

TEXAS COURT OF APPEALS, THIRD DISTRICT, AT AUSTIN

NO. 03-17-00286-CV

In re Heath Howeth

ORIGINAL PROCEEDING FROM HAYS COUNTY

MEMORANDUM OPINION

Relator Heath Howeth filed a petition for writ of mandamus asking this Court to direct the trial court to vacate its order granting a motion to compel and directing Howeth to produce his tax returns and supporting material. *See* Tex. Gov't Code § 22.221; *see also* Tex. R. App. P. 52.1. We will conditionally grant the writ in part.

BACKGROUND

This original proceeding arises from a dispute over an alleged partnership related to the development of a piece of commercial real property (the "Property") and an alleged oral loan. The underlying suit was filed by the real parties in interest, Knight's Crossing LLC and Paul Albini, seeking a declaratory judgment that Howeth has no interest in the Property and that Knight's Crossing is the owner of the Property in fee simple. Howeth counterclaimed for a partnership accounting, for breaches of the duties of loyalty and care, for breach of fiduciary duty, for

common-law fraud and fraud in the inducement, and for the winding up of the partnership. He also asserted a claim against Albini for usury based on a loan made by Albini to Howeth (the “50K Note”).

After Howeth served his objections and responses to Knight’s Crossing and Albini’s requests for production, Knight’s Crossing and Albini filed a motion to compel the following categories of documents: (1) Howeth’s federal tax returns and schedules for tax years 2009–2016;¹ (2) “all materials and correspondence delivered to/from Mr. Howeth’s accountant (the ‘Accountant Documents’) relating to the preparation of the Returns to the extent they relate, refer to or evidence the items/properties/categories set forth in [request for production] 4”;² and (3) property-tax bills, canceled checks for those taxes, and tax receipts for tax payments made by Howeth on the Property and the Crossroads Parcel that was conveyed to a lender entity owned or controlled by Albini on the 50K Note.

After a hearing, the trial court found that certain documents sought by Knight’s Crossing and Albini “are responsive to [their] Requests for Production, are relevant to the issues in dispute in this lawsuit, are material and discoverable, and the information contained therein is not

¹ The request for production sought tax returns for the “tax years 2011–2015,” but the real parties in interest moved to compel production on tax years 2009–2016.

² The categories listed in request for production 4 are the Property; the 50K Note; the 50K Deed in Lieu; the 50K Deed of Trust; the Crossroads Parcel (another property owned by Howeth); “the partnership you allege in this Litigation to have with Paul Albini”; the Cattleman’s Note; the Cattleman’s Deed of Trust; the Cattleman’s Deed in Lieu; a listing of any improvements constructed on the Property (regardless of who constructed them); any appraisal, broker opinion of value, or other estimate of value of the Property; and “any claim or lien or other allegation of unpaid tax liability alleged by the IRS against you or any entity owned or controlled by you from 2009 through 2016.”

available from other sources.” The court further found that “the pursuit of justice outweighs the privacy interests in the Documents, except that the Court is issuing a protective order . . . to further safeguard such privacy interests.”

Accordingly, the trial court ordered Howeth to produce: (1) his complete tax returns and all schedules for the tax years 2011 through the present; and (2) “all documents, correspondence, notes, worksheets, receipts, checks, and other items delivered to Mr. Howeth’s accountant, exchanged between the Howeths and their accountant or contained in the Howeth accountant’s file pertaining to the Relevant Tax Years” (the “accountant documents”). Although Knight’s Crossing and Albin had agreed that information unrelated to the issues in the lawsuit (e.g., Social Security numbers, dependent information, information related to charitable or other personal deductions or income derived solely from Mrs. Howeth, etc.) should be redacted from Howeth’s tax returns and the accounting documents, the trial court denied Howeth’s request to redact irrelevant information from the documents. Instead, the trial court granted a protective order that ordered all parties and their counsel to refrain from disclosing any of the documents “to any third parties other than the parties’ representatives, the attorneys and firm personnel working on this lawsuit, any court reporters or videographers in any depositions, any persons properly in attendance at any depositions, any experts retained in this case, and the Court’s own personnel as may be necessary.” The trial court also ordered the parties not to file of record any of the documents without leave of court or Howeth’s agreement to ensure that they do not inadvertently become public record. This mandamus proceeding followed.

