North Dakota Law Review

Volume 46 | Number 1 Article 1

1969

The Lawyer's Role in a Criminal Tax Evasion or Fraud Case prior to Indictment

Carlton J. Hunke

THE LAWYER'S ROLE IN A CRIMINAL TAX EVASION OR FRAUD CASE PRIOR TO INDICTMENT

CARLTON J. HUNKE*

Each year several criminal indictments for tax fraud or evasion are returned in North Dakota by the Federal Government. There are probably only two or three attorneys in North Dakota who regularly defend the federal criminal tax case at the trial level. There are many more attorneys who may be involved earlier in the development of a criminal tax case, during the investigation prior to indictment. This article concerns itself with the development of a criminal tax case prior to the indictment. Often this is the time when, as a practical matter, knowledgeable counsel is most important. This article will present what steps should be considered and taken in order to preserve an effective defense.

The most crucial stage of the defense case often occurs before indictment. The problems in this area are often not known by attorneys because at this stage, the proceedings are administrative rather than criminal. The various stages of the investigation by the Government will be presented first and then the problems that may arise for defense counsel will be discussed. Since the problems that may be encountered encompass constitutional rights under the Fourth, Fifth and Sixth Amendments, it is important that both sides are well prepared so that on the one hand precious rights of the taxpayer are not waived and so that on the other hand years of investigation and preparation and the justified conviction itself are not unavailing because of the unwitting denial of constitutional rights by an unknowledgeable or over-zealous agent.

INVESTIGATION

The investigation of a taxpayer by the Internal Revenue Service for possible criminal violations of the federal tax laws is generally a lengthy process often requiring two years or more. Occasionally,

* J.D., *cum laude* 1967, University of North Dakota; Law Clerk for Judge Charles J. Vogel; associate with law firm of Wattam, Vogel, Vogel and Peterson, Fargo, North Dakota.

a taxpayer is investigated criminally without a prior civil audit of his returns. Such an investigation might be the result of a tip by an informer who is seeking a financial reward or personal revenge. Generally, however, a criminal tax case results after a revenue agent has made a routine audit and finds irregularity, either in the taxpayer's return or in his records, which irregularities cause the agent to suspect that there has been tax evasion or fraud. The agent classifies and notes these discrepancies and reports his conclusions to his group chief. If the group chief concurs in the agent's suspicions, the agent is directed to present the matter to the Intelligence Division of the Internal Revenue Service. This division is the "F.B.I." of the Internal Revenue Service. If the Intelligence Division agrees that an investigation is indicated, it assigns an Intelligence agent—the special agent—to the case. This special agent and the revenue agent, who first brought the case to light, conduct the investigation together.

These two agents start a wide-ranging investigation interviewing persons, but concentrating primarily on public or private records, such as bank statements, stock brokerage records and insurance company records. During this investigation, generally after it is well underway, a letter may be sent by the special agent to the taxpayer informing him that he is under investigation for violation of the tax laws.

In the course of the investigation, the taxpayer will be called in and after being given a limited warning of his constitutional rights, he will be questioned.[1] The Supreme Court has held that the Fifth and Sixth Amendments protect statements made by a taxpayer in custody when the taxpayer has not been given the *Miranda* warnings.[2] The Eighth Circuit has held that a taxpayer is not entitled to be warned of his Fifth and Sixth Amendment rights in a non-custodial tax investigation interview.[3] The Supreme Court's refusal to grant certiorari suggests that there will be no expansion of *Miranda* into these pre-custodial interviews regardless

1. "At the initial meeting with a taxpayer, a Special Agent is now required to identify himself, describe his function, and advise the taxpayer that anything he says may be used against him. The Special Agent will also tell the taxpayer that he cannot be compelled to incriminate himself by answering any questions or producing any documents, and that he has the right to seek the assistance of an attorney before responding." I.R.S. News Release, I.R.-949, Nov. 26, 1968.

2. Mathis v. United States, 391 U.S. 1 (1968). *See* Lipton, *Constitutional Rights in Criminal Tax Investigations*, 45 F.R.D. 293, 323 (1968).

3. Cohen v. United States, 405 F.2d 34 (8th Cir. 1968), *cert. denied*, 394 U.S. 943 (1969). The other circuit courts that have considered the question have also refused to apply *Miranda* to pre-custodial interviews. *See* Taglianetti v. United States, 398 F.2d 558 (1st Cir. 1968); United States v. Marcus, 401 F.2d 563 (2d Cir. 1968); United States v. Mancuso, 378 F.2d 612 (4th Cir. 1967), *modified*, 387 F.2d 376 (4th Cir. 1967); United States v. Maius, 378 F.2d 716 (6th Cir. 1967); United States v. Mansfield, 381 F.2d 961 (7th Cir. 1967), *cert. denied*, 389 U.S. 1015 (1967). *See* United States v. Lackey, 413 F.2d 655 (7th Cir. 1969); *Contra*, United States v. Dickerson, 413 F.2d 1111 (7th Cir. 1969).

if conducted by a special agent or revenue agent and regardless of the technical "stage" of the proceedings.

