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Internal Revenue Service National Office Technical Assistance

MEMORANDUM FOR John T. Lyons, Assistant Commissioner (International)
Thomas W. Wilson, Jr., Assistant Commissioner (Examination)

FROM: Philip Tretiak, Senior Technical Reviewer, CC:INTL:4

SUBJECT: Partnership Questions

This memorandum responds to your request for Technical Assistance. Technical Assistance is not binding on Examination or Appeals and is not a final case determination. This document is not to be used or cited as precedent.

ISSUES:

If for a particular tax year the Service sends a taxpayer a set of questions regarding the taxpayer's direct interest in corporations and trusts and direct and indirect interests in partnerships and disregarded entities and reviews the answers, will that constitute the start of an exam so that any subsequent examination activities with respect to the same taxpayer for the same year may constitute a second exam for which notice would be required under § 7605(b)? Does the information being requested constitute "books of account" under § 7605(b), so that subsequent to receiving the information, the Service could only further inspect the taxpayer's books and records if § 7605(b) notice is provided?

CONCLUSION:

Sending the questions and reviewing the answers will not constitute the start of an exam. Therefore, any subsequent examination activities with respect to the same taxpayer for the same tax year cannot constitute a second exam for which § 7605(b) notice would be required. In addition, the information being requested does not appear to constitute "books of account" for purposes of § 7605(b). Accordingly, subsequent to sending the questions and reviewing any answers received, the Service could inspect the taxpayer's books and records without giving notice under § 7605(b).

FACTS:

The Assistant Commissioner (International) and Assistant Commissioner (Examination) have created a list of questions to send to CEP taxpayers to discover their ownership interests in certain entities. The questions ask taxpayers to provide in writing information about their direct interests in corporations and trusts, and about their direct and indirect interests in partnerships and disregarded entities. Taxpayers will be asked to answer the questions with respect to their ownership interests during the most recent year for which they have filed an income tax return. The questions were developed in connection with the foreign joint venture/partnership initiative. The purpose of the initiative is to assist field examiners in obtaining information about taxpayers' organizational structures to assist them in the early identification of returns associated with foreign and domestic joint venture activity and the protection of statute of limitations where there is significant audit potential. If a taxpayer does not answer the questions, the Service will not attempt to compel production of the information through a summons, at least not until an examination begins (assuming sending the questions and reviewing the answers does not constitute the start of an examination). The Service does not intend to conduct an audit of the taxpayer's return at this stage of the initiative. The Assistant Commissioner (International) and the Assistant Commissioner (Examination) want to know whether sending the questions and reviewing the answers constitutes the start of an examination so that they can ensure agents comply with the requirements of § 7605(b).

LAW AND ANALYSIS:

Section 7605(b) provides as follows:

> No taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.

Section 7605(b) imposes restrictions on two activities: (1) unnecessary examinations or investigations, and (2) more than one inspection of a taxpayer's books of account for a tax year. In construing the language of this section, courts have held that the prohibition against a second "inspection" must be read in pari materia with the opening clause of the section. As the Fifth Circuit Court of Appeals noted in United States v. Schwartz, 469 F.2d 977, 983 (1972), the first clause appears to be the original purpose for which the statute was enacted. See also United States v. Kendrick, 518 F.2d 842, 846 (7th Cir. 1975). In applying the restrictions of § 7605(b), courts have been reluctant to restrict legitimate investigations by the Service. Section 7605(b) first appeared as § 1309 of the Revenue Act of 1921, 42 Stat. 310. Congress designed the section in response to

taxpayer complaints that revenue agents were subjecting them to onerous and unnecessarily frequent examinations and investigations. See H.R. Rep. No. 67-350, at 16 (1921). The purpose of the section is to relieve taxpayers from unnecessary annoyance. 61 Cong. Rec. 5855 (Statement of Sen. Penrose)(1921). Section 7605(b) was not, however, designed to prevent an agent from "diligently exercising his statutory duty of collecting the revenues." Benjamin v. Commissioner, 66 T.C. 1084, 1098 (1976). Indeed, the Ninth Circuit Court of Appeals stated in DeMasters v. Arend, 313 F.2d 79, 87 (9th Cir. 1963), that the grants of power in § 7601 (power to canvass districts) and § 7602 (power to examine books, records, etc.) "are to be liberally construed in recognition of the vital public purposes which they serve; the exception stated in § 7605(b) is not to be read so broadly as to defeat them."