STANDARD OF REVIEW

Mandamus is an extraordinary remedy granted only when the relator shows that the trial court abused its discretion and that no adequate appellate remedy exists. *In re Prudential Ins. Co. of Am.*, 148 S.W.3d 124, 135-36 (Tex. 2004) (orig. proceeding). The relator bears the burden of proving these two requirements. *See Walker v. Packer*, 827 S.W.2d 833, 840 (Tex. 1992) (orig. proceeding). “A trial court abuses its discretion when it acts in an unreasonable or arbitrary manner or, stated differently, when it acts without reference to guiding rules and principles.” *In re Colonial Pipeline Co.*, 968 S.W.2d 938, 941 (Tex. 1998) (orig. proceeding) (per curiam). While we may not substitute our judgment for that of the trial court with respect to factual issues or matters committed to the trial court’s discretion, “a clear failure by the trial court to analyze or apply the law correctly will constitute an abuse of discretion.” *Walker*, 827 S.W.2d at 839-40. The scope of discovery is largely within the trial court’s discretion. *In re Colonial Pipeline*, 968 S.W.2d at 941. However, a trial court’s order that requires production of documents beyond what the procedural rules permit is an abuse of discretion. *In re Dana Corp.*, 138 S.W.3d 298, 301 (Tex. 2004) (per curiam) (orig. proceeding).

A party will not have an adequate remedy by appeal when the appellate court would not be able to cure the trial court’s discovery error. *Walker*, 827 S.W.2d at 843. For example, when privileged information would be revealed, appeal is not an adequate remedy; likewise, an appeal may not be an adequate remedy when “a discovery order compels the production of patently irrelevant or duplicative documents, such that it clearly constitutes harassment or imposes a burden on the producing party far out of proportion to any benefit that may obtain to the requesting party.” *Id.*; *see*

also *In re House of Yahweh*, 266 S.W.3d 668, 673 (Tex. App.—Eastland 2008, orig. proceeding) (applying standard to production of tax returns). Consequently, we will consider whether the trial court abused its discretion when it compelled (1) the production of the tax returns and accountant documents and (2) their production without redaction.

ANALYSIS

In this mandamus proceeding, Howeth asserts in two issues that the trial court abused its discretion by compelling production of his tax returns and the accountant documents and by compelling production of those documents without requiring redaction of irrelevant information. Howeth argues that the trial court did not require Knight’s Crossing and Albini to make the required showing that the information was relevant, material, and could not be obtained from other sources. In response, Knight’s Crossing and Albini contend that the tax returns and the accountant documents are material and relevant to the central issue in the case: Howeth’s claims related to the existence of the alleged partnership.

As an initial matter, we note that different burdens apply to the production of the tax returns and the accountant documents. The party seeking discovery of tax returns has the burden of showing their materiality and relevance. *In re Sullivan*, 214 S.W.3d 622, 624 (Tex. App.—Austin 2006, orig. proceeding). On the other hand, “[t]he general rule in financial records production cases is that the burden on the discovery of financial records lies with the party seeking to prevent production.” *In re Patel*, 218 S.W.3d 911, 916 (Tex. App.—Corpus Christi 2007, orig. proceeding) (citing *Peeples v. Honorable Fourth Supreme Judicial Dist.*, 701 S.W.2d 635, 637 (Tex. 1985) (orig.

proceeding)). The parties make essentially the same arguments regarding relevance for both categories of documents, however, so we will consider the relevance of the two categories together.

The general rule is that “a party may obtain discovery regarding any matter that is not privileged and is relevant to the subject matter of the pending action,” whether it relates to its own or another party’s claim or defense, as long as “the information sought appears reasonably calculated to lead to the discovery of admissible evidence.” Tex. R. Civ. P. 192.3(a). Knight’s Crossing and Albini argue that both the tax returns and the accountant documents are material and relevant to the central issue in the case—the existence of the alleged partnership. They assert that the documents contain “contemporaneous and post-hoc representations (both express statements and admissions by omission) by Howeth to the federal government of the United States” related to a long list of relevant topics, including the following:

- the ownership of the Property;
- ownership of the alleged partnership interests;
- the change in ownership of the Property;
- Howeth’s explanation of the cessation of the rental income from the Property (and removal of the Property from the worksheets and schedules relating to the income-producing Property);
- the related expenses and tax deductions for taxes, insurance, etc. and explanation to the accountant for why those expenses are no longer being deducted;
- any capital gains or losses attributable to the Property; and
- the total loss of the property via the Deed in Lieu or the alleged conversion of the equity value claimed by Howeth from the income-producing real property to his alleged basis in the alleged partnership.

Howeth contends that Knight's Crossing and Albini "are on an impermissible fishing expedition." Based on this particular record, we disagree. These topics are relevant to the issues in the lawsuit, and Knight's Crossing and Albini are correct that their treatment—whether by admission or by omission—in the tax returns and accountant documents appears to be information that is reasonably calculated to lead to the discovery of admissible evidence. Howeth has not shown that the accountant documents are not discoverable. The remaining question related to Howeth's first issue is whether Knight's Crossing and Albini have shown that the tax returns are material and thus discoverable.

