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I. INTRODUCTION

Today, there seems to be a lingering impression that tax-evasion is a type of technical crime for bringing to justice those gangsters and racketeers who might otherwise evade all punishment for their acts. However, a broad spectrum of high-profile individuals have been convicted for tax crimes: Al Capone and Mickey Cohen, former gangsters; Robert B. Anderson, former Secretary of the Treasury; Joseph D. Nunan, Jr., former Commissioner of Internal Revenue; Dave Beck, former president of the Teamsters Union; Chuck Berry, rock and roll star; Albert Nippon, fashion designer; Mario Biaggi, former congressman and, as of 1989, the most decorated New York City policeman; Spiro Agnew, former Vice-President of the United States; Dana Kirk, former basketball coach at Memphis State University; Robert Huttenbach, Chancellor at the University of California at Santa Barbara; Victor Posner, millionaire industrialist; Harry Reems, co-star of the porn classic "Deep Throat;" Leona Helmsley, the "Queen" of the Helmsley Hotel chain; Moses Annenberg, the founder of *TV Guide*; and Pete Rose, former baseball player and manager.

By the same token, it should be noted that equally great attention is afforded enforcement against the everyday citizen who is otherwise law abiding and is frequently a prominent member of his community. For example, in the same annual report which contained boasting about the organized crime efforts in Newark, New Jersey, and other areas, one also finds listed among the Internal Revenue Service's ("Service") prosecution victories a physician, an optometrist, two lawyers, a real estate promoter, a philosophy professor and a multimillionaire clothing manufacturer who were sentenced to prison for their various evasions of tax.[1] Its well-publicized efforts in this area are recurrently set out (e.g., from the 1970s to the 1990s) with some degree of pride in the annual reports of the Commissioner of Internal Revenue

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1. 1971 ANNUAL REPORT OF THE COMM'R OF INTERNAL REVENUE 36; 1978-1988 ANNUAL REPORT OF THE COMM'R OF INTERNAL REVENUE.

("Commissioner").[2] The Service likewise appears to be extending its criminal enforcement activities into areas of legitimate business not previously subject to such exacting scrutiny. In 1982 the Commissioner announced that the Service had discovered widespread tax fraud among large business corporations and would make such taxpayers the object of special enforcement efforts.[3]

Criminal tax enforcement includes a process which has long been characterized by prosecutions of highly visible individuals who have violated only the tax laws, as well as prosecutions for tax crimes of persons also engaged in nontax criminal activity. Indeed, the violation of criminal tax statutes has long been a natural and frequently inevitable handmaiden of the commission of many nontax crimes.

Recent statutory changes in federal criminal law, however, have multiplied the potential federal criminal violations that may now accompany what historically would have been solely state crimes. The most important of these are the Racketeer Influenced and Corrupt Organizations statute (RICO),[4] the Continuing Criminal Enterprise provisions,[5] the Bank Secrecy Act,[6] the money laundering prohibitions,[7] the Comprehensive Forfeiture Act,[8] and other federal drug offense legislation.

The financial investigation skills of the Service's special agents can and do serve an important function in detecting and successfully prosecuting nontax federal financial crimes, most notably violations of the Bank Secrecy Act and money laundering statutes. Thus, it is no surprise that recent years have witnessed a significant shift of the Service's law enforcement resources in the direction of developing cases against narcotics dealers and other criminals. What is surprising, however, is that this predominantly nontax law enforcement effort may be of sufficient magnitude to raise questions concerning the continuing ability of the Service at current budget levels to use criminal enforcement adequately to fulfill its primary mission of assuring maximum compliance with federal tax laws. Although the share of the Service's budget devoted to criminal enforcement has remained relatively

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2. Richard M. Roberts & Richard F. Riley, Jr., A-1, *Criminal Tax Procedure*, 162 T.M. (1987).

3. *Id.*

4. 18 U.S.C. §§ 1961-1968 (1988).

5. 21 U.S.C. § 848 (1988).

6. 12 U.S.C. §§ 1829(b), 1951-1959 (1988).

7. 12 U.S.C. §§ 1464, 1786, 1817, 1818, 3403, 3413 (1988); 18 U.S.C. §§ 981, 982, 1952, 1956, 1957, 1961, 2516 (1988); 31 U.S.C. §§ 5312, 5316-5318, 5321, 5322 (1988).

8. 18 U.S.C. § 1963 (1988); 19 U.S.C. §§ 1589, 1600, 1602, 1605-1612, 1644 (1988); 21 U.S.C. §§ 824, 848, 853, 854, 881, 970 (1988); 28 U.S.C. § 524 (1988).

constant throughout the past decade, at about 5 3/4% of the total budget,[9] the increasing role of the Service in enforcing nontax federal crimes, perhaps in combination with the declining audit rate, has changed the sources of the Service's criminal prosecutions. Far fewer cases now originate with examination. For example, audits, which—withholding aside—historically have been the Service's principal tax enforcement weapon, have declined significantly over the past two decades. The total audit coverage of individuals has shown a steady decline during the past decade from an audit rate of about 2% in 1978 to 1% in 1988.[10] If one goes back further in time, the decline is even more precipitous; audit coverage exceeded 6% in 1965.

The selection of cases for criminal investigation that more frequently lead to prosecution and conviction cannot be attributed solely to the Service's criminal investigation division. Although the entire Service's criminal enforcement program has as its goal improving voluntary compliance with the tax laws,[11] many convictions result from the Service's participation in law enforcement efforts directed principally at nontax criminal activity, most significantly involving drugs, money laundering or organized crime. The Service historically has classified cases as falling into either the General Enforcement Program ("GEP"), the category of cases in which violations of the criminal tax statutes are principally at issue, or the Special Enforcement Program ("SEP"), which includes cases in which a nontax crime is typically coupled with a tax crime.[12]

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9. Budget data can be found in 1970-1988 ANNUAL REPORT OF THE COMM'R OF INTERNAL REVENUE.

10. Data on audit rates can be found in 1978-1988 ANNUAL REPORT OF THE COMM'R OF INTERNAL REVENUE.

11. I.R.M. § 915 (1987).

12. I.R.M. § 9153 (1987) states:

> [The Special Enforcement Program] encompasses the identification and investigation of that segment of the public who derive substantial income from illegal activities and violate the tax laws or other related statutes in contravention of the Internal Revenue laws. The very nature of their operations requires national coordination of enforcement efforts, close cooperation and liaison with the Department of Justice and other Federal, State and local law enforcement agencies (see IRM 9400).

Id.

I.R.M. § 9152 (1987) states:

> [The General Enforcement Program] encompasses all criminal enforcement activities of the Criminal Investigation Division except those included in the special enforcement program discussed in IRM 9153. The identification and investigation of income tax evasion cases of substance with prosecution potential is a primary objective. The program also provides for balanced coverage as to types of violations, as well as geographic locations and

As a practical matter the Service may be more likely to press a case involving a locally prominent taxpayer than a relatively obscure person. The basic reason for this is that the maximum deterrent, in the view of the Service, comes from prosecution of the otherwise reputable taxpayer.[13] Similarly, in the case of celebrities or nationally prominent persons, indictment will be sought for their national publicity and deterrent value although the process of internal review is apparently more stringent in such instances. Exemplary of the philosophy of the Service is the following statement:

> The criminal prosecution of tax fraud cases is required as a deterrent to tax evasion. Relatively few cases are prosecuted—around 700 or 800 a year out of 75 or 80 million corporate and individual taxpayers. The Service's objective is to get maximum deterrent value from the few cases prosecuted.[14]

Thus, a criminal tax fraud is a viable and realistic problem faced by a wide variety of taxpayers.

And, although one often finds widespread resentment against "high taxes" and concomitant resort by taxpayers to any means or devices short of clear illegality in the desperate effort to reduce the "tax bite," there is little indication that the strong enforcement procedures for tax evasion lack "public support." Apparently, as one author notes, "[this] is but another vivid demonstration of the American penchant for following double standards' of morality . . . ."[15]

Because the statutory definition of criminal tax evasion is extremely broad, the decision as to who should or should not be prosecuted on this charge has been mainly an administrative one. Since 1939, there have been no significant legislative changes in the tax evasion field, but there have been many significant developments which stem from administrative attitudes and court decisions. In light of this, the objective of this article is to examine the major developments and problems which have been raised since the 1950's.

> economic and vocational status of violators as considered necessary to stimulate voluntary compliance.

Id.

13. I.R.M. § 9161.1 (1987). As an overriding goal, the service aims to investigate and prosecute high-profile taxpayers in order to "create maximum positive impact on the compliance attitudes and practices of taxpayers" in general. In addition, "[t]he Service will endeavor to obtain news coverage of its enforcement activities in order to help deter violations of the internal revenue laws, and increase the confidence of conscientious taxpayers that the Service prosecutes violators." *Id.* § 9161.6.

14. 1971 ANNUAL REPORT, *supra* note 1, at 29.

15. Harry G. Balter, *A Ten Year Review of Fraud Prosecution*, 19 INST. ON FED. TAX'N 1125, 1126 (1961).

The research methodology utilized to achieve this objective consists primarily of an analysis of court decisions rendered during the years under review, but is supplemented by a review of the current literature. The findings generated from these techniques are presented in three parts. First, background material is provided via a general overview of the legislative provisions in Section II of this Article and the administrative process in Section III. Finally, in Section IV, some of the key developments and recurrent problems, as evidenced in the court cases analyzed, are scrutinized with the hope of delineating significant trends surrounding the criminal tax fraud area.

II. STATUTORY FRAMEWORK

As previously noted, the statutory definition of criminal tax fraud is extremely broad. Basically, the statutory provisions to which a taxpayer may be subjected in a criminal fraud investigation are found in the criminal sections of the Internal Revenue Code ("Code"), principally Title 26 of the United States Code, sections 7201-7207,[16] and in the general criminal provisions of Title 18 of the United States Code.[17]

A. Code Provisions Unchanged

Although there was in evidence some pointed criticism directed at both the legislative and administrative policies which had combined to subject the tax evader to criminal felony charges in the early 1950's, the 1951-52 tax scandals realistically ended prospects for any substantial change.[18] When the Code was revised in 1954, no opposition was generated to the criminal sections for tax evasion in the 1939 Code.[19]

B. 26 U.S.C. Section 7201[20]

The bulk of cases litigated involve suspected violations of section 7201. It provides that

> [a]ny person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction

16. I.R.C. §§ 7201-7207 (1988 & Supp. I 1989).

17. 18 U.S.C.A. §§ 1-6005 (West 1988 & Supp. 1990).

18. Myron S. Winer, *An Appraisal of Criminal and Civil Penalties in Federal Tax Evasion Cases*, 33 B.U. L. REV. 387 (1953).

19. Balter, *supra* note 15, at 1125.

20. I.R.C. § 7201 (1988).

> thereof, shall be fined not more than $10,000 ($500,000 in the case of a corporation), or imprisoned not more than 5 years, or both, together with costs of prosecution.[21]

Thus, the basic elements required for conviction under section 7201 are as follows:

1. a tax due and owing for the year involved;
2. affirmative acts of wrongdoing; and
3. willfulness.[22]

Although the Supreme Court has acknowledged the breadth of the statute, it has refused to impose judicial limitations in deference to the Court's belief that Congress intended the evasion statute to remain unrestricted. In *Spies v. United States*,[23] a landmark case, the Court stated that

> Congress did not define or limit the methods by which a willful attempt to defeat and evade might be accomplished and perhaps did not define lest its efforts to do so result in some unexpected limitation. Nor would we by definition constrict the scope of the Congressional provision that it may be accomplished "in any manner."[24]

Commentators have suggested that the purpose of the uncertainty of the statute was to deter taxpayers from treading too closely to the line of legality in their tax planning efforts.[25] Other writers have pointed out that vagueness can be a double-edged weapon which allows marginal acts of evasion to escape prosecution.[26] In any event, the fact remains that section 7201 is drawn in broad general terms; hence, its basic requirements have been the subject of considerable refinement in the case law.

In *Spies*, the Supreme Court distinguished the felony of tax evasion from the tax misdemeanors by focusing on the word "attempt." The Court concluded that "in employing the terminology of attempt to embrace the gravest of offenses against the revenues Congress intended some willful commission in addition to the willful omissions that make up the list of misdemeanors."[27] Thus, a willful failure to file a return, a misdemeanor under section 7203 of the Code[28] is not sufficient for section 7201[29] evasion unless accompanied by some affirmative conduct evidencing an attempt to

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21. *Id.*

22. United States v. Coppola, 425 F.2d 660, 661 (2d Cir. 1969); Elewert v. United States, 231 F.2d 928, 932-33 (9th Cir. 1956).

23. 317 U.S. 492 (1943).

24. *Id.* at 492-93.

25. Howard A. Heffron, *Limitations in Fraud Cases*, 19 N.Y.U. INST. ON FED. TAX'N 1195, 1201 (1961).

26. BORIS KOSTEANETZ & LOUIS BENDER, CRIMINAL ASPECTS OF TAX FRAUD CASES 10 (2d ed. 1967); Roberts & Riley, *supra* note 2, at A-5.

27. *Spies*, 317 U.S. at 499.

28. I.R.C. § 7203 (1988).

29. *Id.* § 7201.

evade. However, a taxpayer who files false W-4 withholding certificates claiming exempt status (thereby causing his employer to withhold no federal taxes), and who fails to file a return, can be convicted of felony evasion. The affirmative and willful act of filing the false withholding certificates satisfies the *Spies* requirement.[30] The Supreme Court has held that the filing of a false tax return is a sufficient affirmative act to support a conviction under section 7201.[31]

The *Spies* Court provided a list of "badges of fraud" that would support an inference of the required willful attempt to evade tax. The list includes keeping a double set of books, destruction of books or records, concealment of assets or covering up sources of income, and "any conduct, the likely effect of which would be to mislead or to conceal."[32] The *Internal Revenue Manual* contains a lengthy listing of conduct considered by the Service to be a "badge of fraud."[33] Additional examples of the type of conduct that will satisfy the affirmative act element include lying to Service agents, consistently overstating deductions, holding property in nominee names, diverting corporate funds to pay an officer's personal expenses, and concealing bank accounts.[34] A taxpayer whose conduct amounts to one or more "badges of fraud" will not only have satisfied the affirmative-act-to-evade element of evasion, but will also have minimized her chances of defeating the element of willfulness, since the "badges" are circumstantial evidence supporting willfulness.[35]

Unless there is a deficiency in tax, a conviction under section 7201 cannot be sustained.[36] The elements of section 7201 that the government must prove beyond a reasonable doubt are: (1) the existence of a tax deficiency; (2) an affirmative act of evasion or attempted evasion of tax; and willfulness.[37] The Service need not prove the exact amount of the deficiency.[38] However, some courts have indicated that the deficiency must be "substantial," but this element is not based on either the statute or the principal Supreme Court decisions construing it.[39] The "substantiality" of a deficiency, according to one court, "is not measured in terms of gross or net income nor by an particular percentage of the tax shown to be due and payable. All the

30. *See, e.g.*, United States v. House, 617 F. Supp. 240 (W.D. Mich. 1985).

