[As IRS Ditches Contractor Experiment, Pitfalls May Persist, 2020 Law360 232-59](#)

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Summary

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Regulations proposed by the Internal Revenue Service mark an attempt to leave behind a controversial chapter of its recent history in which an outside law firm was hired to assist with an examination of Microsoft. (AP)The Internal Revenue Service proposed regulations on a provision of the 2019 Taxpayer First Act (116 P.L. 25) that bars agency contractors from asking substantive questions of a witness in summons interviews. The rules would also clarify the types of contractors who are allowed access to taxpayers' sensitive information — books and records, for instance — under the privacy protections laid out in Internal Revenue Code Section 6103 (26 USC 6103). Violating those proscriptions could potentially expose IRS attorneys to civil or criminal repercussions.

While individuals and businesses involved in IRS summons interviews would have no reason to expect an interrogation from a private law firm under the proposed rules, it's still their prerogative to ensure that agency employees respect their privacy rights and retain control over legal strategy.

"If, as a government attorney, you're disclosing taxpayer information to a contractor, there are civil and criminal statutes out there that say you can't do so unless you've followed all the proper procedures, unless you've dotted your i's and crossed your t's," Stu Bassin, principal at the Bassin Law Firm PLLC, told Law360.

The proposed regulations mark an attempt to leave behind a controversial chapter of the IRS' recent history in which the agency hired an outside law firm, Quinn Emanuel Urquhart & Sullivan LLP, to assist in pursuing a transfer price-oriented examination of Microsoft Corp.

The genesis for soliciting the assistance of Quinn Emanuel was likely the IRS' spotty record of prevailing in transfer price cases, Rob Kovacev, attorney at Norton Rose Fulbright, told Law360.

Because of its mixed track record, the IRS likely sought to hire outside counsel "to go toe-to-toe with big law firms that are representing taxpayers," he said.

The backlash from practitioners and lawmakers in Congress was swift, resulting in the language included in the Taxpayer First Act that would prevent the agency from essentially outsourcing legal strategy to private law firms.

Calling in Quinn Emanuel "was an ill-advised idea," Bassin said.

Not only was the IRS forced to hire a firm without a tax department, so as to avoid conflicts of interest endemic to other large law practices, but the agency also didn't have the requisite budget to hire the private law firm to do the job effectively, Bassin said.

"Once they brought in the guys who conceivably could have run the litigation, who had the skills to do so, they only used them for a little bit here and there," he said, adding that the Microsoft case alone would have cost upward of $10 million.

The IRS simply did not and does not have the budget to approach cases that way, Bassin said.

So it was in that context that the IRS released proposed regulations this month that would prohibit contractors from questioning witnesses under oath or their counsel in noncompliance investigations.

The rules would specify, however, that it would be appropriate for the IRS to hire outside specialists to assist with determining the correctness of a self-assessed tax liability. The agency may seek the assistance of "economists, engineers, appraisers, individuals with specialized knowledge who are also attorneys, industry specialists and actuaries," according to the proposed rules.

The IRS may also hire nongovernmental attorneys under a few conditions under the proposed rules. An outside attorney can be hired if he or she specializes in foreign, state or local law or in another nontax subject relevant to an examination, or if the attorney is hired for knowledge or skill in a nonlegal area, the rules say.

But while the proscriptions outlined in the proposed regulations are generally clear insofar as they would prevent the IRS' Office of Chief Counsel from undertaking another Quinn Emanuel-like initiative, there are still gray areas in the guidance that practitioners should be wary of in order to protect their clients' interests.

For example, the IRS has made no secret that it is aggressively pursuing cryptocurrency cases, Carina Federico, an associate at Crowell & Moring LLP's tax group, told Law360. It might, however, be challenging for the IRS to hire an outside contractor who's an expert in cryptocurrency while abiding by the distinctions outlined in the proposed

regulations, she said.

That's because the proposed regulations make clear that the IRS may only hire nongovernmental attorneys for their expertise in areas unrelated to legal practice. But adhering to that proviso may be challenging in a nascent and burgeoning field such as cryptocurrency where limited numbers of professionals are available to provide consultations to the agency, Federico said. It's possible that if the IRS hired someone with expertise in the cryptocurrency field, he or she may also be an attorney, or even a tax attorney.

Is the IRS "actually hiring just straight crypto people, if that exists as a specialty, or are these people also tax professionals?" she said.

In such a scenario, practitioners should be vigilant to ensure that the third-party contractor is merely providing subject matter expertise and is not engaged with the agency's legal strategy, she said.

"I think it can be difficult to say that 'I'm wearing my technical cryptocurrency hat now and I'm not going to be a tax lawyer when I'm helping them prepare something or review files,'" she said.

In instances where practitioners doubt the agency's division of labor, as prescribed in the proposed guidance, they can challenge the summons on procedural grounds, Kovacev said.

Another potential area of concern for practitioners involves the intersection of Sections 6103 and 7602 (26 USC 7602).

That's because the proposed regulations would prevent, per Section 7602(f), IRS attorneys from sharing books, records or other information with contractors unless they were hired "for the sole purpose of providing expert evaluation and assistance to the Internal Revenue Service."

If IRS attorneys disregarded that restriction and shared information with unauthorized contractors, they'd be violating Section 6103, namely because the allowances provided under Section 6103(n) don't apply in this case.

If practitioners learn of IRS attorneys improperly sharing information with unauthorized contractors, that could be a game changer for the dynamics of any given case, Bassin said.

That's because sovereign immunity wouldn't necessarily prevail if IRS attorneys run afoul of the privacy protections under Section 6103, meaning individual attorneys could face both civil and criminal penalties. Practitioners therefore have every interest in ensuring that IRS attorneys have conducted their due diligence before sharing private information with third-party contractors, Bassin said.

"When I would be engaged in litigation, as a government attorney, I'd be real careful in that area because no government employee wants to be rightfully accused of illegality," he said.

"A taxpayer can file a damage suit for violation of 6103," Bassin said. "And that would generate way too much publicity for anyone's comfort level."

--Editing by Tim Ruel and Robert Rudinger.

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