Ash v. Commissioner, 96 T. C. 459 (1991)

The Tax Court has the inherent power to limit the IRS's use of information obtained through administrative summonses issued after a petition is filed, if such use undermines the court's discovery rules.

Summary

Mary Kay Ash challenged the IRS's use of administrative summonses to obtain information for her tax case. The Tax Court held that it could limit the use of information from summonses issued after the petition was filed if they undermined its discovery rules. However, the court declined to issue a protective order in this case, as the summonses in question were issued either before the petition or for independent reasons. This decision balances the IRS's statutory authority to issue summonses with the court's need to maintain control over its discovery process, impacting how similar cases should handle summons-obtained evidence.

Facts

Mary Kay Ash filed a petition in the Tax Court challenging IRS notices of deficiency for the taxable years 1983 and 1985. The IRS had issued administrative summonses to obtain information related to Ash's tax liabilities, including summonses to Mary Kay Corp. and third parties like Ernst & Young before and after Ash's petition was filed. Ash moved for a protective order to prevent the IRS from using information obtained through these summonses in the Tax Court proceedings.

Procedural History

The IRS issued notices of deficiency to Mary Kay Ash for the years 1983 and 1985. Ash filed a petition with the U. S. Tax Court on December 29, 1989, challenging these deficiencies. The IRS had previously issued administrative summonses on September 20, 1989, and October 3, 1989, to gather information related to Ash's tax liabilities. Ash then filed a motion for a protective order on July 6, 1990, to restrict the IRS's use of the information obtained through these summonses. The Tax Court denied Ash's motion.

Issue(s)

1. Whether the Tax Court has the authority to issue a protective order restricting the IRS's use of information obtained through administrative summonses issued before the filing of the petition?
2. Whether the Tax Court has the authority to issue a protective order restricting the IRS's use of information obtained through administrative summonses issued after the filing of the petition?

Holding

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1. No, because the Tax Court's discovery rules are not applicable to summonses issued before the petition is filed, and such summonses do not threaten the integrity of the court's discovery process.
2. Yes, because the Tax Court has inherent power to limit the IRS's use of information from summonses issued after the petition if they undermine the court's discovery rules, but in this case, Ash failed to show that the summonses were issued without independent and sufficient reason.

Court's Reasoning

The Tax Court's decision was based on the balance between the IRS's statutory authority to issue summonses under sections 7602 and 7609 of the Internal Revenue Code and the court's need to maintain control over its discovery process. The court distinguished between summonses issued before and after the filing of the petition. For pre-petition summonses, the court reasoned that its discovery rules were not yet applicable and thus could not be undermined. For post-petition summonses, the court recognized its inherent power to issue protective orders if necessary to protect the integrity of its processes, but emphasized that such power should be exercised cautiously and only when the summonses threaten to undermine the court's discovery rules. The court cited *Universal Manufacturing Co. v. Commissioner* and *Westreco, Inc. v. Commissioner* but modified their holdings, stating that the Tax Court would not normally exercise its inherent power to limit the use of information from post-petition summonses unless the taxpayer can show a lack of independent and sufficient reason for the summonses. In this case, Ash failed to demonstrate such a lack of reason for the post-petition summonses issued to third parties.

Practical Implications

This decision clarifies the Tax Court's authority to limit the IRS's use of information obtained through administrative summonses issued after a petition is filed, particularly when such use undermines the court's discovery rules. Practically, this means that taxpayers may seek protective orders in similar situations, but they must demonstrate that the summonses lack an independent and sufficient reason unrelated to the pending litigation. The decision also reinforces the IRS's broad authority to issue summonses before a petition is filed, which remains unchallenged by the Tax Court's discovery rules. Legal practitioners should carefully consider the timing and purpose of IRS summonses in relation to pending Tax Court cases, as this may affect the admissibility of the information obtained. This ruling may influence how the IRS conducts audits and how taxpayers respond to summonses, potentially leading to more strategic use of summonses and challenges to their use in court.

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