31. Sansone v. United States, 380 U.S. 343, 351-52 (1965).

32. *Spies*, 317 U.S. at 499.

33. I.R.M. § [4231] 940 (1987).

34. *Id.*

35. I.R.M. § [7231] 940 (1987); *see, e.g.*, United States v. Beacon Brass Co., 344 U.S. 43, 45-46 (1952) (false statements to Treasury agents can constitute the willful act); United States v. Thetford, 676 F.2d 170, 175 (5th Cir. 1982), *cert. denied*, 459 U.S. 1148 (1983) (unreported diversion of corporate monies can be the willful act).

36. Sansone v. United States, 380 U.S. 343, 351 (1965).

37. *Id.*

38. *See* United States. v. Canaday, 354 F.2d 849, 851 (8th Cir. 1966) (unsuccessful reliance on "substantiality" defense).

39. *Sansone*, 380 U.S. at 351; *Spies*, 317 U.S. at 499; United States v. Coppola, 425 F.2d 660, 661 (2d Cir. 1969).

attendant circumstances must be taken into consideration."[40] For example, a taxpayer who refuses to cooperate during an audit, and whose suspicious or criminal behavior prompts a criminal investigation, could be prosecuted and convicted under section 7201 for omitting $2,500 in income (or overstating deductions by a similar amount). Similarly, a "high-profile" individual, such as a politician or entertainer, might be prosecuted and convicted under the felony evasion statute for relatively minor transgressions, if committed willfully and accompanied by the requisite affirmative act to evade. In these circumstances, the deterrent effect of "making an example" of the individual can outweigh the general reluctance to prosecute for relatively small deficiencies.

C. 26 U.S.C. Section 7202[41]

Although only a minimal amount of litigation has arisen from violations of section 7202, it nonetheless poses a threat to the unwary. It provides that

> [a]ny person required under this title to collect, account for, and pay over any tax imposed by this title who willfully fails to collect or truthfully account for and pay over any such tax shall, in addition to other penalties provided by law, be guilty of a felony and upon conviction thereof, shall be fined not more than $10,000, or imprisoned not more than 5 years, or both, together with costs of prosecution.[42]

In a Tenth Circuit decision,[43] the court definitively squelched a defendant's contention that he could not be guilty of failure to account since he never collected the money. In part, the court's response was as follows:

> This argument is specious . . . . If the statute is followed [U.S.C. § 3102(a) and § 3111(a)], the amount retained as taxes never leaves the employer's possession. It is true that the employer makes the deductions for the benefit of the United States, but he does not actually collect the tax; he merely retains money already in his possession which is part of the employee's wages . . . . If he delivers the deducted amounts to the employee or anyone else, he still must file a return and account, and failure to do so violates the general penalty Statute of 26 U.S.C. § 7202.[44]

Based on this response and the relatively few litigated cases in the area, it seems reasonable to conclude that the provisions in section 7202 are sufficiently explicit, and there is little chance for a taxpayer to escape prosecution if the provisions are violated.

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40. United States v. Nunan, 236 F.2d 576, 585 (2d Cir. 1956), *cert. denied*, 353 U.S. 912 (1957).

41. I.R.C. § 7202 (1988).

42. *Id.*

43. United States v. Porth, 426 F.2d 519 (10th Cir.), *cert. denied*, 400 U.S. 824 (1970).

44. *Id.* at 522.

D. 26 U.S.C. Section 7203[45]

A section 7203 conviction involves a willful failure to file. The degree of willfulness under this misdemeanor statute is now identical to that required for a section 7201 felony conviction.[46] Section 7203 provides that

> [a]ny person required under this title to pay any estimated tax or tax, or required by this title or by regulations made under authority thereof to make a return, keep any records, or supply any information, who willfully fails to pay such estimated tax or taxes, make such return, keep such records, or supply such information, at the time or times required by law or regulations, shall, in addition to other penalties provided by law, be guilty of a misdemeanor and, upon conviction thereof, shall be fined not more than $25,000 ($100,000 in the case of a corporation), or imprisoned not more than one year, or both, together with the cost of prosecution.[47]

A series of cases have burgeoned in recent years from this section—generally coupled with a prosecution under section 7201. The discussion of the key developments and problems arising from this interrelationship is reserved until Section IV of this Article.

E. 26 U.S.C. Section 7204[48]

During the years under review, there were no cases litigated under section 7204. Section 7204 provides for a fine of "not more than $1,000, or imprisonment not more than one year, or both" for any person who willfully furnishes a fraudulent statement or who willfully fails to furnish a statement to employees in the manner required under section 6051 of the Code.[49]

F. 26 U.S.C. Section 7205[50]

Relatively few cases have arisen under section 7205. Section 7205 provides for a fine not to exceed $1,000 or imprisonment of not more than one year, or both, for any person convicted of either willfully supplying false withholding information to his employer, or complete failure to supply such information. The primary issue raised in the court cases prosecuted under section 7205 is the definition of willfulness. Because this is applicable to all sections it is reserved for discussion in Section IV of this Article.

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45. I.R.C. § 7203 (1988).
46. United States v. Bishop, 412 U.S. 346, 349 (1973).
47. I.R.C. § 7203 (1988).
48. *Id.* § 7204.
49. I.R.C. § 6051 (1988 & Supp. I 1989).
50. I.R.C. § 7205 (1988).

G. 26 U.S.C. Section 7206[51]

A section 7206 conviction requires proof of willful making or subscribing or willfully assisting in the preparation of a false return. This is also a felony statute, and in order to get a conviction, the government need not prove a tax deficiency.[52] The case analysis for the years under review indicates the recent popularity of this section among federal prosecutors. A return preparer who knowingly makes a false statement on a return can be convicted under section 7206(1), as well as section 7206(2).[53]

One type of investigation that merits closer scrutiny involves "Multiple Fraudulent Returns Prepared by Unscrupulous Return Preparers." This frequent charge pertains either to section 7206(2), aiding or assisting in preparation of false returns, or to section 371 of Title 18 of the United States Code,[54] the conspiracy statute. The government has been very successful in prosecuting such violators by authorizing special agents to work in an undercover status—i.e., to pose as a potential client with a fictitious W-2 form and attempt to have his return prepared.[55]

H. 26 U.S.C. Section 7207[56]

Section 7207 provides for a fine of not more than $10,000 ($50,000 in the case of a corporation), imprisonment of not more than one year, or both, to be inflicted upon any person who willfully delivers fraudulent returns, statements, or other documents to the Secretary. Most of the litigation under this section has been intertwined with violations of other sections, rendering it difficult, if not impossible, to determine the noteworthy problems and developments. However, this interrelationship, in and of itself, merits special consideration, and thus is reserved for discussion in Section IV of this Article.

III. ADMINISTRATIVE PROCEDURES

Neither the Service nor the Department of Justice published any procedural rules for the administrative handling of criminal tax cases until 1978. Attorneys or their clients were forced to rely upon secondary literature by practitioners, reports of conferences between bar groups and representatives of the Service or the Department of Justice, and information supplied by the Service itself upon inquiry.[57] In general, the representatives of the Service were helpful in explaining the steps involved, but there were obvious limitations to this approach. Now, however, as a result of the Freedom of

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51. *Id.* § 7206.

52. United States v. Accardo, 298 F.2d 133 (7th Cir. 1962).

53. United States v. Shortt Accountancy Corp., 785 F.2d 1448 (9th Cir. 1986).

54. 18 U.S.C. § 371 (1988).

55. United States v. Warner, 428 F.2d 730, 732 (8th Cir.), *cert. denied*, 400 U.S. 930 (1970).

56. I.R.C. § 7207 (1988).

57. Roberts & Riley, *supra* note 2, at A-1.

Information Act of 1978,[58] the Service makes public its audit manuals for both revenue and special agents. An outline of the procedures followed by each agent in his investigations is provided. While many of the practical aspects of dealing with the agents are not set out, one can find the directives under which the agents operate and the precise mechanics of the investigation. Obviously, this should afford opportunity for better preparation on the part of defense counsel.

A. Intelligence Division

Special agents of the Service operate out of the Criminal Investigation Division of the district office.[59] When a tax fraud investigation is approved by the Intelligence Division, a revenue agent is assigned by the Audit Division for a joint investigation, but he or she is specifically under the control of the special agent.[60] Moreover, until the criminal aspects of the case are terminated, no civil negotiation concerning the amount of the tax is allowed.[61]

1. Functions of the Special Agent

The first point to be emphasized is that the special agent's investigation is directed principally toward the development of a criminal case. He regards himself as a criminal investigator and this is the tone in which the "*Handbook for Special Agents, Intelligence Division*,"[62] (the "Manual") is written. Although a special agent's efforts may produce no more than a civil case because of factors beyond his control, the appearance of the special agent signals the point at which a taxpayer becomes a prospective defendant. Although court decisions frequently emphasize the nature of the special agent's inquiry, one should not be under an illusion in this respect.

2. Sources of Assignment

A special agent becomes involved in a case only after some form of referral.[63] The *Manual* mentions the following sources:

1. the Audit or Collection Division of the Service;
2. data processing;

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58. Pub. L. No. 95-454, 92 Stat. 54 (codified as amended at 5 U.S.C. § 552 (1988)).

59. I.R.M. § 9311.2 (1987). This administrative division operates at the district level—almost no investigative functions are handled at the National Office of the Service in Washington, D.C., which is concerned with policy and planning matters. An organization chart may be obtained from the Service.

60. I.R.M. § 4565.32, 9781 (1987).

61. George D. Crowley, *The Role of the Practitioner When His Client Faces a Criminal Tax Fraud Investigation*, 40 J. TAX'N 18 (1974).

62. Internal Revenue Manual, "Handbook for Special Agents," I.R.M. § 9900 (April 3, 1986) [hereinafter Manual].

63. I.R.M. § 4565.21 (1987).

3. other special agents;
4. government agencies;
5. the public, including informants;
6. reports from financial institutions, such as Currency Transaction Reports.[64]

While the Collection Division, informants, and other government agencies are regular sources of referrals, the most common, in all probability, is the audit referral.[65] Generally, a revenue agent's suspicions are aroused during the course of a routine civil audit.[66]

Once the examining revenue agent suspects a possible criminal violation, he prepares a fraud referral report which is forwarded to the Intelligence Division for evaluation. Upon acceptance of the case by Intelligence, it is assigned to a special agent. The special agent gives the case preliminary consideration to determine if a fraud investigation is warranted. If so, the case is "jacketed," that is, a special investigation file is set up and the investigation commenced. The special agent arranges the interviews, makes third party contacts, and develops the criminal case.

3. Initial Considerations

An important consideration at this stage is jury appeal. While it is difficult to evaluate the precise importance of this factor, it can be assumed that the special agent will not readily expend his efforts in a pursuit that has little probability of an ultimate conviction. The language of the *Manual* reads, "[a]re there factors of age, health, intelligence, voluntary disclosure or other considerations which may render conviction unlikely?"[67]

Of these factors, the most commonly misunderstood is voluntary disclosure. The formal policy of granting immunity to those who voluntarily disclose their fraudulent activities prior to the initiation of an investigation was ended in 1952.[68] Nevertheless, the timely disclosure of the taxpayer's illegal actions is still an important consideration in the Service's decision regarding prosecution.[69] The question of what constitutes the requisite disclosure is

64. I.R.M. § [4231] 910, 911 (1987).

65. I.R.M. § [4231] 911 (1987). The Special Agents Handbook provides that fraud or indications of fraud are usually discovered during the course of an examination. *See generally* I.R.M. § 9781 (1987).

66. Roberts & Riley, *supra* note 2, at A-2.

67. Manual, *supra* note 62, at ch. 9781, §§ 210-234-.2.

68. Treasury Department Information Release S-2930 (Jan. 10, 1952).

69. I.R.M. § 9781 (1987). "It is the practice of the IRS that a voluntary disclosure will be considered along with all other factors in the case determining whether criminal prosecution will be recommended." *Id.* § 342.142(1). To qualify, a taxpayer must make her disclosure before an investigation by the Service has begun and before an event has occurred that would ordinarily alert the Service to the fraud. Disclosure after the investigation has begun is not considered voluntary, and the Service will pursue criminal and civil sanctions. *Id.*; *see, e.g.*, Badaracco v. Commissioner of Internal Revenue, 464 U.S. 386 (1984) (taxpayers who filed correct amended returns after grand jury subpoenaed their records were convicted for filing

subject to varying interpretation.[70] In one case,[71] an attorney mailed a letter to the local district director and enclosed a cashier's check in the amount of the estimated deficiency on behalf of his unnamed clients. This permitted the clients to claim that they did not owe any money in taxes if a criminal case did develop, while it let them keep their identity secret.

4. Prosecution Decision

If, subsequent to the initiation of the investigation, the agent discovers there is little or no chance of successful prosecution, the *Manual* directs him to withdraw from the case.[72] While absent from the *Manual's* most recent revision, Section 332 of the 1972 edition lists the following factors that may warrant withdrawal:

1. a key witness' death or his inability to testify;
2. inability to establish evidence of willfulness;
3. a small tax deficiency or a one-time case;
4. insufficient proof concerning the main criminal item;
5. a new court decision having a substantial bearing on the case issues;
6. complete deterioration of the taxpayer's mental or physical health and no prospect for eventual improvement, as a terminal illness;
7. a plausible defense that cannot be disproved.[73]

One caveat, however, bears heavily on the weight given to the above factors. The decision to withdraw is most readily made at the initial stages of the investigation. Once it is "substantially completed" there is much less likelihood of discontinuance. The investigation will be considered substantially completed when one or more of the following conditions exists:

1. All significant investigative inquiries have been made,
2. The special agent has prepared a draft of his final report in the case.
3. The investigation has progressed to the point where the taxpayer would normally be afforded a final interview.
4. The documentary evidence in possession of a special agent with respect to civil fraud features of the case is such that its submission to the cooperating officer would require the expenditure of considerable time on his part in becoming familiar with such evidence and preparing the detailed report necessary to present that evidence.[74]

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false returns).