"Federal income tax returns are not material if the same information can be obtained from another source." *In re Sullivan*, 214 S.W.3d at 624-25. The requesting party must show that it cannot obtain whatever relevant information is contained in the tax returns from another source, such as interrogatories and depositions. *Id.* at 625. Howeth submitted a declaration to the trial court with his response to the motion to compel (the "tax declaration"). He has also already produced certain documents, including a Quickbooks sub-report reflecting what he alleges is a partial partnership distribution and ad valorem tax payments on the Property and the Crossroads property (another property that Howeth asserts that he owns). Howeth contends that his declaration, along with these documents, fully explains how information related to the relevant topics identified by Knight's Crossing and Albini was treated on his tax returns; thus, he asserts, Knight's Crossing and Albini have not carried their burden.

In his declaration, Howeth asserts that he was unsophisticated in tax matters and was unaware he could have depreciated the building on the Property, so he never thought it was necessary to tell his accountant about his purchase of the Property and he never depreciated the pre-existing building on the Property. He further attests that he collected rents from the Property from 2005 until February 2011 and reported those rents in Quickbooks as income. He keeps track of all his income and expenses in Quickbooks; assembles documents concerning his income and expenses from Quickbooks, Forms 1098 and 1099; and brings them to his accountant, who prepares his tax return. His accountant incorporates his income and expenses into a Schedule C-Profit or Loss from Business, and therefore the Property rents from 2005 until February 2011 (on the Property that he asserts he never told the accountant he purchased) would have been reflected on that schedule as Income-Gross Receipts or Sales, along with his other business income.

The trial court considered Howeth's declaration (as well as the court's entire file, including multiple declarations of Howeth and Albini and all attachments) and found that the information in the tax returns and accountant documents is not available from other sources. Knight's Crossing and Albini explained how Howeth's contemporaneous representations about any income, expense, or deductions related to the partnership or the Property are material to his claim of the alleged oral partnership agreement. Those material contemporaneous representations to his accountant and the federal government are themselves the relevant documents. On this record, we cannot conclude that the trial court abused its discretion by ordering Howeth to produce the tax returns and accountant documents. *See In re ClearVision Techs.*, No. 07-16-00210-CV, 2016 WL 3452760, at *2 (Tex. App.—Amarillo June 21, 2016, orig. proceeding) (mem. op.) (per

curiam) (holding no abuse of discretion when party seeking discovery demonstrated its unsuccessful efforts to obtain information from party resisting discovery of tax returns).

We next consider Howeth’s second issue—whether the trial court abused its discretion by compelling production of the documents without redaction of irrelevant information. The Texas Supreme Court has mandated that trial courts must discriminate when ordering discovery “between information disclosed by income tax returns which is relevant and material to the matters in controversy and information which is not,” further stating:

The protection of privacy is of fundamental—indeed, of constitutional—importance. Subjecting federal income tax returns of our citizens to discovery is sustainable only because the pursuit of justice between litigants outweighs protection of their privacy. But sacrifice of the latter should be kept to the minimum, and this requires scrupulous limitation of discovery to information furthering justice between the parties which, in turn, can only be information of relevancy and materiality to the matters in controversy.

Maresca v. Marks, 362 S.W.2d 299, 301 (Tex. 1962). An appellate court should “afford extraordinary relief when no discretion has been exercised, i.e., when the order of the trial judge does not separate for protection against discovery those portions of income tax returns plainly irrelevant and immaterial to the matters in controversy.” *Id.* Although we recognize that the trial court attempted to safeguard Howeth’s privacy with its protective order, that order does not go far enough to balance the privacy concerns underlying the protection of tax returns with the pursuit of discoverable information. In this case, redaction of the tax returns and accountant documents is necessary to limit disclosure solely to the discoverable information outlined in the order. *See, e.g., id.; In re Sullivan*, 214 S.W.3d at 625. Accordingly, we conclude that the trial court abused its

discretion by refusing to allow Howeth to redact wholly irrelevant information from the tax returns and accountant documents.

CONCLUSION

We conditionally grant the petition for writ of mandamus to the extent that it requests that we direct the trial court to allow Howeth to redact irrelevant information from the tax returns and accountant documents and to accordingly amend its April 24, 2017 order granting the motion to compel. The mandamus is otherwise denied. *See* Tex. R. App. P. 52.8. The writ will issue only if the court does not comply with this opinion. We also lift the temporary stay of the April 24, 2017 order granting the motion to compel.

Cindy Olson Bourland, Justice

Before Chief Justice Rose, Justices Field and Bourland

Filed: June 22, 2017