

Facebook Ignores IRS, But You Shouldn't

By Robert W. Wood

Facebook is huge, worth billions, and is *very* lawyered up. And like many other tech companies that have a mix of U.S. and offshore operations, it has 'tax strategies' that are at least aggressive. The Internal Revenue Service sure thinks so. Of course, Facebook is not the only company to seek offshore and cross-border deals with tax reduction at their center. There are other companies facing similar allegations.

But Facebook may have proven itself to be the boldest in how it responds — or does not respond — to the IRS. In this case, the IRS is looking into whether Facebook undervalued the assets it transferred to an Irish subsidiary in 2010. This is no small matter, and has become more feud than spat. Plainly, the stakes are huge.

In fact, Facebook has disclosed in its corporate filings that the potential liability at stake is something on the order of \$3 billion to \$5 billion, plus interest and penalties. Facebook is hardly giving in, but the sheer magnitude of the potential taxes is staggering. The IRS opened an investigation in 2013, but Facebook has not exactly been forthcoming.

And as you might expect with any government agency, failing to cooperate voluntarily can have consequences. Now, the Justice Department has filed a lawsuit in the Northern District of California to enforce the IRS summonses that were served on Facebook for various documents the IRS says it needs. See *U.S. v. Facebook Inc.*, 16-03777. On Wednesday, a California federal judge ordered Facebook to appear in court on Nov. 17 to explain why it has not complied with six IRS summonses.

To begin with, it is worth noting the bottom line: In the vast majority of cases, the government wins these disputes. The government usually gets the data, and it does not like to have to sue to collect it. In that sense, fighting over the data in the first place is usually not where companies want to spend their money. Eventually, the merits of the tax dispute must be addressed. The fight on the merits of the tax issue should generally be the real fight, not the documentary preliminaries.

On the merits, of course, many tax disputes — like many other types of disputes — end up getting compromised, as could happen here. But what is not common is to clam up and stop cooperating, which is what Facebook evidently thought was the right approach. The jury is still out whether that will prove to be wise.

There may be privilege issues, for example, that can make this kind of an approach more understandable. But for most people, and for most companies, failing to comply with an IRS summons is a mistake. Almost any IRS correspondence is stressful. But when a simple request for substantiation or documents looks like legal process, stress levels go higher still.

Ignoring IRS requests can be dangerous and expensive. Usually, the IRS asks for information in a memo called an Information Document Request, on IRS Form 4564. In the tax world, these common documents are known as "IDRs." You are under no legal obligation to respond, but you generally should, since otherwise your case with the IRS will escalate.

The first way an IRS probe usually escalates is from an IDR to a summons. An IDR is quite informal, a kind of list of items the IRS requests from you informally. Next comes a summons, which the IRS has the power to issue.

When the IRS issues a summons, you can comply, refuse, or ignore it. Alternatively, you can even go to court and attempt to quash it by showing you have legitimate legal reasons not to disclose the information. If you refuse or ignore it, the Justice Department can get

a court order to enforce it. If you still refuse, you could face sanctions for criminal or civil contempt.

A summons to hand over books, records or other data is more potent than an IDR, since it carries the threat of court enforcement. In fact, the mere fact that the IRS issues a summons rather than an IDR sends a stern message. A summons ups the ante, showing that the IRS is playing tough and is willing to go to court.

What grounds can you cite for not complying with an IRS summons? Common grounds are attorney-client privilege or work product protection, but the standards are high. The IRS uses its summons power frequently today, and court fights are becoming more common. But taxpayers generally lose these cases, which means the IRS generally gets the documents in the end.

There are some sobering statistics. According to the U.S. Taxpayer Advocate Service, there were only 44 such disputes in 2005. Then, by 2012, the number ballooned to 153. While the number of cases has decreased since 2012, summons enforcement continues to be a significant source of litigation.

The Taxpayer Advocate Service says that the IRS has won 96 percent of its summons cases during June 1, 2014, through May 31, 2015. With that many cases litigated, many more were probably resolved short of litigation. You should consider those odds when you decide whether and how to fight.

With a normal summons, the IRS seeks information about a specific taxpayer whose identity it knows. But is also worth noting that the IRS also has the power to issue a 'John Doe summons.' A John Doe summons allows the IRS to get the names of all taxpayers in a certain group. The IRS needs a judge to approve it, but recent IRS success that the IRS has had with offshore bank matters may lead to even more of these blanket IRS summonses in the future.

A John Doe summons is ideal for pursuing tax shelter investors, or account holders at a financial institution. The IRS can claim major successes on this front. The IRS was able to sniff out thousands of American taxpayers with Swiss accounts at UBS with a John Doe summons. Then, the IRS did the same with HSBC in India.

To return to Facebook, it has very deep pockets, and can play hardball well and for a long time. Facebook may well be playing this one just right, though the proof, as they say, will be in the pudding. But for most people, if the IRS is going to get the information anyway, which statistically speaking is what usually occurs, fighting over such issues can end up being unwise.



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