70. Ira L. Tilzer, *Protecting Taxpayers' Rights During the Tax Fraud Investigation Process*, 41 J. TAX'N 356 (1974).

71. Baird v. Koerner, 279 F.2d 603 (9th Cir. 1960).

72. Manual, *supra* note 62, at ch. 9900.

73. *Id.* § 332.

74. Thomas S. Charles, *Special Agent's Manual Gives Insight into IRS Procedures*

In the typical context, according to section 100 of the *IRS Law Enforcement Manual IX*, criminal prosecutions are limited to cases in which (1) the additional tax that will be generated from a successful prosecution is substantial, (2) the crime appears to have been committed in three consecutive years, or (3) the taxpayer's flagrant or repetitive conduct was so egregious that the Service believes that it is virtually certain to obtain a conviction.

5. Steps Subsequent to Prosecution Recommendation

Upon completion of investigation, the special agent submits a detailed report containing all the necessary facts to support his recommendation for prosecution to his group chief. As a matter of policy, the Service usually affords the taxpayer or her representative a "district intelligence conference" with the special agent and his group chief before the report is approved,[75] but it should be noted that no absolute right to this interview exists.[76]

The service views the conference as an opportunity to fill any remaining gaps in the proof of their case.[77] The dynamics of the conference, of course, will vary among different conferees. However, the Service's conferees generally state the alleged fraudulent features of the case, including the method of proof relied upon by the special agent, and then await comment by the taxpayer's representative. Useful information may be obtained from the conferees in response to facts contrary to the investigation raised by the taxpayer's representative.[78]

If the report is approved by the Intelligence Division, it is then forwarded to the Assistant Regional Counsel (Intelligence). While Treasury Regulation 601.107(c)[79] provides for a further conference at this level, most practitioners waive this opportunity as it does not serve an information-gathering purpose.[80] The Assistant Regional Commissioner (Intelligence) will ordinarily notify the taxpayer or counsel when he forwards the case to the Office of Chief Counsel of the Service.

B. Regional Counsel (Enforcement)

When the special agent's report is approved by the Criminal Investigation Division, it is submitted to the Enforcement office of the Regional Counsel in the region where the referring Criminal Investigation Division is located.[81] The Regional Counsel provides legal advice to the Intelligence Division,[82]

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for Tax Fraud Audits, 43 J. TAX'N 290, 290-91 (1971).

75. Treas. Reg. § 601.107(b)(2) (1991).

76. United States v. Goldstein, 342 F. Supp. 661, 665-66 (E.D.N.Y. 1972).

77. I.R.M. § [9781] 363:1, 364 (1987).

78. Crowley, *supra* note 61, at 23-24.

79. Treas. Reg. § 601.107(c) (1991).

80. *Id.*

81. *Id.*

82. *See* Paul E. Treusch, *Chief Counsel's Office: A Dynamic View of Its Organization and Procedures: The 'Hows' and Something of the 'Whys'*, 1960 S. CAL. TAX INST. 19.

including evaluation of evidentiary or other legal problems. If the regional counsel finds any insolvable problems, he may return the matter to Intelligence for further investigation or he may decline to recommend prosecution.[83] The standards for review are a determination that

1. the taxpayer is in fact guilty of tax evasion; and
2. there is reasonable probability of his conviction.[84]

The taxpayer or his counsel is offered another conference at this level. In this conference, the Assistant Regional Counsel usually discloses the theory of the case (e.g., method of proof, the amounts of understatement attributable to criminal items, and the proposed civil liabilities). Apparently, the Regional Counsel is not to substantiate or defend the criminal case to the taxpayer's representative, instead the purpose is to permit the taxpayer to offer argument and evidence on his behalf.[85] Frank discussion of any legitimate issues at this conference usually occurs.

C. Department of Justice

The special agent's report with appropriate recommendations is forwarded to the Department of Justice, Tax Division, Criminal Section. Again, it is accepted policy to offer the taxpayer or his attorney one conference at this level. The standards for review in the Justice Department are similar to those at Regional Counsel, although there is more concern with local prosecutions.[86] The Justice Department's attorney may make the following recommendations on the case:

1. prosecution;
2. forwarding to U.S. Attorney with instructions for a grand jury investigation of recalcitrant witnesses;
3. forwarding to U.S. Attorney with instructions that he exercise discretionary judgment in light of local factors that may have serious jury impact;
4. returning case to the Service for further specific investigation;
5. non-prosecution.[87]

D. U.S. Attorney's Office

If the Department of Justice recommends prosecution, the case is forwarded to the appropriate U.S. Attorney's Office, usually with instructions to secure an indictment.[88] While conferences do take place at the U.S.

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83. *Id.* at 19-20.

84. *Id.*

85. *Id.*

86. For a more detailed discussion of the difference between the two reviews, see Harry G. Balter, *Tax Fraud and Evasions*, §§ 3.3-4, 3.4 (4th ed. 1976).

87. Crowley, *supra* note 61, at 23.

88. *See* Joseph S. Platt, *Mr. Borderline in the Department of Justice*, TAX CASES

Attorney's Office prior to indictment, they are not routinely granted.[89] The U.S. Attorney's Office usually has no authority to stop the criminal cases in advance of the indictment but will on occasion return the matter to the Service or Justice for further investigation, or present it to a grand jury for examination of unreliable witnesses.[90]

E. Summary of Criminal Procedure After Referral to U.S. Attorney

Under the Federal Rules of Criminal Procedure, the U.S. Attorney may file a complaint before the U.S. Commissioner and obtain a warrant for the arrest of the defendant or summons for his appearance.[91] The U.S. Marshal for the district serves the summons or executes the warrant by arresting the defendant.[92] In the case of arrest, the defendant is required to be brought before the U.S. Commissioner "without unnecessary delay."[93] The Commissioner informs the defendant of his rights and conducts a preliminary examination unless it is waived by the defendant.[94] If the Commissioner believes there is "probable cause to believe that an offense has been committed and that the defendant has committed it," the Commissioner holds the defendant over to answer in the United States District Court.[95] The Commissioner has the power to admit the defendant to bail.[96]

The U.S. Attorney may choose to file information to present his evidence to the grand jury and obtain an indictment if the offense to be charged is a misdemeanor.[97] After the filing of an information or indictment, the clerk of the district court issues a summons or warrant as requested by the government to bring the defendant before the court.[98] Similarly, a summons or warrant can be obtained by submitting an application to the U.S. Commissioner which shows either that the information has been filed or that the indictment has been returned by the grand jury.[99] Upon the arrest of the defendant under a warrant, the defendant must be brought promptly before the Court or before the U.S. Commissioner for purposes of bail.[100]

After the defendant is arrested, he is required to be arraigned in court.[101] Arraignment under Rule 10 consists of reading the indictment or

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PRAC. & PROC. 147 (1951); Robert M. Schmidt, *Current Department of Justice Criminal Income Tax Policies*, 38 TAXES 293 (1960); Turner L. Smith, *Procedure in Department of Justice*, TAX FRAUD CASES PRAC. AND PROC. 29, 33 (1951).

89. Smith, *supra* note 88, at 33-35.
90. *Id.*
91. FED. R. CRIM. P. 3-4.
92. *Id.* 4(c).
93. *Id.* 5(a).
94. *Id.* 5(b)-(c).
95. *Id.* 5(c).
96. *Id.* 9(c).
97. *Id.* 7(a).
98. *Id.* 9(a).
99. *Id.* 4(a).
100. *Id.* 9(c).
101. *Id.* 10.

information to him and calling upon him to plead thereto.[102] At that time, the defendant may plead guilty, not guilty, or with the consent of the court, *nolo contendere*[103] (further discussed in Section IV of this Article).

As a practical matter, the common procedure in tax cases is for the taxpayer's attorney to confer with the U.S. Attorney prior to the arrest of the defendant on an indictment or information. At a preliminary conference matters such as surrender, waiver of indictment, bail and similar matters are agreed upon. Under Rule 7(a) of the *Federal Rules of Criminal Procedure*, an offense which may be punished by imprisonment for a term exceeding one year must be prosecuted by indictment unless indictment is waived. Any other offense may be prosecuted by information or by indictment. A defendant may waive indictment "after having been advised of the nature of the charge and of [his] rights."[104] Such waiver must be given in open court.[105] Normally, the taxpayer's counsel will have advised the attorney for the government whether his client will waive indictment and, in such case, the waiver of indictment will have been prepared by the U.S. Attorney in advance of arraignment. At arraignment, the waiver of indictment is signed, the information is filed, and the defendant pleads thereto. In certain cases, namely where it feels that the publicity resulting from the indictment will be beneficial in the administration of the tax laws, the Department of Justice has indicated that it will refuse to accept a waiver of indictment and will insist upon prosecuting the case upon indictment rather than information.[106]

F. Methods of Proof

The methods of proof of tax evasion extend from the simple direct proof of the omission of a single specific item of income to the complex circumstantial net worth and bank deposit methods of proof that assets acquired by the taxpayer represent unreported income. Two concepts, however, are common to all methods of proof. First, the precise amount of the tax evaded need not be proved; it is sufficient for the government to show that a substantial amount of income was omitted from the taxpayer's return.[107] Second, the government is free to use all legal evidence available to it to determine

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102. *Id.*
103. *Id.* 11.
104. *Id.* 7(b).
105. *Id.*
106. Roberts & Riley, *supra* note 2, at A-9.
107. United States v. Johnson, 319 U.S. 503 (1943); Gendelman v. United States, 191 F.2d 993 (9th Cir. 1951); Dawley v. United States, 186 F.2d 978 (4th Cir. 1951); Brodella v. United States, 184 F.2d 823 (6th Cir. 1950); Stinnett v. United States, 173 F.2d 129 (4th Cir. 1949); United States v. Rosenblum, 176 F.2d 321 (7th Cir. 1949); Cave v. United States, 159 F.2d 464 (8th Cir. 1947); United States v. Schenck, 126 F.2d 702 (2d Cir. 1942); Gleckman v. United States, 80 F.2d 394 (8th Cir. 1934); United States v. Stoehr, 100 F. Supp. 143 (M.D. Pa.), *aff'd*, 196 F.2d 276 (3d Cir. 1952).

whether the taxpayer's books accurately reflect his financial history without first establishing the inadequacy of such books.[108]

The direct evidence or specific item method is the simplest method of proving evasion. Proof may consist of little more than the taxpayer's return, and the testimony and records of a third party showing the payment of an unreported item of income to the taxpayer or the nonpayment of a claimed deduction by the taxpayer, and some element of willfulness.[109] On the other hand, a net worth case may involve scores of witnesses and numerous accounting exhibits reflecting literally years of investigation by the IRS.

The circumstantial method of proof in common use today developed during the period commencing with the Supreme Court's decision in *United States v. Johnson*,[110] and ending with its 1954 decision in *United States v. Holland*.[111] Except for a period of refinement in the middle 1950's following *Holland* and its companion cases, these methods remain substantially unchanged over the last twenty-five years.[112] Based upon the reported cases, it appears that taxpayers as well have developed little or nothing new in the way of defenses.

Although the cases repeatedly reaffirm the proposition that the government has the burden of proving each element of tax evasion beyond reasonable doubt, the practical result of the use of circumstantial methods is that the taxpayer must come forward with an affirmative case.[113] Proof of an unexplained accumulation of assets tends to be tainted as proof of unreported taxable income. After the government shows a likely source and negates nontaxable sources for the accumulation, the taxpayer remains silent "at his peril." In light of this realization, it is obviously essential for the taxpayer's representative to be familiar with the methods of proving a deficiency. Only then is he afforded the opportunity to determine the direction of investigation and the problem areas involved.

1. Net Worth Method

The best known of the circumstantial methods of proof of evasion is the net worth method. Although this method was originally used against taxpayers whose principal source of income was some kind of illegal activity, it is now regularly applied to routine cases of tax evasion where other methods of proof are insufficient.[114] The springboard for the current use of the net

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108. Holland v. United States, 348 U.S. 121 (1954); McKenna v. United States, 232 F.2d 431 (8th Cir. 1956); Clark v. United States, 211 F.2d 100 (8th Cir. 1954).

109. Roberts & Riley, *supra* note 2, at A-1 to A-5.

110. 319 U.S. 503 (1943).

111. 348 U.S. 121 (1954).

112. For a more detailed discussion of this refinement, see Balter, *supra* note 15, at 1125-58.

113. *Holland*, 348 U.S. at 139.

114. Demetree v. United States, 207 F.2d 892 (5th Cir. 1953); United States v. Fenwick, 177 F.2d 488 (7th Cir. 1949); United States v. Clark, 123 F. Supp. 608 (S.D. Cal. 1954); Joseph W. Burns & Mary L. Rachlin, *How to Defend Net Worth Cases*, 32 TAXES 537 (1954).

worth method was the decision of the Supreme Court in *Holland v. United States* and the series of companion cases.[115] The Supreme Court granted an overall review of the net worth method because "it involved something more than the ordinary use of circumstantial evidence in the usual criminal case" and had "evolved from the final volley to the first shot in the Government's battle for revenue."[116]

Although frequently complex in application, the theory of the net worth method of computing income is simple. Basically, the following steps lead to the determination of the increase in net worth:

1. Determine all assets and liabilities of the taxpayer on a cost basis as of the beginning and end of the first year in question.
2. Subtract the total liabilities from the total assets.
3. Extend the same mechanical analysis to the assets and liabilities of all subsequent years involved in the case to demonstrate the "increase" or "decrease" in net worth over the period of years.
4. Add all nondeductible items, such as nondeductible living and household expense items, and other nondeductible personal expenditures which would represent items paid out as part of taxpayers "cash flow," (e.g., Federal income taxes and insurance premiums paid) to this "increase in net worth."
5. From the total amount representing increase in net worth plus nondeductible personal expenditures, deduct all nontaxable sources of funds, such as gifts, inheritances, income tax refunds, the 50% tax free portion of capital gains, etc.
6. Subtract the reported net income from the adjusted increase in net worth to determine the unreported income—the amount presumably arising from current earnings.[117]

The most common defenses to this form of indirect proof may be categorized as follows:

1. The computation failed to include assets at the beginning of the net worth period which were sold or expended during the period such as (a) prior accumulated funds not held in the bank account

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115. Balter, *supra* note 15, §§ 10.4-11(4).