The Service treats the restrictions contained in § 7605(b) as applying to a case that has been closed but for which there are grounds to reopen. IRM section 4023, titled "Reopening of Closed Cases," restates the language of § 7605(b) and directs that when a reexamination of taxpayer's books and records is necessary, a notice signed by the appropriate official be delivered to the taxpayer. Although neither the Code nor the regulations define the terms "examination or investigation," Revenue Procedure 94-68, 1994-2 C.B. 803, which amplifies and updates Rev. Proc. 85-13, 1985-1 C.B. 514, contains a non-exclusive list of taxpayer contacts that are not considered examinations, inspections, or reopenings. For example, a contact with a taxpayer to correct math or clerical errors is not an examination, inspection, or reopening. A contact to verify a discrepancy disclosed by an information return matching program may include inspection of the taxpayer's books of account, to the extent necessary to resolve the discrepancy, without being considered an examination, inspection, or reopening within the meaning of § 7605(b). Additionally, a contact with an investor to verify the accuracy of, or the need for, a Tax Shelter Registration number is not an examination within the meaning of § 7605(b), provided the information sought is limited to obtaining the name and address of the promoter.

The Service has also provided a rule for determining when an exam has begun in the context of a request for a change in a method of accounting. Revenue Procedure 97-27, 1997-1 C.B. 680, provides rules for requesting a change in a method of accounting that are different if a taxpayer is under examination. Compare Section 5 (Procedures for Taxpayers Not Under Examination) with Section 6 (Procedures for Taxpayers Under Examination). Section 3.07 of the revenue procedure defines the beginning of an examination as follows:

> [A]n examination of a taxpayer with respect to a federal income tax return begins on the date the taxpayer is contacted in any manner by a representative of the Service for the purpose of scheduling any type of examination of the return.

The Tax Court and the Service have not interpreted the meaning of examination in Rev. Proc. 97-27. However, with respect Rev. Proc. 80-51, 1980-2 C.B. 818, an earlier version of Rev. Proc. 97-27, the Tax Court held that the Service did not abuse its discretion in concluding that a taxpayer had been contacted for the purpose of scheduling an exam, or when it handled a taxpayer's application for a change in accounting method in accordance with the procedures that apply when a taxpayer is under examination, where the taxpayer had (1) received a phone call from the Service in the taxpayer was informed that a letter requesting information regarding refunds sought by the taxpayer would soon be sent to the taxpayer, (2) been sent a letter from the Service stating that an examination of the taxpayer's returns was to be undertaken, and (3) acknowledged on its application that prior to filing the application the Service had contacted it for the purpose of scheduling an exam. Capitol Federal Savings & Loan Assoc. v. Commissioner, 96 T.C. 204, 221 (1991). Interpreting Rev. Proc. 84-74, 1984-2 C.B. 736, also an earlier version of Rev. Proc. 97-27, the Service concluded that a phone call notifying a taxpayer that its return had been selected for examination constitutes "contact for the purpose of scheduling an examination," and therefore the start of an examination of the taxpayer. Tech. Adv. Mem. 9316002 (Dec. 22, 1992).

In this case, the proposed questions seek information about a taxpayer's ownership interest in various types of entities. The questions, though they may be asked during an examination, do not–standing alone–appear to request any specific information with respect to the taxpayer's tax liability. Additionally, they do not explicitly address the opening of an examination. Therefore, we do not believe that sending these questions and reviewing the answers would constitute the opening of an examination or investigation. Additionally, we conclude that the information being requested does not constitute "books of account" under § 7605(b), so that subsequent to receiving the information, the Service could inspect the taxpayer's books and records without giving notice under § 7605(b).

If you have any further questions, please call Philip Tretiak at (202) 622-3860.

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