proving fraud and might need to call the interviewed individuals as witnesses. To balance the interests of both parties, the court decided to delay production until after the petitioners responded to the Commissioner’s requests for admissions, ensuring that the petitioners would present their facts without prior knowledge of the Commissioner’s evidence. This approach was seen as preserving the fullest presentation of evidence. The court also dismissed concerns about potential witness tampering, noting that such issues could be addressed through cross-examination.

Practical Implications

This decision provides guidance on how courts may handle discovery requests for third-party statements in tax cases. It underscores the importance of balancing the right to discovery with the need to preserve the effectiveness of cross-examination. Practitioners should be aware that while third-party statements may be discoverable, courts have discretion to delay their production to prevent tailoring of testimony. This ruling may influence how parties approach discovery in similar cases, potentially leading to more strategic use of requests for admissions to shape the timing of discovery. Additionally, it highlights the court’s role in managing discovery to ensure a fair trial, which could impact how attorneys prepare for and conduct discovery in tax litigation.

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