116. *Holland*, 348 U.S. at 124, 126-27.

117. *See* Spurgeon Avakian, *Net Worth Computations as Proof of Tax Evasion*, 10 TAX L. REV. 431, 442 (1955); Joseph Berman, *Recent U.S., I.R.S. and Tax Court Policy on Reconstructing Net Income and Fraud Penalties*, 61 DICK. L. REV. 57 (1956); Fred R. Bohlen, *The Net Worth Method: How to Analyze an Agent's Findings: Errors Commonly Made: Sensitive Areas*, 3 TAX'N FOR ACCT. 14 (1967); Fred R. Bohlen, *I.R.S. Using Net Worth Indiscriminately Against Taxpayers with Poor Records*, 15 J. TAX'N. 159 (1961); Thomas W. Hill, Jr., *The Defense of a Criminal Net Worth Tax Case in the Light of Recent Supreme Court Decisions*, 41 CORNELL L. REV. 106 (1955); Leshie Mills, *The Net Worth Approach in Determining Income*, 41 VA. L. REV. 927 (1955); Wald, *The Net Worth Theory in Fraud Cases*, PROC. 5TH ANN. VU. DENVER TAX'N (1955); U.S. v. William A. Massei, Annotation, *Use of Net Worth Method in Prosecution for Evasion of Federal Income Tax*, 2 L. Ed. 2d 1870 (1958).

(cash hoard defense)[118] or (b) an asset previously purchased by the taxpayer, held in another's name, and sold during the period.

2. The computation failed to take into consideration nontaxable sources of income, such as loans from the taxpayer's family or friends.

Most of the proof of specific items in the net worth form of analysis can be obtained from third party sources. Of considerable importance to this method are net worth statements filed with banks by the taxpayer himself. Another evidentiary windfall to the Service may be the taxpayer's bankruptcy proceedings, which can fix the crucial starting point—the opening net worth—at zero or at a small uncomplicated sum. Bankruptcy also forecloses argument about prior accumulated funds.[119]

The government's proof of a taxable source of income in net worth cases generally takes the form of proof of a likely source rather than negation of all possible sources of nontaxable income.[120] Proof of the affirmative case is simpler and more readily understandable to a trier of fact than the proof of the negative proposition. There are two important considerations which should be kept in mind in dealing with problems of proof of a likely source:

1. The Government need not show that the understatement of income is due to the probable source of income. Although the Government frequently tries to show that the probable source is also the source of the understated income, it is not required to do so and evidence of the existence of a likely source is sufficient for conviction.
2. While the prosecution is required to prove all elements of its evasion case beyond reasonable doubt, the evidentiary showing required in connection with the proof of a likely source has been accepted by the courts in situations which might be called marginal at best.[121]

2. Bank Deposit Method

The bank deposit method is based on the premise that a taxpayer's bank deposits most frequently represent income, and in instances when this is not true, the taxpayer is in the best position to explain the nature of the deposits.[122]

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118. For a more detailed discussion of utilization of the cash hoard defense, see Olyde A. Maxwell, *Employing the Cash Hoard Defense Against a Net Worth Fraud Determination*, 44 J. TAX'N 86 (1976).

119. Crowley, *supra* note 61, at 20.

120. United States v. Massei, 355 U.S. 595 (1958); United States v. Tolbert, 406 F.2d 81 (7th Cir. 1969); Lenske v. United States, 383 F.2d 20 (9th Cir. 1967); United States v. Moody, 371 F.2d 688 (6th Cir. 1967); United States v. Vardine, 305 F.2d 60 (2d Cir. 1962); Mighell v. United States, 233 F.2d 731 (10th Cir. 1951); United States v. Dong, 293 F. Supp. 1249 (D. Ariz. 1969), *aff'd*, 436 F.2d 1237 (9th Cir. 1971).

121. Roberts & Riley, *supra* note 2, at A-10.

122. Dillon v. United States, 218 F.2d 97, 98 (8th Cir.), *cert. denied*, 350 U.S.

The pure bank deposit method requires that the taxpayer have some potential source of income and be making deposits into a bank account or accounts. The total of such deposits is computed for the tax period in question to determine gross income. Then, an adjustment is made in the total deposits to eliminate the inclusion of non-income items, such as gifts, loans, redeposits, bank transfers, and amounts earned in pre-prosecution years. Finally, credit is given for ascertainable expenses, deductions, and exemptions.[123]

The bank deposit method is generally used where the taxpayer's books and records are inadequate or nonexistent, the taxpayer refuses to make his records available, or where he uses the bank deposits method to prepare his returns. However, the government is not required to prove that the taxpayer's books and records are inaccurate as a prerequisite to the use of the bank deposit method.[124]

The same defenses used against the net worth method are available here.[125] In addition, the taxpayer may prove that he had no interest in the particular bank in question, particularly if the account was a joint account used by the taxpayer and others.

3. Expenditures Method

The expenditures method, sometimes referred to as the net worth and expenditures method, is a variation of the net worth method used to prove income from circumstantial evidence. The method was described in *United States v. Caserta*[126] as follows:

> It starts with an appraisal of the taxpayer's net worth situation at the beginning of a period. He may have much or he may have nothing. If, during that period, his expenditures have exceeded the amount he has returned as income and his net worth at the end of the period is the same as it was at the beginning (or any difference accounted for) then it may be concluded that his income tax return shows less income than he has in fact received. Of course it is necessary, so far as possible, to negative nontaxable receipts by the taxpayer during the period in question.[127]

The expenditures method also requires a net worth analysis. However, in the expenditure method the net worth determination is not used to calculate income; rather, it is used to show the resources available to the taxpayer for

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906 (1955).

123. Gleckman v. United States, 80 F.2d 394, 397 (8th Cir. 1935), *cert. denied*, 297 U.S. 707 (1936); United States v. Frank, 151 F. Supp. 866, 868-69 (W.D. Pa. 1956), *aff'd*, 245 F.2d 284 (3d Cir.), *cert. denied*, 355 U.S. 819 (1957).

124. Bostwick v. United States, 218 F.2d 790 (5th Cir. 1955).

125. United States v. Ramsdell, 450 F.2d 130 (10th Cir. 1971).

126. 199 F.2d 905 (3d Cir. 1952).

127. *Id.* at 907.

expenditures.[128] Income is calculated from the excess of expenditures over available resources.

The expenditures method is generally more appropriate than the net worth method in situations where the taxpayer consumes his income instead of channeling it into investments or tangible property.[129] In such a situation, the expenditures method is a simpler case for the prosecution to present since assets and liabilities that do not change during the prosecution period can be eliminated from the expenditures statement used as a trial exhibit. The prosecution can then emphasize the expenditures without being burdened with the complexities of net worth changes.

For reasons not given, the "Handbook for Special Agents" states that the Department of Justice with "rare exceptions" prefers the net worth method and advises agents to include a proof of income by the net worth method along with expenditures proof so that the trial attorney can make the final decision as to the method used.[130]

4. Key to Proving Deficiency

Regardless of the method employed by the Government, the most significant source of proof is the information supplied by the taxpayer himself. His prior returns provide key admissions with respect to his financial condition. Leads supplied to agents often provide crucial evidence which would not otherwise be developed. Most often the taxpayer will not be represented by counsel in the early stages of the investigation and will be anxious to cooperate with the agents. Evasion cases are often lost at this stage of the proceedings, long before the trial and before retention of counsel. Prompt and effective assertion of the taxpayer's rights to withhold information from the agents may be the only way to prevent proof of evasion by the Government.

IV. KEY DEVELOPMENTS

Fraud is not defined in either the Code or the Regulations. One longstanding judicial definition of fraud describes it as "actual, intentional wrongdoing . . . the intent required is the specific purpose to evade a tax believed to be owing."[131] This definition has been expanded to include acts that are done without a "bad or evil purpose." In *United States v. Pomponio*, the Supreme Court held that "willfulness," which is a crucial element of fraud, is present when the taxpayer's actions constitute "a voluntary, intentional violation of a known legal duty."[132]

There have been no significant legislative changes in the criminal tax fraud area since the 1950's. But, as previously noted, there have been many

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128. 13 AM. JUR. *Trials* § 65 (1967).

129. *See, e.g.*, Taglianetti v. United States, 398 F.2d 558, 562 (1st Cir. 1968), *aff'd*, 394 U.S. 316 (1969).

130. Manual, *supra* note 62, § 325.3(2).

131. Mitchell v. Commissioner, 118 F.2d 308, 310 (5th Cir. 1941).

132. United States v. Pomponio, 429 U.S. 10 (1976).

significant developments which stem from administrative attitudes and court decisions. The most important developments and the problems which have been raised may be listed as follows:

1. new meaning of willfulness for tax felonies and misdemeanors;[133]
2. successful and unsuccessful use of plea bargaining;[134]
3. new interpretations of IRS responsibility in investigation procedures including:
   a. special agents warnings
   b. limits on use of summonses
   c. limits on use of search warrants;[135]
4. further weaknesses in the accountant privilege armor;[136]
5. increasing limits placed on privilege against self-incrimination;[137]
6. effective use of the fifth amendment as a defensive weapon;[138]
7. effective use of the sixth amendment as a defensive weapon.[139]

A. New Concept of Willfulness

Conviction in any of the principal tax crimes, including both felonies and misdemeanors, requires that the Service prove beyond a reasonable doubt that the defendant (taxpayer) acted "willfully."[140] The Supreme Court has observed that Congress included this element in the tax crimes to ensure that a person would not "become a criminal by his mere failure to measure up to the prescribed standard of conduct."[141] In language that would bedevil the court for years thereafter, the *Murdock* Court further stated that "willfully" usually means "an act done with a bad purpose; without justifiable excuse; stubbornly, obstinately, perversely . . . or with bad faith or evil intent."[142] Ten years later, the Court in *Spies v. United States*,[143] stated that the term willfulness connotes "evil motive and want of justification."[144] Thirty years after *Spies*, in 1973, the Supreme Court was still referring to the willfulness requirement in terms of bad purpose or evil motive. In *United States v.*

133. *See infra* notes 140-218 and accompanying text for a discussion of this area.
134. *See infra* notes 219-232 and accompanying text for a discussion of this area.
135. *See infra* notes 233-273 and accompanying text for a discussion of this area.
136. *See infra* notes 274-287 and accompanying text for a discussion of this area.
137. *See infra* notes 288-302 and accompanying text for a discussion of this area.
138. *See infra* notes 303-306 and accompanying text for a discussion of this area.
139. *See infra* notes 307-310 and accompanying text for a discussion of this area.
140. United States v. Bishop, 412 U.S. 346 (1973); Sansone v. United States, 334 F.2d 287 (8th Cir. 1964); United States v. Beck, 59-2 U.S.T.C. para. 9486 (W.D. Wash. 1959), *rev'd in part and aff'd in part*, 298 F.2d 622 (9th Cir. 1962).
141. United States v. Murdock, 290 U.S. 389, 396 (1933) (citations omitted).
142. *Id.* at 394-398.
143. 317 U.S. 492 (1943).
144. *Id.* at 498.

Bishop,[145] the Court stated that it "shall continue to require, in both tax felonies and tax misdemeanors that must be done 'willfully,' the bad purpose or evil motive described in *Murdock*."[146] Precisely what is meant by the term, and whether it might mean different things in different contexts, has been a continuing puzzle for the courts.

Because it involves the defendant's state of mind, willfulness must ordinarily be proven by circumstantial evidence. Its existence is a question of fact for the jury.[147] Typically, those with actual information about the alleged crime will not confess or assist in the prosecution, thus necessitating the use of circumstantial evidence.[148]

The complexity of the tax laws and the human tendency to make errors require that our society impose some sort of buffer between taxpayers and the threat of a prison sentence. The buffer provided by Congress is the willfulness requirement, which shields from conviction those who make innocent or even negligent errors, or who genuinely misunderstood the law.

The constitutionality of the criminal sections of the Code, via their overlapping tendency, has been the subject of attack in a number of cases. However, taxpayers have presented desultory arguments lacking any persuasive reasoning. Responding in kind, judicial decisions have been tolerant but cursory in striking down every challenge. Until recently, the courts have continually avowed that there is no overlap in the penal laws by distinguishing between the degree of proof of willfulness required for a felony and that required for a misdemeanor.[149] In *United States v. Bishop*,[150] however, the Supreme Court stated that the definition of willfulness is uniform in all the offenses included in sections 7201-7207.[151] Obviously, this ruling will affect both the prosecution and the defense.

1. Background of *Bishop* Case

Cecil J. Bishop, a California lawyer, was convicted of violating section 7206(1) which provides that anyone who

> [w]illfully makes and subscribes any return . . . which contains or is verified by a written declaration that is made under the penalties of perjury,

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145. 412 U.S. 346 (1973).

146. *Id.* at 361.

147. United States v. Snider, 502 F.2d 645 (4th Cir. 1974); United States v. McCorkle, Jr., 510 F.2d 565 (7th Cir. 1974); United States v. Bengimina, 495 F.2d 211 (8th Cir. 1974); Cooley v. United States, 501 F.2d 1249 (9th Cir. 1974); United States v. Ducharme, 505 F.2d 691 (9th Cir. 1974); United States v. Hawk, 497 F.2d 365 (9th Cir. 1974).

148. In this respect, the 1989 prosecution and conviction of Leona Helmsley, aided largely by testimony of former employees, is somewhat unique.

149. *See* Sansone v. United States, 380 U.S. 343, 351 (1965); Spies v. United States, 317 U.S. 492, 497 (1943); United States v. Schipani, 362 F.2d 825, 831 (2d Cir.), *cert. denied*, 385 U.S. 934, *vacated*, 385 U.S. 372 (1966).

150. 412 U.S. 346 (1973).

151. *Id.* at 361.

