

Zaentz v. Commissioner, 73 T. C. 469 (1979)

The scope of discovery in Tax Court includes relevant information and documents that may lead to admissible evidence, even if they pertain to transactions or non-parties not directly at issue in the case.

Summary

In *Zaentz v. Commissioner*, the Tax Court clarified the scope of discovery under its rules, focusing on relevance and the duty of parties to respond to discovery requests. The case involved royalty payments to foreign entities, with the Commissioner questioning their legitimacy. The court ruled that the Commissioner's broad discovery requests were relevant because they aimed to uncover the entire scheme leading to the disputed payments. The court emphasized that parties must make reasonable inquiries of their agents, including attorneys and accountants, to respond to discovery requests. The decision also addressed the petitioner's discovery requests, affirming the Commissioner's obligation to produce existing documents but not to reveal legal authorities or prepare a statement of all known facts.

Facts

Saul Zaentz was a partner in Fantasy/Galaxy Record Co. (FGRC), which paid royalties to foreign corporations Gesternte, N. V. and Basalt Finance Co. , N. V. for recording rights. The Commissioner disallowed these royalties, alleging that FGRC controlled these entities and that the payments were not ordinary and necessary business expenses. The Commissioner sought extensive discovery on the history and ownership of the recording rights, which Zaentz contested as irrelevant. Zaentz also sought discovery from the Commissioner, including facts, documents, and legal authorities supporting the Commissioner's position.

Procedural History

The Commissioner served interrogatories and requests for production of documents on Zaentz, who objected to several requests. Zaentz also served discovery requests on the Commissioner. Both parties filed motions to compel discovery under Tax Court Rule 104(b). The Tax Court considered these motions and issued a ruling on the scope of discovery applicable to both parties.

Issue(s)

1. Whether the Commissioner's discovery requests were relevant to the issues in the case.
2. Whether Zaentz had a duty to inquire of his agents, including his attorney and accountant, to respond to the Commissioner's discovery requests.
3. Whether the Commissioner was required to produce documents and reports, and to reveal legal authorities and all known facts in response to Zaentz's discovery

requests.

Holding

1. Yes, because the Commissioner's requests were relevant to understanding the entire scheme leading to the disputed royalty payments, even if they pertained to transactions or non-parties not directly at issue.
2. Yes, because parties have a duty to make reasonable inquiries of their agents, including attorneys and accountants, to respond to discovery requests.
3. No, because while the Commissioner must produce existing documents and reports, he is not required to reveal legal authorities or prepare a statement of all known facts.

Court's Reasoning

The Tax Court applied a liberal standard of relevancy for discovery under Rule 70(b), allowing the Commissioner to seek information relevant to the subject matter of the case. The court emphasized that the Commissioner's allegations of an elaborate scheme to transfer recording rights justified broad discovery to understand the full context of the transactions. The court rejected Zaentz's objections, stating that the Commissioner was not seeking discovery from non-parties but about them, which was permissible if relevant. The court also clarified that parties must inquire of their agents, including attorneys and accountants, before claiming lack of knowledge in responses to discovery requests. Regarding Zaentz's requests, the court ruled that while the Commissioner must produce existing documents and reports, he was not required to reveal legal authorities or prepare a statement of all known facts, as these were considered work product.

Practical Implications

This decision expands the scope of discovery in Tax Court proceedings, allowing parties to seek information that may lead to admissible evidence, even if it pertains to transactions or non-parties not directly at issue. Practitioners should be prepared for broad discovery requests and understand their duty to inquire of agents to respond. The ruling also clarifies that while the Commissioner must produce existing documents, he is not required to reveal legal authorities or all known facts, which may affect how petitioners approach discovery in tax disputes. This case has been cited in subsequent Tax Court decisions to support the broad scope of discovery and the duties of parties in responding to discovery requests.