

Office of Chief Counsel
Internal Revenue Service
memorandum

CC:PA:CBS:B03: -----
POSTN-111815-04-----

Number: **200417032**
Release Date: 4/23/04

UILC: 7610.00-00

date: March 25, 2004

to: Randall B. Pooler
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from: Joseph W. Clark
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subject: **Fees and Costs for Witnesses**

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUES

May a third party witness recover compliance costs for a third party summons in excess of the reimbursement amounts provided for in I.R.C. § 7610 and Treas. Reg. § 301.7610-1 when the third party uses an independent storage facility to search, reproduce and transport the summoned records.

CONCLUSIONS

Treas. Reg. 301.7610-1 provides specific reimbursement rates for a third party's compliance costs that are necessary and directly related to compliance. Payments to an independent storage facility to comply with a summons are deemed directly incurred by the summoned party, and reimbursed as if the summoned party had retrieved the documents itself. The regulation permits the Service to reimburse a taxpayer at the following rates: \$8.50 and hour for search costs; \$.20 a copy for general reproduction costs; the actual amount for transportation costs; the actual amount for copying film or photographs, and; the actual cost for computer searches for electronically stored files (so long as the documents are normally produced in an electronic format). The Service should not reimburse the summoned party at a higher rate simply because the storage facility charged a higher rate for its research, reproduction and transportation costs.

FACTS

The Service served a summons on a bank pursuant to an investigation of an unrelated taxpayer. The Service initially limited the summoned production to monthly bank statements over a specified period. The bank complied with the request. After reviewing the statements, the agent conducting the investigation determined that the Service needed additional records and asked the bank for copies of specific items on the statements. The bank indicated that the requested documents were stored at an independent storage company.

The bank estimated that under its contract with the storage company it would have to pay a substantial sum to comply with the summons. Given the rates established in the Service's reimbursement schedule for third-party's summons compliance costs, the bank would absorb a large portion of these actual compliance costs. Accordingly, the bank requested assurances that the Service would reimburse it for the total amount that the storage facility billed the bank. The Service refused, stating that it would only reimburse the bank for the storage facility's research, reproduction and transportation costs at the same rates it would reimburse the bank had the bank retrieved the records itself. The bank insisted that it was entitled to full reimbursement for the amount the storage facility billed the bank, reasoning that the storage facility's production of records fell under the definition of "directly incurred costs" that the bank was entitled to recover. Unless the Service assures the bank it will pay the entire amount, the bank indicated that it would not release the records.

LAW AND ANALYSIS

I.R.C. § 7610(a) grants the Service regulatory authority to establish reimbursement rates for costs "reasonably necessary" and "directly incurred" by third party witnesses when complying with the Service's requests for information. Pursuant to that authority, the Service adopted Treas. Reg. § 301.7610-1. Subsection (a) of that regulation provides that the Service generally will not reimburse third parties for their actual compliance expenses. Rather, third parties are reimbursed at the designated rates.

Treas. Reg. § 301.7610-1(c) establishes rates for production pursuant to a summons. Subsection (c)(1) establishes the general rules that "payment will be made only for [those] costs that are both directly incurred and reasonably necessary." It is assumed that the storage facility's retrieval costs in your case are reasonably necessary. Treas. Reg. § 301.7610-1(b)(1) defines "directly incurred costs" as:

costs incurred solely, immediately, and necessarily as a consequence of searching for, reproducing, or transporting records in order to comply with a summons. They do not include a proportionate allocation of fixed costs, such as overhead, equipment depreciation, etc. However, where a third party's records are stored at an independent storage facility that charges the third party a search fee to search for, reproduce, or transport particular records requested, these fees are considered to be directly incurred by the summoned third party.

Since the storage facility's search costs are by definition directly incurred costs, as well as reasonably necessary, they are recoverable by the summoned party at the rates established by the regulation. Treas. Reg. § 301.7610-1(c)(2) establishes the following basic rates for retrieving documents: Search costs - \$8.50 per person hour; Reproduction costs - \$.20 per page for copies of documents; Transportation costs – actual cost.¹

Since Treas. Reg. 301.7610-1 only permits the Service to reimburse the bank for its compliance costs at the above rates regardless of whether the bank or the third party storage facility retrieves the documents, the bank must provide an itemized breakdown of the third party storage facility's search, reproduction and transportation costs before they are entitled to payment. Furthermore, the third party is only entitled to payment after the documents are produced. Treas. Reg. 301.7610-1(c). Production cannot be conditioned on an assurance of payment. *Id.* We recommend that you inform the bank that reimbursement cannot be made at a rate higher than that provided for in the regulation. If they fail to comply, we recommend immediate referral of the summons for enforcement.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

Although the Service is only required/permitted to reimburse the bank at the rates established in the regulation, we note that the Tenth Circuit upheld a lower court order requiring the Service to pay a summoned party at a rate higher than that stated in Treas. Reg. 301.7610-1. *U.S. v. Community Bank and Trust Co.*, 768 F.2d 311, 314 (10th Cir. 1985). The Tenth Circuit reasoned that I.R.C. § 7610 did not remove the court's jurisdiction to review IRS reimbursement rates. *Id.* The court based its ruling on lines of cases that hold that courts are allowed to scrutinize, modify, and even refuse to enforce administrative summonses, and to protect parties from burdens imposed by federal agencies. *Id.* (citing *United States v. Bisceglia*, 420 U.S. 141, 146, 95 S.Ct. 915, 919, 43 L.Ed.2d 88 (1975); *Securities and Exchange Commission v. Wheeling-Pittsburgh Steel Corp.*, 648 F.2d 118, 123 (3d Cir.1981); *United States v. Southwestern Bank and Trust Co.*, 693 F.2d 994, 996 (10th Cir.1982); and, *Securities and Exchange Commission v. Arthur Young*, 584 F.2d 1018, 1033 (D.C.Cir.1978), cert. denied, 439 U.S. 1071, 99 S.Ct. 841, 59 L.Ed.2d 37 (1979)).

We agree with the Tenth Circuit that a court could refuse to enforce a summons on an unrelated third party if production would be extremely burdensome. However, because Treas. Reg. 301.7610-1 is a legislative regulation, the Tenth Circuit was wrong to adjust those rates. As the Supreme Court recognized, Congress may either explicitly or implicitly delegate rule-making authority to an administrative agency. *Chevron, U.S.A. v. Natural Resources Defense Council*, 467 U.S. 837, 843 (1984)("If Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to

¹ Treas. Reg. 301.7610-1(c)(2) provides limited situations where different amounts may be recovered for each category of expense. For example, actual costs for computer time and necessary supplies may be recovered for computer searches if the information stored on the computer is normally produced in an electronic format.

the agency to elucidate a specific provision of the statute by regulation." Id. at 843-44). Legislative regulations are given "controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute." Id. Since the rates established by the Service were neither arbitrary, capricious, nor manifestly contrary to the statute, the Tenth Circuit should have upheld them.



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