> and which he does not believe to be true and correct as to every material matter . . . shall be guilty of a felony. . . .[152]

Bishop had taken improper deductions on his 1963, 1964, and 1965 income tax returns amounting to more than $45,000.[153] His defense was that he had only failed to check the returns for accuracy after his office secretary had prepared them.[154] He contended that the kind of willfulness with which he had acted involved no more than gross negligence or carelessness and thus could not have risen to the level of bad faith or evil motive required to establish a felony.[155] On that basis, he requested a jury instruction for a lesser-included-offense.[156]

A lesser-included-offense instruction is appropriate if

1. some of the elements of the crime charged also constitute a lesser offense; and
2. to convict of the greater crime the jury must find a disputed material element not necessary to convict of the lesser.

And here Bishop contended that the lesser offense was a violation of a misdemeanor statute, section 7207. According to Bishop, the disputed element was the degree of scienter necessary to constitute a willful violation. His proposed instructions would have afforded the jury a choice between a misdemeanor based on caprice or careless disregard and a felony based on evil purpose.[157]

The district court refused Bishop's requested instructions and charged the jury only on the felony, instructing it to determine whether the defendant intended to disobey or disregard the law "with evil motive or bad purpose."[158] On appeal, the Court of Appeals for the Ninth Circuit reversed and declared: "Under the evidence presented, the elements of the two offenses

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152. *Id.* at 347-48.

153. *Id.* at 349-50.

154. *Id.* at 350.

155. *Id.* at 350-51.

156. *Id.* at 350. FED. R. CRIM. P. 31(c) provides: "The defendant may be found guilty of an offense necessarily included in the offense charges . . . ."

There are two approaches to the instruction. The common law formulation requires that all the elements of the lesser crime be present in the greater, so that it would never be possible to commit the greater without also having committed the lesser offense. CHARLES WRIGHT, FEDERAL PRACTICE AND PROCEDURE: CRIMINAL 2D, § 515 (1969). The more recent interpretation requires only that the facts adduced to prove the greater offense should also be proved a related lesser offense; under this approach inclusion is allowed even if some elements of the lesser crime are not found in the crime. *See* United States v. Whitaker, 447 F.2d 314, 317 (D.C. Cir. 1974).

The Government in *Bishop* chose the common law formulation of the lesser-included offense rule. Bishop argued that his requested instruction was warranted by either the Government's chosen approach or the more modern interpretation. *Bishop*, 412 U.S. at 350, 361.

157. *Bishop*, 412 U.S. at 350-51.

158. *Id.* at 351.

are the same, with the exception of the element of willfulness."[159] The Government's petition for certiorari was granted because of a divergence among the circuits regarding the meaning of willfulness to be applied in criminal tax cases.[160]

The Supreme Court upheld the district court's refusal to give the requested instruction and remanded to the court of appeals for consideration of other issues it had not reached.[161] The court held that the standard of willfulness is the same in both felony and misdemeanor statutes in the criminal tax area.[162] The court did not expound on the meaning of willfulness except to state that it implies "a voluntary, intentional violation of a known legal duty"[163] and that it requires "bad purpose or evil motive."[164]

Bishop advanced two arguments in favor of interpreting misdemeanor willfulness to require something less than the bad purpose or evil motive required in felony cases. First, such a standard would be consistent with that traditionally required for "other purely statutory misdemeanors, since willfulness is typically treated as meaning 'intentional' in crimes which do not involve moral turpitude."[165] Bishop's second argument concerned the potential overlap between tax felony and tax misdemeanor statutes which would yield an arguable result from a uniform definition of willfulness. Bishop contended that "but for" a variation in the level of willfulness, sections 7206(1) and 7207 would be exact duplicates in the area of income tax returns.

The Court in the past has responded to such claims of overlap by initially assuming that Congress would not create criminal statutes that are identical as to the elements of the offense but that vary as to penalty.[166] At the same time, the Court has always recognized that some criminal tax statutes are specific and thus may be included within other more general ones.[167] Even so, the Court has been more willing to find a complete overlap of statutes on a given state of facts than to define willfulness as a variable.[168]

In *Bishop*, the Court took the position that tax statutes with otherwise distinguishable elements do not overlap merely because they share a common element of willfulness. "Congress distinguished the statutes," observed the court, "in ways that do not turn on the meaning of the word 'willfully.'"[169] In general, felonies are differentiated from misdemeanors by the "additional misconduct" required for felonies. Accordingly, the Court in this case found

159. United States v. Bishop 455 F.2d 612, 614 (9th Cir.), *cert. granted*, 409 U.S. 841 (1972), *rev'd*, 412 U.S. 346 (1973).

160. *Bishop*, 412 U.S. at 348.

161. *Id.* at 349.

162. *Id.* at 361.

163. *Id.* at 360.

164. *Id.* at 361.

165. ROLLINS M. PERKINS, CRIMINAL LAW 780 (2d ed. 1969).

166. Achilli v. United States, 353 U.S. 373, 378-79 (1957); Berra v. United States, 351 U.S. 131, 133-34 (1956).

167. Sansone v. United States, 380 U.S. 343, 351 (1965).

168. *Id.*

169. *Bishop*, 412 U.S. at 358.

various grounds on which to differentiate the sections wholly in terms of elements other than willfulness.[170]

2. Definition of Willfulness

Thus, after *Bishop*, the definition of willfulness is uniform—with the exception of frivolous positions—in all the offenses included in sections 7201-7207. In order to establish that a violation is willful, the Government must prove:

1. a legal duty,
2. knowledge of that duty, and
3. a violation of the duty which is voluntary and intentional.[171]

In addition, the Court in *Bishop* declared that it will continue to require, in both tax felonies and tax misdemeanors that must be done 'willfully,' the bad purpose or evil motive described in *Murdock*.[172] In that case, the taxpayer refused to supply information in violation of the predecessor to section 7203[173] and invoked his fifth amendment right against self-incrimination in good faith but without legal grounds.[174] His failure to supply information was held not willful.[175]

The requirement of bad purpose or evil motive in order to establish willfulness is considered objectionable by one author for two reasons:

1. The Government, in order to prove an element of the offense, and the defendant, in order to fashion his defense, would have to develop standards by which to separate good purposes or motives from evil ones.
2. Neither *Bishop* nor *Murdock* indicated whether bad purpose or evil motive refers to the immediate intent or, instead to an ultimate goal. . . . If the *Bishop* Court is directing the lower courts to focus on motive in order to identify willfulness, it has created an element of tax offense which is almost unsusceptible of proof.[176]

3. Immediate Effects of *Bishop*

As a result of the *Bishop* concept of willfulness, a lesser-included instruction is not available to defendants where the degree of willfulness is the only disputed element of the offense charged. Juries, deprived of the option

170. *Id.* at 356-58.

171. *Id.* at 360.

172. *Bishop*, 412 U.S. at 361 (citing United States v. Murdock, 290 U.S. 389 (1933)).

173. Internal Revenue Act of 1928, Sec. 146(9).

174. United States v. Murdock, 290 U.S. 389, 391, 397 (1933).

175. *Id.* at 396-98.

176. Diana S. Donaldson, *Meaning of Willfulness for Tax Felonies and Misdemeanors*, 35 OHIO ST. L.J. 229, 235 (1974).

of finding the accused guilty of a lesser crime, may be forced to grant felony convictions in cases which involve only a minimal degree of willfulness.

The failure of *Bishop* to dispel the confusion surrounding the meaning of willfulness is indicated by subsequent appellate court opinions which either have ignored the requirement of bad purpose or evil motive,[177] or have paid lip service to reciting the words without elaboration.[178] The deficiencies in the opinion are unfortunate because the general criminal law has in the past borrowed its definition of willfulness from criminal tax cases.[179] The suggestion which emanates from *Bishop* that motive is intrinsic to willfulness could have far-reaching effects.[180]

B. New Interpretation of Willfulness for Tax Protest Suits: Cheek

In *United States v. Cheek*,[181] a decision that may have major implications for future tax protest suits, the Supreme Court held that a good-faith misunderstanding of the law or a good-faith belief that one is not violating the law negates the willfulness element of a tax evasion charge, regardless of whether the claimed misunderstanding or belief is objectively reasonable. This Supreme Court decision will allow evidence of a defendant's view of the tax system, in spite of any or all appearances of unreasonableness, to go to the jury for consideration of the willfulness of an evasion of taxes. Prior to this decision, a good faith misunderstanding or belief had to be objectively reasonable and the tax evasion could not be based on constitutionality issues.[182]

1. Facts of *Cheek*

The taxpayer was a pilot for a major airline. Through 1979, he filed his income tax returns, but thereafter ceased to file. Also, for the years 1981 through 1984, he indicated on his forms W-4 that he was exempt from federal taxes. The taxpayer was indicted for 10 federal violations of federal tax law, including willfully failing to file federal tax returns[183] and willfully evading income taxes.[184] These tax offenses are specific-intent crimes requiring that the defendant acted willfully.

In the district court, the government showed that the taxpayer was involved in at least four civil cases challenging various aspects of the federal

177. United States v. Andros, 484 F.2d 531 (9th Cir. 1973).

178. United States v. DiVarco, 484 F.2d 670, 673-75 (7th Cir. 1973), *cert. denied*, 415 U.S. 916 (1974).

179. *See* Screws v. United States, 325 U.S. 91, 101 (1945); United States v. Illinois Cent. R.R., 303 U.S. 239, 242 (1938).

180. For example, the Securities Act of 1933, 15 U.S.C. § 77X (1971) and the Securities Exchange Act of 1934, 15 U.S.C. § 78 ff (1971) require a willful violation.

181. 882 F.2d 1263 (7th Cir. 1988), *cert. granted* 443 U.S. 1068 (1990), *vacated* 111 S. Ct. 604 (1991).

182. *See* United States v. Buckner, 830 F.2d 102, 103 (7th Cir. 1987).

183. I.R.M. § [7203] (1987).

184. I.R.M. § [7201] (1987).

income tax system. He also belonged to a group that believes the federal tax system is unconstitutional. Testifying in his own defense, the taxpayer stated that he sincerely believed that the tax laws were unconstitutionally enforced against him, that his wages were not subject to taxation and that his non-filing was lawful. He argued that he had acted without the willfulness required for criminal conviction. The district court judge, in his instructions, advised the jury that, in order to prove "willfulness," the government must prove the voluntary and intentional violation of a known legal duty, a burden that could not be proved by showing mistake, ignorance, or negligence. He further advised that an objectively reasonable good-faith misunderstanding or belief of the law would negate willfulness, but that mere disagreement with the law would not. After the jury indicated that it could not reach a verdict, the judge further instructed the jury that an honest but an unreasonable belief is not a defense and does not negate willfulness. The jury found the taxpayer guilty on all counts, based on a lack of finding the taxpayer's good-faith misunderstandings and beliefs objectively reasonable.[185] On appeal to the Court of Appeals for the Seventh Circuit, the taxpayer argued that the district court erred by instructing the jury that only an objectively reasonable misunderstanding of the law negates the statutory willfulness requirement. The Seventh Circuit upheld the conviction as it agreed that the taxpayer's good-faith misunderstanding of the law was not objectively reasonable.[186] In prior cases, the Seventh Circuit had clarified that good-faith misunderstanding of the law negates willfulness only if the defendant's beliefs are objectively reasonable.[187] Because the Seventh Circuit's interpretation of "willfully" conflicted with that of other courts of appeals, the Supreme Court granted certiorari.

2. What Determines Willfulness

In *Cheek*, the Supreme Court traced the evolution of the standard for the statutory willfulness requirement from the common-law general rule that ignorance or mistake of the law is no defense to the present situation where willfulness is the voluntary, intentional violation of a known duty.[188]

The Court noted that, in a criminal case, as presently construed, the willfulness standard, requires the government to prove that the defendant was aware of the duty at issue.[189] This awareness cannot be found if the jury accepts a good-faith misunderstanding and belief submission by the defendant.[190] In this decision, the Supreme Court added that the jury may consider the claim regardless of whether the misunderstanding or belief is

185. Cheek v. United States, No. 82 C 2304 (N.D. Ill. March 8, 1984) (per curiam).

186. Cheek v. United States, 882 F.2d 1263 (7th Cir. 1989).

187. United States v. Bressler, 772 F.2d 287, 290 (7th Cir. 1985).

188. Cheek v. United States, 111 S. Ct. 604 (1991). *See, e.g.*, United States v. Pomponio, 429 U.S. 10 (1976) (*per curiam*) ; Bishop v. United States, 412 U.S. 346 (1973).

189. *Cheek*, 111 S. Ct. at 610.

190. *Id.* at 611.

objectively reasonable.[191] In this case, the taxpayer's claims that he was not a person required to file a return or pay taxes and that wages are not taxable should have gone to the jury without instructions limiting their potential persuasiveness.[192] The jury could determine the sincerity and credibility of these good-faith claims through other admissible evidence.[193] The Court explained that knowledge and belief are questions for the fact finder.[194] The characterization of a particular belief as not objectively reasonable transforms the inquiry into a legal one and would prevent the jury from hearing it.[195] Additionally, the Court asserted that forbidding the jury to consider evidence pertaining to the taxpayer's good-faith beliefs that could negate willfulness would raise a serious issue under the Sixth Amendment's jury trial provisions.[196]

The taxpayer also maintained that he believed in good faith that the income tax law was unconstitutional as applied to him and, thus, could not legally impose a duty on him of which he would have been aware.[197] According to the Court, claims involving the constitutionality of a tax provision reveal full knowledge of the law at issue and a studied conclusion that the provisions are invalid and unenforceable.[198] Such a mind-set, reasoned the Court, indicates a voluntary and intentional violation of a known duty and would not negate the willfulness requirement.[199] Therefore, the Court concluded that a defendant's views about the validity of tax statutes (1) are irrelevant to the issue of willfulness, (2) need not be heard by the jury, and (3) if heard, an instruction to disregard would be proper.[200]

Accordingly, the Supreme Court decided that the district judge did not err when instructing the jury to disregard the taxpayer's claims that the tax laws were unconstitutional.[201] However, it was an error for the court to instruct the jury to disregard the taxpayer's asserted beliefs that wages were not income and that he was not a taxpayer within the meaning of the Code when the jury was determining the willfulness of the taxpayer's actions.[202]

In his concurrence, Justice Scalia agreed with the judgment only.[203] He questioned the possibility that a belief in the nonexistence of a textual prohibition may excuse liability, while a belief in the invalidity of a textual prohibition will not excuse liability and cannot even be considered.[204] He asserted that the new interpretation of a willful violation being established by

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191. *Id.*
192. *Id.*
193. *Id.*
194. *Id.*
195. *Id.*
196. *Id.*
197. *Id.* at 612.
198. *Id.* at 612-13.
199. *Id.*
200. *Id.* at 613.
201. *Id.*
202. *Id.*
203. *Id.* (Scalia, J., concurring).
204. *Id.*

full knowledge and a studied conclusion may impose criminal sanctions on those who find incompatibilities between Treasury regulations and the Code, Treasury rulings and the regulations, or even IRS auditor pronouncements and Treasury rulings.[205]

In their dissent, Justices Blackmun and Marshall (Justice Souter did not participate) found the district court's instruction requiring an objectively-reasonable good-faith belief to be an additional protection for the taxpayer and an additional hurdle for the prosecution.[206] The new interpretation of willfulness broke down that additional wall. Additionally, these Justices maintain that this opinion will encourage taxpayers to cling to frivolous views of the law in hope of convincing a jury of their sincerity.[207] In their view, this decision may have gone beyond the limits of common sense.

