Mescalero Apache Tribe v. Commissioner, 148 T. C. No. 11 (U. S. Tax Ct. 2017)

In a significant ruling, the U. S. Tax Court held that third-party taxpayer information can be disclosed in judicial proceedings to absolve an employer of withholding tax liabilities under IRC section 3402(d). The Mescalero Apache Tribe sought discovery of its workers' tax payment records to prove they had independently paid their taxes, potentially relieving the Tribe of its tax liability. The court's decision clarifies the scope of IRS confidentiality under IRC section 6103 and supports broader discovery rights in tax disputes.

Parties

The petitioner in this case was the Mescalero Apache Tribe, a recognized sovereign government under the Indian Reorganization Act of 1934, located in New Mexico. The respondent was the Commissioner of Internal Revenue, representing the U. S. government.

Facts

The Mescalero Apache Tribe classified several hundred workers as independent contractors during the tax years 2009-11. The Commissioner audited the Tribe and reclassified these workers as employees, resulting in a significant tax bill for the Tribe under IRC section 3402(a), which requires employers to withhold income tax on wages. The Tribe attempted to prove that its workers had paid their taxes independently by obtaining Form 4669 from them but was unable to contact 70 of these workers due to their remote locations and lack of communication services. The Tribe sought discovery of the IRS's records to determine if these workers had reported their income and paid their taxes, which could absolve the Tribe of its withholding tax liability under IRC section 3402(d).

Procedural History

The Tribe initially filed a motion to compel discovery of the IRS's records, which was denied without prejudice as premature. After unsuccessful attempts at informal discovery, the Tribe filed another motion to compel, which was denied due to noncompliance with Rule 71(c) of the U. S. Tax Court Rules of Practice and Procedure. The Tribe then filed a compliant motion to compel discovery, leading to the court's decision on the issue of whether an employer could discover its workers' IRS records to reduce its tax liability under IRC section 3402(d).

Issue(s)

Whether an employer may take discovery of its workers' IRS records to reduce its own tax liability under IRC section 3402(d)?

Whether the disclosure of third-party taxpayer information to absolve an employer of

© 2025 SCOTUSreports.com. All rights reserved.

its IRC section 3402(a) tax liabilities is barred under IRC section 6103?

Rule(s) of Law

IRC section 3402(a) requires employers to deduct and withhold income tax from wages paid to employees. IRC section 3402(d) provides that if an employer fails to withhold and the employee subsequently pays the tax, the employer is relieved of the withholding tax liability. IRC section 6103 generally prohibits the disclosure of tax returns and return information, but section 6103(h)(4) allows such disclosure in judicial and administrative tax proceedings if certain conditions are met.

Holding

The court held that the disclosure of third-party taxpayer information to absolve an employer of its IRC section 3402(a) tax liabilities is not barred under IRC section 6103(h). Furthermore, the court held that the burden of proof on the employer to show that its workers paid income tax does not make their confidential return information nondiscoverable.

Reasoning

The court's reasoning focused on the interpretation of IRC section 6103 and its exceptions. It followed the Tenth Circuit's precedent, which allows the disclosure of third-party tax-return information in judicial and administrative tax proceedings to persons other than government officials under IRC section 6103(h)(4), provided that the information directly relates to the resolution of an issue in the proceeding. The court found that the workers' tax payment records directly relate to the transactional relationship between the Tribe and its workers, which affects the resolution of the issue of the Tribe's tax liability. The court also considered the burden of proof, noting that under Rule 70(b) of the U. S. Tax Court Rules, the burden of proof does not affect the obligation to comply with appropriate discovery requests. The court concluded that the requested information was both disclosable and discoverable, and thus granted the Tribe's motion to compel discovery.

The court addressed the Commissioner's objections, including the argument that the burden of proof under IRC section 3402(d) should prevent discovery. However, the court emphasized that the burden of proof does not preclude discovery and that the requested information was relevant to the case's resolution. The court also considered the Commissioner's claim that producing the information would be burdensome but found that the request was not unreasonably voluminous and that the Tribe had exhausted other means of obtaining the information.

Disposition

The court granted the Tribe's motion to compel discovery of the IRS's records regarding the workers' tax payments.

© 2025 SCOTUSreports.com. All rights reserved.

Significance/Impact

This case has significant implications for tax litigation and the scope of discovery in tax disputes. It clarifies that third-party taxpayer information can be disclosed in judicial proceedings to resolve issues related to an employer's tax liability, expanding the interpretation of IRC section 6103(h)(4). The decision supports the rights of taxpayers to access relevant information held by the IRS, which may be crucial in defending against tax assessments. The ruling may influence future cases involving worker classification and withholding tax liabilities, potentially affecting how employers and the IRS approach such disputes. The decision also highlights the importance of the burden of proof in discovery requests and may lead to more robust discovery practices in tax litigation.

© 2025 SCOTUSreports.com. All rights reserved.