3. The Impact of *Cheek* for the Future

While added frivolous claims may enter the court system under this broader interpretation of willfulness, a jury will still have the final say on how sincere a taxpayer's beliefs are when weighed against the alleged reasonableness of the asserted good-faith beliefs. However, many tax protest cases revolve around constitutional issues, an aspect the Court appears to have left untouched. Moreover, it should be noted that the decision affects criminal cases only. Civil sanctions are still available to collect back taxes, interest and penalties. Issues raised by this decision will eventually work their way through the court system and lend guidance for determining the acceptability and accessibility of tax protests suits.

4. Future Effects of *Bishop*

According to one author, *Bishop* can be read to support three contradictory positions:

> 1. The Court may have intended to make motive an element of every tax offense requiring willfulness. If so, the prosecutorial burden will be extremely heavy and valid defenses will abound.
> 2. The prosecution does not have to prove motive, but defenses based on lack of bad purpose or evil motive will be available. Defenses of this type were frequently asserted before *Bishop* without success, and their fate after *Bishop* is examined below.
> 3. [There is] an equivalence between motive and intent so that proof of an intentional violation of a known duty suffices to establish willfulness. Interpreted thus, the words "bad purpose or evil motive" add nothing of substance to the definition of willfulness.[208]

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205. *Id.*
206. *Id.* at 615 (Blackmun, J., dissenting).
207. *Id.*
208. Donaldson, *supra* note 176, at 235.

The existence of three defensible characterizations of *Bishop* complicates analysis of the results of the case. However, given that knowledge is now the minimum possible scienter requirement for willfulness, and that this level of scienter is uniform in tax felonies and misdemeanors, one can speculate as to probable effects of *Bishop*.

5. Limitations of *Bishop*

In 1976, the Supreme Court ended the confusion caused by the early and continuing references to bad purpose and evil motive. Simply put, the issue was whether proof of a specific intent to violate the law was sufficient, or whether the jury was required to find that the taxpayer acted with bad purpose or evil motive. In *United States v. Pomponio*,[209] a *per curiam* decision, the Court seemed surprised that lower courts were requiring a finding of bad purpose or evil motive. The Court stated that the lower courts "incorrectly assumed that the reference to an 'evil motive' in *United States v. Bishop* and prior cases meant something more than the specific intent to violate the law . . . ."[210] The Court then stated the meaning of the term in language that remains the standard definition: willfulness "simply means a voluntary, intentional violation of a known legal duty."[211]

Although courts and commentators still refer to the evil motive or bad purpose requirement, it is important to recognize that these terms are illustrative and do not impose any additional proof requirement. Thus, a jury finding that a defendant acted with an evil motive is tantamount to the ultimate finding of willfulness; on the other hand, a jury can find that a defendant acted willfully without finding that he acted with a bad purpose or evil motive. In other words, although a voluntary and intentional violation of a known legal duty may reflect a bad purpose or evil motive, the Service need not prove, and the jury need not find, both the specific intent to violate the law and evil motive or bad purpose. Moreover, the Supreme Court has ruled that the *Bishop* concept of willfulness is no longer applicable to criminal prosecution for frivolous positions (as previously discussed).

6. Effect on Governmental Prosecution

As previously mentioned in Section II, a major purpose of criminal tax prosecution is deterrence of potential future violators. To that effect, possible cases undergo a screening procedure within the Treasury Department to insure that only cases with an excellent chance of conviction are prosecuted. For example, in 1971, 72 million returns out of over 113 million were mathematically verified, and the Intelligence Division forwarded to the Justice Department for prosecution only 1,021 income tax and miscellaneous criminal tax cases.[212]

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209. 429 U.S. 10 (1976) (per curiam).
210. *Id.* at 11.
211. *Id.* at 12.
212. MCCALL, THE DIMENSIONS OF TAX FRAUD, (1973).

Will this small number of cases decrease further in view of the fact that a showing of caprice or careless disregard will no longer be sufficient to establish a willful misdemeanor? It is difficult to determine how the greater burden of proof will affect government prosecutors, though they have long been faced with an identical burden in felony cases. It at least seems safe to predict that if the taxpayer is disreputable and there exists clear proof of a repetitive pattern of evasion, Treasury officials will recommend criminal prosecution notwithstanding lack of convincing proof of willfulness.[213] These considerations may mitigate the effect of *Bishop* on misdemeanor prosecutions.

One provision which may be seriously affected by a more stringent scienter requirement for willful misdemeanors is the "failure to file" charge, the only really viable part of section 7203. Speculation has been that "[as] data processing becomes more effective, it is likely that failure to file cases will be on the increase."[214] Despite this trend, the government, after *Bishop* and *Cheek*, may be reluctant to recommend prosecution under section 7203 unless it can prove a repetitive pattern of failure to file and the taxpayer is not the sort likely to elicit sympathy from a jury as to willfulness.[215]

7. Effect on Defendants

A taxpayer who is unfortunate enough to become a defendant may be benefitted by a greater range of possible defenses if *Bishop* has added motive to the elements of tax offenses or at least allowed benevolent motives as an independent defense. For example, the defense of emotional disturbance is often used by defendants and rarely accepted by courts.[216] After *Bishop*, a defendant's showing that he is incapable of forming the requisite evil motive

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213. Balter, *supra* note 15, at § 13.3.

214. Jackson L. Boughner, *How Practitioners Should Handle Willful Failure to File Cases*, 32 J. TAX'N. 46 (1970).

215. The filing of purported "returns" that lack sufficient information to permit determination of the tax due does not constitute the filing of a "return," and the protestor can be prosecuted under Section 7203 and assessed civil penalties for delinquent filing. *See, e.g.*, United States v. Daly, 481 F.2d 28 (8th Cir. 1973) (upheld a section 7203 conviction against a person whose "return" contained only demographic information and documents questioning the constitutionality of the tax laws). Similarly, United States v. Vance, 730 F.2d 736 (11th Cir. 1984) shows that a return that simply identifies the taxpayer and makes a blanket "fifth amendment" claim is not a "return," or a valid assertion of the fifth amendment protection against self-incrimination. However, United States v. Edwards, 777 F.2d 644 (11th Cir. 1985) shows to avoid the "no return" problem and at the same time validly invoke the fifth amendment, the claim must be made as to only specified types of questions, such as the source of the taxpayer's income, and the return must otherwise be correct and complete.

216. *See* United States v. Bernabei 473 F.2d 1385, 1385 (6th Cir.), *cert. denied*, 414 U.S. 825 (1973); United States v. Haseltine, 419 F.2d 579, 581 (9th Cir. 1969); United States v. Fancy, 411 F.2d 1213, 1215 (9th Cir.), *cert. denied*, 396 U.S. 957 (1969); United States v. Levy, 326 F. Supp. 1285, 1294, 1298 (D. Conn.), *aff'd*, 449 F.2d 769 (2d Cir. 1971).

for conviction may be a valid defense.[217] Similarly, an intent to comply in the future may be an acceptable defense as showing lack of bad purpose or evil motive. A mistaken belief, albeit held perversely in the face of contradictory information, may now provide a defense even if motive is not considered an element, because it vitiates the knowledge or intent required for willful violation. In short, any explanation which is a believable alternative to a bad purpose or evil motive could conceivably defeat the criminal charge if motive is an element of defense.[218]

Although *Bishop* for the most part seems to aid defendants, it saddles them with at least one clear disadvantage: the unavailability of a lesser-included-offense instruction when all the elements of the greater offense except willfulness are clearly proved. On the other hand, if the government's proof of willfulness after *Bishop* is doubtful enough to have warranted a lesser-included-offense instruction under the disapproved felony-misdemeanor willfulness dichotomy, that weakness should now warrant acquittal because the proof of willfulness would necessarily be inadequate to sustain a misdemeanor conviction. Logically, *Bishop* leaves the defendant's position either unchanged or strengthened as regards the effect of the government's failure to meet the willfulness test.

In actuality, this must not be the case; otherwise, *Bishop* would not have appealed the district court's refusal of the lesser-included-offense instruction. Apparently, providing a jury with an alternative offense on which to convict, even one much less severe than that charged, increases the chance of a finding that the government failed to establish the requisite degree of willfulness for a felony conviction. If the only alternative is to acquit altogether, the jury is probably more hesitant to find insufficient the government's proof of willfulness. If this analysis is correct, to deny defendants a lesser-included-offense instruction on willfulness as a variable is to increase the chances of a felony conviction on a tenuous showing of willfulness.

C. Plea Bargaining

Closely akin to the lesser-included-offense problems discussed above is the use of plea bargaining. Balter describes this as the "tax fraud syndrome" due to the ironic results of a taxpayer violating both a misdemeanor and a felony section.[219]

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217. *But see* Sansone v. United States, 380 U.S. 343, 353-54 (1965) (defense of emotional disturbance held insufficient); United States v. Edwards, 375 F.2d 862, 867 (9th Cir. 1967) (same).

218. *E.g.*, Martin v. United States, 317 F.2d 753 (9th Cir. 1963) (the belief that income as low as $1,500 does not trigger the obligation to file income tax returns); Abdul v. United States 254 F.2d 292, 293 (9th Cir. 1958), *cert. denied*, 364 U.S. 832 (1960) (the belief that the filing of a return must be accompanied by payment of the tax); Ripperger v. United States, 248 F.2d 944, 945 (4th Cir. 1957), *cert. denied*, 355 U.S. 940 (1958) (same).

219. Harry G. Balter, *"Plea Bargaining" and the "Tax Fraud" Syndrome*, 52 TAXES 333, 333-36 (1974).

1. Meaning of Plea Bargaining

At one time, plea bargaining in the tax fraud area meant that the taxpayer who was ready to "call it quits" would be allowed by the U.S. Attorney to plead "guilty" to the principal felony count in a multi-count indictment (assuming it contained a felony count), with the understanding that the remaining counts would be dismissed.[220] Next, it became popular for plea bargaining to be based on the defendant's agreement to plead *nolo contendere* (no contest) to one or more counts of a multi-count indictment if the rest of the counts were dismissed.[221] Today, the concept has progressed even further, primarily due to the emergence of the following factors:

1. agreement by government prosecutors to grant partial (bringing fewer criminal charges than they could on the evidence available), or total immunity, in return for the potential defendant's testimony against others; and
2. agreement by prosecutors to accept a plea of guilty or (more often) "no contest" to a misdemeanor charge rather than to a felony charge (which either is part of a multi-count indictment, or was to have been included in the charges actually brought).[222]

2. Ironic Effects of New Factors

The latter of these two developments brings to the fore some interesting considerations in light of the Supreme Court decision in *Bishop*. Since the degree of willfulness required for a conviction of a misdemeanor charge is probably identical to that required in a felony charge, it is doubtful that a prison sentence meted out on a plea of guilty or no contest, or after a finding of guilty by a court or a jury, on a felony count would exceed that imposed on a misdemeanor count.

If this is the case, then there must be other motivating forces which cause the taxpayer to often hold out for a plea to a misdemeanor rather than to a more clearly applicable felony count. Balter suggests the following concepts as the more obvious motivating forces:

1. The relative impact of a misdemeanor versus felony conviction on suspension or disbarment in the case of a defendant who is a lawyer. [A]s a practical matter conviction on a misdemeanor charge is more likely to result in a more favorable disposition than would result from conviction in a felony charge.
2. The relative impact of the felony versus misdemeanor conviction vis-a-vis obtaining or retention of state licenses required of defendants who are not lawyers, but must have a state license in order to earn a livelihood, e.g., physicians, dentists, optometrists,

220. *See* Schmidt, *supra* note 88, at 299.
221. *Id.*
222. Balter, *supra* note 15, at § 13.3.

contractors, plumbers, electricians, and innumerable others who are engaged in professions, trades or businesses.

3. The relative impact of a misdemeanor versus felony conviction on the ability of the defendant to retain or in the future attain a public office.
4. The relative impact of a felony versus a misdemeanor count vis-a-vis pardon, commutation of sentence, restoration of civil rights, and similar restorative procedures, available under both federal and state statutes.[223]

In summary then, it appears that the defendant who faces these problems after conviction of a misdemeanor is in a far better position to achieve a satisfactory solution than if his conviction were for a felony, regardless of the imprisonment, if any, actually meted out. Moreover, it seems that the taxpayer has indeed been afforded a viable defense mechanism. However, a review of the case law indicates that there are a few inherent dangers in plea bargaining.

3. Case Law

Although the "Supreme Court has unequivocally put its stamp of approval on the 'plea-bargaining' process,"[224] *United States v. Bednarski*[225] demonstrates the dangers of attempting to negotiate a plea. The defendant in *Bednarski* entered a guilty plea to one of six tax fraud counts in the indictment and in response to the court's inquiries, stated that no threats or promises had been made to elicit such plea. In fact, the U.S. attorney had agreed to dismiss the other counts and recommended a one-month sentence and a $1,000 fine if the defendant would plead guilty to the single count. When the court became aware of the actual circumstances surrounding the guilty plea, it refused to accept it. The defendant was thereupon tried, found guilty on all six counts, and sentenced to four months imprisonment and fined $9,000. Accordingly, the defendant attempted to establish that the court was required to accept his initial plea of guilty. However, the court ruled that the acceptance of a guilty plea is discretionary, not mandatory.[226]

Apparently, the withdrawal of a plea offers another obstacle to the otherwise successful use of plea bargaining. The Fifth Circuit denied a taxpayer the right to withdraw his voluntary pleas of guilty and *nolo contendere* to misdemeanors since the pleas were knowingly and freely given.[227]

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223. *Id.* at 335.

224. *See* Brady v. United States, 397 U.S. 742, 757-58 (1970); Parker v. North Carolina, 391 U.S. 790, 799 (1970); United States v. Slatko, 462 F.2d 1169, 1171 (5th Cir.), *cert. denied*, 409 U.S. 1075 (1972) (citing North Carolina v. Alford, 400 U.S. 25, 31, 37 (1970)).

225. 445 F.2d 364 (1st Cir. 1971).

226. *Id.* at 365-66.

227. United States v. Slatko, 72-2 T.C. 9571 (1972).

The Third Circuit has further delineated the use of plea bargaining. In *United States v. Dixon, F. Dixon,*[228] the court was critical of the district court because it had failed to follow the procedures outlined in *Paradiso v. United States,*[229] an earlier decision by the Third Circuit Court of Appeals in which the same kind of problem was anticipated.[230] In *Paradiso,* the court had carefully outlined a procedure to help avoid ostensible claims by defendants of unfairness in the guilty plea process and minimize the escalating number of cases complaining of aborted plea bargains, involuntary pleas, or frustrated plea expectations.[231] So, in *Dixon,* the Third Circuit, under its supervisory powers, instructed the district courts of the Third Circuit to thereafter follow the procedure outlined (i.e., committing any plea bargain to the record at the time of the arraignment in connection with the Rule 11 inquiry).[232]

D. New Interpretations of IRS Responsibility in Investigation Procedures

Until 1969, the courts had maintained the position that the administrative rules and procedures of the IRS were discretionary.[233] Therefore, actions of the Service were not invalidated merely because it did not comply with such rules and procedures. However, decisions after 1969 indicate that this notion has become academic history.

1. Special Agent Warnings

Miranda v. Arizona[234] established the principle that, under certain circumstances, warnings had to be given by investigating agents to suspects or targets of an investigation before they are interrogated or requested to submit personal records. If these warnings are not given, use of a taxpayer's statements or records will be suppressed and will be inadmissible upon trial.

The requirements of *Miranda* came into play during a custodial interrogation, which was defined as one occurring after the suspect was taken into custody "or otherwise deprived of his freedom of action in any significant way."[235] If a taxpayer is in custody at the time of the interrogation, the

228. 504 F.2d 69 (3d Cir. 1974), *cert. denied,* 420 U.S. 963 (1975).

229. 482 F.2d 409 (3d Cir. 1973).

230. *Id.* at 72.

231. *Paradiso,* 482 F.2d at 413.

232. *Dixon,* 504 F.2d at 72.

233. Geurkink v. United States, 354 F.2d 629, 632 (7th Cir. 1965); Luihring v. Glotzbach, 304 F.2d 560, 565 (4th Cir. 1962); Cleveland Trust Co. v. United States, 266 F. Supp. 824, 831-32 (N.D. Ohio 1966), *aff'd,* 421 F.2d 475 (6th Cir.), *cert. denied,* 400 U.S. 819 (1970); Sherwood v. United States, 246 F. Supp. 502, 503 (E.D.N.Y. 1956); Hamilton v. United States, 324 F.2d 960, 965 (Ct. Cl. 1963); Flynn v. Commissioner, 40 T.C. 770 (1963).

234. 384 U.S. 436 (1966).

235. *Id.* at 436-38.

necessary warnings have to be given, whether the interrogator is a revenue agent or a special agent.[236]

The *Miranda* warnings that must be given to a suspect include the following:

1. the right to remain silent;
2. any statements that he makes may be used against him;
3. the right to counsel with an attorney prior to and during an interrogation; and
4. an attorney would be appointed for him if he could not afford one.[237]

Most circuits which have considered the problem have held that under ordinary circumstances interrogations by special agents are not custodial in nature and, therefore, that *Miranda* warnings are not required.[238]

The Seventh Circuit, however, has held to the contrary in *United States v. Dickerson*,[239] which determined, in effect, that the investigation became criminal in nature at the time the case was referred to the Intelligence Division. However, in *United States v. Waitkus*[240] the Seventh Circuit refused to apply *Dickerson* retroactively to a special agent's interrogation which occurred prior to the *Dickerson* decision.[241] Furthermore, the Seventh Circuit in *Waitkus* used language which may have weakened somewhat the thrust of the *Dickerson* decision:

> we find no showing that defendant was in custody or was deprived of his freedom of action in any significant way at the inception of the first contact with the special agents . . . .[We] see no basis for finding a denial of due process to defendant.[242]

If the problem of special agents' warnings had ended with principles enunciated in *Miranda*, there would have been relative certainty in the interpretation and application of the opinion in that case. However, the matter was complicated by two news releases issued by the Service.

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236. Mathis v. United States, 391 U.S. 1, 4-5 (1968).

237. *Miranda*, 389 U.S. at 444.

238. United States v. Stribling, 437 F.2d 765, 771-72 (6th Cir.), *cert. denied*, 402 U.S. 973 (1971); United States v. Jaskiewicz, 433 F.2d 415, 420 (3d Cir. 1970), *cert. denied*, 400 U.S. 1021 (1971); United States v. Prudden, 424 F.2d 1021, 1026-28 (5th Cir.), *cert. denied*, 400 U.S. 831 (1970); United States v. Brevik, 422 F.2d 449, 450 (8th Cir.), *cert. denied*, 398 U.S. 943 (1970); Simon v. United States, 421 F.2d 667, 668 (9th Cir.), *cert. denied*, 398 U.S. 904 (1970); United States v. Caiello, 420 F.2d 471, 473 (2d Cir. 1969), *cert. denied*, 397 U.S. 1039 (1970); Hensley v. United States, 406 F.2d 481, 484-85 (10th Cir. 1968); United States v. Bagdasian, 398 F.2d 971, 971 (4th Cir. 1968).

239. 413 F.2d 1111 (7th Cir. 1969).

240. 470 F.2d 18 (7th Cir. 1972), *cert. denied*, 410 U.S. 930 (1973).

241. *Dickerson* was decided July 28, 1969.

242. *Waitkus*, 470 F.2d at 22.

The news releases describe the Service procedures for protecting the constitutional rights of persons suspected of tax fraud during all phases of its investigations. The essence of the two news releases follows:[243]

1. *News Release of 10/3/67*—On the initial contact the Special Agent will introduce himself by title and state that he is investigating the possibility of criminal fraud. If the investigation goes beyond preliminary inquiries, the Special Agent is required to advise the taxpayer of his Constitutional rights to remain silent and to retain counsel.
2. *News Release of 11/26/68*—At the initial meeting with the taxpayer, the Special Agent will identify himself, describe his function and give full *Miranda* warnings.[244]

2. Effect of Noncompliance

Two oft-cited decisions, *United States v. Heffner*[245] and *United States v. Leahey*,[246] have held that the failure by special agents to give the warnings prescribed by the Service requires the suppression of evidence produced by a taxpayer.[247] In *Leahey*, the court announced that agents of the Service had a duty to conform to its procedures, that citizens have a right to rely on conformance with publicized instructions, and that the courts must enforce both the right and the duty.[248] In *Heffner*, it was stated that it is of no significance that procedures of the Service are more generous than the Constitution requires.[249]

Several district courts, however, have refused to follow the *Heffner-Leahey* doctrine.[250] The rationale of these decisions seems to be that the Constitution and laws may dictate conditions for the admissibility of evidence in a federal trial; administrative agencies may not.

Several decisions have held that substantial compliance with requirements set forth in the news releases is all that is required; literal compliance is not necessary.[251] The First Circuit expressed a "disinclination to view an agency as irrevocably locked into the specific verbal formulation" of a news release.[252]

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243. United States v. Harary, 71-1 T.C. 9362 (1971).

244. Roberts & Riley, *supra* note 2, at A-21 to A-22.

245. 420 F.2d 809 (4th Cir. 1969).

246. 434 F.2d 70 (1st Cir. 1970).

247. *See, e.g.*, Beckwith v. United States, 425 U.S. 341 (1976); Mathis v. United States, 391 U.S. 1 (1968).

248. Leahey, 434 F.2d at 71-72.

249. *Heffner*, 420 F.2d at 812.

250. *See* Fukushima v. United States, 372 F. Supp 212 (D. Haw. 1974); United States v. Luna, 313 F. Supp 1294 (W.D. Tex. 1970); United States v. Middleton, 70-2 T.C. 9491 (1970).

251. United States v. Dawson 486 F.2d 1326, 1130 (5th Cir. 1973); United States v. Bembridge, 458 F.2d 1262, 1264 (1st Cir. 1972).

252. *Bembridge*, 458 F.2d at 1264.

3. Limits on Summons Enforcement

General restrictions on the enforceability of administrative summonses were imposed by the Supreme Court in *United States v. Powell*.[253] There, the Court held that the Commissioner need not meet any standard of probable cause to obtain enforcement of his summons, either before or after the expiration of the three-year statute of limitations applicable to ordinary tax liabilities.[254] However, he must show that

> the investigation will be conducted pursuant to a legitimate purpose, that the inquiry may be relevant to the purpose, that the information sought is not already within the Commissioner's possession, and that the administrative steps required by the Code have been followed .... It is the court's process which is invoked to enforce the administrative summons and a court may not permit its process to be abused. Such an abuse would take place if the summons had been issued for an improper purpose, such as to harass the taxpayer or put pressure on him to settle a collateral dispute, or for any other purpose reflecting on the good faith of the particular investigation.[255]

There is no express provision in section 7602 for the issuance of a summons for the purpose of securing evidence for use in a criminal prosecution. On the basis of that omission, taxpayers have urged the courts to refuse to enforce administrative summonses issued by special agents on the ground that their function, and accordingly the purpose of the issuance of the summonses, is the furtherance of a criminal prosecution, and therefore not authorized under section 7602. Generally, courts have taken the position that the functions of a special agent are dual, civil as well as criminal. Accordingly, administrative summonses have usually been enforced.[256] The Supreme Court definitely settled all doubts on the matter in *Couch v. United States*.[257] It is now undisputed that a special agent is authorized, pursuant to "Section 7602, to issue an Internal Revenue summons in aid of a tax investigation with civil and possible criminal consequences."[258]

The Supreme Court referred to its prior decision in *United States v. Donaldson*[259] wherein the Court had stated: "We hold that under section 7602 an Internal Revenue summons may be issued in aid of an investigation if it is issued in good faith and prior to a recommendation for criminal prosecution."[260]

As appears from the above quotations, in spite of general enforceability of special agent summonses, there are definite restrictions upon the use of

253. 379 U.S. 48 (1964).
254. *Id.* at 57.
255. *Id.* at 57-58 (footnote omitted).
256. *See e.g.*, Donaldson v. United States, 400 U.S. 517, 535 (1971).
257. 409 U.S. 322 (1973).
258. *Id.* at 326.
259. 400 U.S. 517 (1971).
260. *Id.* at 536.

such summonses.[261] For instance, in *Donaldson* the Court was careful to point out that "where the sole objective of the investigation is to obtain evidence for use in a criminal prosecution, the purpose is not a legitimate one and enforcement may be denied."[262] The Supreme Court referred to several cases in support of this conclusion.[263]

In fraud investigations involving return preparers, the use of "John Doe" summonses by the Service has been restricted to situations involving "either a single unidentified taxpayer or a small group of unknown taxpayers.[264] According to *United States v. Theodore*,[265] the Service is not to be given an unrestricted license to rummage through the files of a returns preparer. In *United States. v. Bisceglia*,[266] in which the Supreme Court first sanctioned the use of John Doe summonses, the Service knew only that $40,000 in uniformly deteriorated $100 bills had been transferred to the Cincinnati Federal Reserve bank in a one week period. The Court enforced a summons on the transferor bank, labeled "In the matter of the tax liability of John Doe," to make available all its deposit records during the relevant weeks involving deteriorated $100 bills.

Code section 7609(f) provides the rules governing "John Doe" summonses. It requires an *ex parte* hearing prior to the service of such a summons, in which the Service must show that:

> (1) the summons relates to an ascertainable group or class of taxpayers (e.g., buyers of a particular tax shelter offering);
> (2) there is a reasonable basis for believing these persons may have failed to comply with the tax laws; and
> (3) the information sought by the summons is not readily available from other sources.[267]

Failure by the Service to establish that these criteria are satisfied should result in a refusal by the court to enforce the summons.

In view of the foregoing, the circumstances under which section 7602 summonses are issued should be carefully scrutinized since there are situations in which the use of such summonses is not permissible and enforcement will not be ordered by the courts.

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261. *See, e.g.*, Mathis v. United States, 391 U.S. 1 (1986); Beckwith v. United States, 425 U.S. 341 (1976).

262. *Donaldson*, 400 U.S. at 533.

263. *Id.* at 533-34 (citing United States v. Roundtree, 420 F.2d 845, 851 (5th Cir. 1969); Venn v. United States, 400 F.2d 207, 210 (5th Cir. 1968); Wild v. United States, 362 F.2d 206, 208-09 (9th Cir. 1966); United States v. O'Connor, 118 F. Supp. 248 (D. Mass. 1953)).

264. United States v. Theodore, 479 F.2d 749, 754 (4th Cir. 1973); *compare* United States v. Carter, 489 F.2d 413 (5th Cir. 1974).

265. 479 F.2d 749 (4th Cir. 1973).

266. 420 U.S. 141 (1975), *reh'g*, 486 F.2d 706 (6th Cir. 1973). *Compare* the limitation in *Bisceglia* with the language of Code section 7609(f) (added by the 1976 Tax Act).

267. I.R.C. § 7609(f) (1988).

4. Limit on Use of Search Warrant

In *Warden v. Hayden*,[268] the Supreme Court departed from the longstanding principle that search warrants were authorized only to seize the instrumentalities and fruits of crime or contraband, but not mere evidence of a crime. The Seventh Circuit in *Hill v. Philpolt*,[269] and the Ninth Circuit in *Vonder Ahe v. Howland*,[270] have held that searches and seizures of taxpayer's records, pursuant to search warrants, violated their privilege against compulsory self-incrimination under the Fifth Amendment. The search warrant procedure was considered as compulsory a method of obtaining these records as a subpoena requiring the taxpayer to produce them. Both courts rejected the government's argument that "once the validity of a search is established under the Fourth Amendment—and by that fact alone—the Fifth Amendment is not and cannot be violated."[271]

The Sixth Circuit reached a contrary conclusion in *United States v. Blank*[272] as it specifically rejected the rationale of *Hill* and concluded that the search warrant involved no element of compulsion as a subpoena would. However, it is noted that the records seized were bookmaking records which even prior to *Warden*, would probably have been considered instrumentalities of the crime, rather than mere evidence thereof.

In *United States v. Rajewick*[273] a conviction for attempted tax evasions was affirmed in spite of the use of a search warrant and the seizure of documents. However, it appears that the documents seized were corporate records which could have been subpoenaed and would not have been protected by a claim of the Fifth Amendment, so that the rationale of *Hill* and *Vonder Ahe* is inapplicable.

Consequently, if search warrants should be used in a tax fraud investigation, the teachings of *Hill* and *Vonder Ahe* should be kept in mind. There is a distinct probability that the use of records of an individual taxpayer seized pursuant to a search warrant will be suppressed.

E. Further Weaknesses in the Accountant-Privilege Armor

Although the assistance of a qualified accountant is almost indispensable in most fraud investigations, the federal courts do not recognize a privilege with regard to communications made by a taxpayer to his accountant.[274] Indeed, an accountant-client privilege will not be recognized by the federal courts even in a state which expressly creates such a privilege.[275] Accord-

268. 387 U.S. 294 (1967).

269. 445 F.2d 144 (7th Cir.), *cert. denied*, 404 U.S. 991 (1971).

270. 508 F.2d 364 (9th Cir. 1974).

271. *Hill*, 445 F.2d at 146.

272. 459 F.2d 383, 385 (6th Cir. 1972).

273. 470 F.2d 666 (8th Cir. 1972).

274. For further discussion, see Robert S. Fink, *The Role of the Accountant in a Tax Fraud Case*, 141 J. ACCT. 41 (April 1976).

275. Falsone v. United States, 205 F.2d 734, 741-42 (5th Cir.), *cert denied*, 346 U.S. 864 (1953).

ingly, an accountant employed by a taxpayer may be compelled to testify as to documents submitted, and statements made to him by the taxpayer.[276]

On the other hand, the federal courts do recognize an attorney-client privilege with one stipulation. Protection may be afforded a taxpayer where the accountant is hired by his attorney and brought within protection of the attorney-client privilege.[277]

1. Records in Accountant's Possession

The decision of the Supreme Court in *Couch v. United States*[278] points up a related problem involving the records of an individual taxpayer in the possession of her accountant. As stated by Mr. Justice Powell, the question presented was "whether the taxpayer may invoke her fifth amendment privilege against compulsory self-incrimination to prevent the production of her business and tax records in the possession of her accountant."[279] The records in question had been given by the taxpayer to her accountant for the purpose of preparing her income tax returns.[280] The Court pointed out, however, that when the taxpayer surrendered possession "she, of course, retained title in herself."[281]

The Supreme Court denied that the privilege was available, holding that possession rather than "ownership" bears the "closest relationship to the personal compulsion forbidden by the Fifth Amendment."[282] The Court further stated that the criterion for Fifth Amendment immunity remains "not the ownership of property but the 'physical or moral compulsion exerted.' We hold today that no Fourth or Fifth Amendment claim can prevail where, as in this case, there exists no legitimate expectation of privacy and no semblance of governmental compulsion against the person of the accused."[283]

When a tax fraud investigation is imminent or in progress, the knowledge to be gained from *Couch* is that a taxpayer's records should, to the extent feasible, be retained in the possession of the taxpayer; or if necessarily taken to the accountant's office they should be returned to the taxpayer as soon as possible. The Fifth Amendment privilege can, of course, be invoked by a taxpayer as to personal records in his own possession.

2. Workpapers in Taxpayer's Possession

The apparently conflicting decisions in the matter of an accountant's workpapers which are turned over to a taxpayer by his accountant appear to

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276. *See* United States v. Arthur Young & Co., 465 U.S. 805 (1984); United States v. Balistrieri, 403 F.2d 472, 481 (7th Cir. 1968), *vacated*, 395 U.S. 710 (1969).

277. *See* Upjohn Co. v. United States, 449 U.S. 383 (1981); United States v. Kovel, 296 F.2d 918, 922-23 (2d Cir. 1969).

278. 409 U.S. 322 (1973).

279. *Id.* at 323.

280. *Id.* at 324.

281. *Id.*

282. *Id.* at 331.

283. *Id.* at 336 (citation omitted).

have been clarified by the *Couch* decision.[284] Moreover, Judge Hunter in a concurring and dissenting opinion in *United States v. Fisher*[285] made the following observation:

> It is my view therefore that the approach taken by the Ninth Circuit in *Cohen*[286] has been explicitly approved by *Couch* and comports fully with the fifth amendment view embraced by the Supreme Court, i.e., that possession, not ownership, is the significant factor and that the privilege protects one from having to produce the evidence, though not from its production.[287]

Accordingly, where accountant's workpapers are in the possession of the taxpayer, their production in response to an administrative summons may not be successfully resisted. While the reasoning of the *Kasmir* opinion is convincing and its principles should ultimately prevail, the Supreme Court has ruled otherwise—i.e., accountant's workpapers in the possession of the taxpayer are not protected from administrative summons.

F. Increasing Limits Placed on Privilege Against Self-Incrimination

The basic restrictions and limitations upon the investigative powers of special agents arise from the self-incrimination clause of the Fifth Amendment to the Constitution.

The Constitution imposes a barrier not only to obtaining testimony from a taxpayer but also to an examination of an individual's books and records. As early as *United States v. Boyd*,[288] the Supreme Court pointed out that "we have been unable to perceive that the seizure of a man's private books and papers to be used in evidence against him is substantially different from compelling him to be a witness against himself."[289]

In a recent decision, *Bellis v. United States*,[290] the Supreme Court reaffirmed this doctrine in the following language:

> It has long been established, of course, that the Fifth Amendment privilege against compulsory self-incrimination protects an individual from compelled production of his personal papers and effects as well as compelled oral testimony . . . . The privilege applies to the business records of the sole proprietor or sole practitioner as well as to personal documents containing more intimate information about the individual's private life.[291]

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284. *See* Rena C. Cohen, *Accountants' Workpapers in Federal Tax Investigations*, 21 TAX L. REV. 183 (1966).

285. 500 F.2d 683 (3d Cir. 1974), *cert. granted*, 420 U.S. 906 (1975), *aff'd*, 425 U.S. 391 (1976).

286. Cohen v. United States, 388 F.2d 464 (9th Cir. 1967).

287. *Fisher*, 500 F.2d at 696.

288. 116 U.S. 616 (1886).

289. *Id.* at 617-18.

290. 417 U.S. 85 (1974).

291. *Id.* at 87-88.

These principles, relating to an individual taxpayer's testimony and records are, of course, accepted without reservation by the Service. On the other extreme is the equally well established principle that corporate books and records are not privileged and are not protected by the Fifth Amendment privilege, even in the hands of a corporate official who may be the target of an investigation.[292] The nonprivileged status of corporate records is not affected by the circumstance that the corporation involved may have, in effect, a one-man corporate structure, and may be the mere *alter ego* of its owner;[293] or may be a Subchapter S corporation.[294]

Between the privileged status of an individual's records and the nonprivileged status of corporate records is an area of controversy and litigation. For instance, the records of an unincorporated association and a labor union have been held to be non-privileged,[295] as have been the records of a Massachusetts trust.[296] It appears clearly that the trend has been to restrict and limit the scope of the privilege.

The most recent pronouncement of the Supreme Court on the subject was made in *Bellis v. United States*[297] which held that the Fifth Amendment privilege against self-incrimination was not available in regard to the records of a dissolved three-man law partnership. In the course of the majority opinion in *Bellis*, delivered by Justice Marshall, reference was made to a number of Supreme Court decisions upholding the compelled production of the records of a variety of organizations over individuals' claims of Fifth Amendment privilege: "These decisions reflect the Court's consistent view that the privilege against compulsory self-incrimination should be 'limited to its historic function of protecting only the natural individual from compulsory incrimination through his own testimony or personal records.'"[298]

In *Bellis*, the majority referred to a major theme running through prior decisions, namely, "protection of individual privacy," and noted that a claim of privacy or confidentiality cannot be maintained with respect to the financial records of an organized collective entity.[299] The Court noted that control of such records is generally strictly regulated by statute and access to the records is guaranteed to others in the organization.[300]

In referring to the three-man partnership, the Court used such expressions as "organized institutional identity," "formal institutional arrangement," "independent entity with a relatively formal organization," leaving open the possibility that there are partnerships whose records might be protected by the

292. Wilson v. United States, 221 U.S. 361, 377-78 (1911).

293. Hair Industry, Ltd. v. United States, 340 F.2d 510, 511 (2d Cir.), *cert. denied*, 381 U.S. 950 (1965).

294. United States v. Mid-West Business Forms, 474 F.2d 722, 723 (8th Cir. 1973); United States v. Richardson, 469 F.2d 349, 350 (10th Cir. 1972).

295. United States v. White, 322 U.S. 694 (1944).

296. Anguilo v. Mullins, 338 F.2d 820 (1st Cir. 1964), *cert. denied*, 380 U.S. 963 (1965).

297. 417 U.S. 85 (1974).

298. *Id.* at 89-90 (quoting United States v. White, 322 U.S. 674, 701 (1944)).

299. *Id.* at 91.

300. *Id.*

Fifth Amendment privilege.[301] The Court stated: "[T]his might be a different case if it involved a small family partnership, or . . . if there were some other pre-existing relationship of confidentiality among the partners."[302]

Under the circumstances, if records are sought by agents during a tax fraud investigation, a decision will have to be made whether the records involved are privileged and whether their production can be resisted in a court proceeding.

G. Effective Use of the Fifth Amendment as a Defensive Weapon

Although there are many instances of the courts' unwillingness to accept the Fifth Amendment defense, there are some situations in which the courts have dismissed a case solely on such grounds. As previously noted, successful uses have been made of this defense in connection with the client's records and the accountant's workpapers.

The Fifth Amendment's protection against compulsory self-incrimination has also been used effectively in a few other types of criminal cases. In *United States v. Sams*,[303] the defendant's conviction under section 7203 was overturned because it was based on his plea of guilty to willful failure to pay the federal occupational tax imposed on wagering. As was held by the Supreme Court in *Marchetti v. United States*,[304] the wagering statutes "may not be employed to punish criminally those persons who have defended a failure to comply with their requirements with a proper assertion of the privilege against self-incriminations."[305] In *Sams*, this principle was used to annul a conviction for a guilty plea entered before the *Marchetti* decision.

This privilege was not waived because the taxpayer entered a guilty plea at the time of his conviction. The taxpayer at that time could not have known that his prosecution was constitutionally invalid and therefore his confession was not "knowingly, intelligently, and voluntarily made."[306] The Court also held that this constitutional infirmity was essentially more than a procedural change in the law which did not undermine the basic accuracy of the fact finding process. Rather, the newly expressed right affected the integrity of the conviction itself and therefore required its invalidation. The defendant had more than just the right to remain silent at trial; he also had the right not to be punished for failure to obey a statute which required an incriminatory act.

In summary, then, while the courts regularly waive the Fifth Amendment defense, there is still some prospect for success in pursuing such an argument. In any event, knowledge of the foregoing principles may be of immeasurable importance in protecting the taxpayer's basic rights during tax fraud investigations.

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301. *Id.* at 95-97.

302. *Id.* at 101 (citing United States v. Slutsky, 352 F. Supp. 1105 (S.D.N.Y. 1972)).

303. 521 F.2d 421 (3d Cir. 1975).

304. 390 U.S. 39 (1968).

305. *Id.* at 42.

306. *Id.* at 43-44.

H. Effective Use of the Sixth Amendment as a Defensive Weapon

As a result of the successful use of the Sixth Amendment defense—guarantee of a speedy trial—it is conceivable that the courts may be likely to grant a defendant's motion to dismiss for unnecessary delay. In *United States v. Blaustein*,[307] the court dismissed a tax evasion indictment where 27 months had transpired between the Court's order to serve a bill of particulars and produce documents for inspection and the government's full compliance therewith. Further support for the conclusion that this delay prejudiced the defendant's case was found in the fact that three material witnesses had died during the period of the government's delay. Moreover, the defendant was held not to have waived his right to a speedy trial.

The court in *Blaustein* cited Rule 4 of the *Second Circuit Rules Regarding Prompt Disposition of Criminal Cases*, announced on January 5, 1971, to become effective six months thereafter.[308] Rule 4 provides as follows:

> In all cases the government must be ready for trial within six months from the date of the arrest, service of summons, detention, or the filing of a complaint or of a formal charge upon which the defendant is to be tried (other than a sealed indictment), whichever is earliest. If the government is not ready for trial within such time, or within the periods as extended by the district court for good cause, then, upon application of the defendant or upon motion of the district court, after opportunity for argument, the charge shall be dismissed.[309]

Also cited in the *Blaustein* opinion was a memorandum of December 28, 1970, from the Chief Justice of the United States to all United States judges, similarly calling for more rapid conclusion of criminal cases.[310]

Thus, the courts have recognized that the passage of time may place a peculiar burden on the defendant-taxpayer and his witnesses and their availability in terms not only of their memories but also of their abilities to resurrect their records. The problem is one that rests squarely within the sound discretion of the trial court, and the trend may now be in favor of the taxpayer.

V. CONCLUSION

In light of what has developed since the 1950's in the criminal tax fraud area, it is appalling to see how widespread is the failure of taxpayers and their representatives to apply sound strategies. Moreover, there seemingly persists the failure to appreciate that, in any event, after the administrative stages are over, a tax evasion case is no longer a tax case with criminal law aspect; rather, it is criminal case with tax involvements.

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307. 325 F. Supp. 233 (S.D.N.Y. 1971).
308. *Id.* at 240.
309. *Id.*
310. *Id.*

Thus, it is of utmost importance that the taxpayer's defense counsel have knowledge of applicable substantiative law, the investigative process, and the court's interpretation of these elements. Only then may the taxpayer be assured his basic constitutional rights.