After they have concluded their investigation, the revenue agent and the special agent each write a report. The revenue agent's report deals with accounting matters and tax liability, while the special agent's report deals with criminal violations and the evidence establishing them. The special agent and the revenue agent have broad discretion to dismiss the criminal aspects of a case while they are in charge.[4]

The reports of the agents are forwarded to the regional counsel of the Internal Revenue Service. The taxpayer is often advised by the regional counsel that a criminal prosecution has been recommended. The taxpayer is afforded the opportunity to meet with the regional counsel and, if he can convince the regional counsel that the revenue agent and the special agent are wrong, the matter is at an end. It is obviously difficult to learn the ratio of taxpayers successfully convincing the regional counsel that the agents were wrong. Even if the taxpayer does persuade the regional counsel to drop criminal prosecution, the revenue agent would no doubt still file a deficiency assessment against the taxpayer.

The regional counsel, after this conference with the taxpayer, forwards the special agent's and revenue agent's reports to the Internal Revenue Service in Washington, with his endorsement recommending prosecution. The Washington office reviews the case and if it believes that criminal charges should be pressed, it forwards the file to the Assistant Attorney General of the United States in charge of tax prosecutions. The taxpayer is usually given another opportunity at this point to confer with the Department of Justice and attempt to convince them that there should be no criminal prosecution. The taxpayer may actually request such a conference and usually obtains it, merely by writing a letter to the Assistant Attorney General in charge of criminal tax prosecutions.

If the Department of Justice, through the Assistant Attorney General, believes that a crime has been committed, the file is then referred to the United States Attorney for the district in which the taxpayer filed his return or has his residence. The United States Attorney, at this point, has complete control of the case and if he declines to present the matter to the grand jury, no criminal prosecution will follow. Generally, the United States Attorney does submit the case to the grand jury and on his recommendation, the grand jury returns the indictment. Of course, since the grand jury generally sits only twice a year, the indictment

4. Cohen v. United States, 405 F.2d 34, 35 n.3 (8th Cir. 1968).

may not follow until six months from the date the matter is first referred to the United States Attorney.[5]

AFFIRMATIVE ACTIONS BY COUNSEL

It is apparent that the sooner the taxpayer's counsel is brought into the case the better. Both the taxpayer and his counsel will be at an extreme disadvantage if they do nothing until after indictment. The intermediate stages prior to indictment are critical times. If counsel cannot avoid prosecution of the taxpayer, he can be gathering evidence and laying the foundation for a successful defense.

Some actions should be taken regardless of whether the taxpayer wants to cooperate with the investigation. Indeed they should be taken routinely so that an intelligent decision on cooperation can be made.

POWER OF ATTORNEY

The first action taken should be the immediate filing of a power of attorney. The Internal Revenue Service regulations require that such a power be filed.[6] In addition, the filing has many practical benefits which result from placing counsel between the taxpayer and the governmental authorities. As a practical matter, the special agent should be provided with a copy of the power of attorney along with a request that all communications to the taxpayer be made through the attorney.

RETAIN AN ACCOUNTANT

The average attorney knows as much about accounting as the average politician knows about the hydrogen bomb. The attorney should, therefore, determine the name of the taxpayer's accountant, if he has one, and the attorney should, in most cases, retain an accountant. The services of an accountant may be necessary to compute the taxpayer's net worth or to analyze the past income, expenses and the taxpayer's records. The accountant can also act as a translator for the attorney so that he may present the technical accounting material in a manner that the attorney and a jury can both understand. While the type of tax fraud case that arises in North Dakota may not always be as complicated as that which

5. For sources of information concerning the procedural aspects of the tax investigation, *see generally* Ross, *What Every Lawyer Should Know About Tax Evasion and Fraud Cases*, 54 A.B.A.J. 1102 (1968); Lofts, *Procedural Aspects of Tax Fraud*, 45 TAXES 508 (1967); Duke, *Prosecutions for Attempts to Evade Income Tax: A Discordant View of a Procedural Hybrid*, 76 YALE L.J. 1 (1966).

6. 26 C.F.R. § 601.503 (1969).

might arise in Washington, D. C., or Miami Beach, the accountant's services should not be overlooked. From the start of the investigation, the Government has had two agents working on the case, both of whom may be accountants or at least very competent in that field. Often the accountant is needed to put the taxpayer's books in some sort of order and determine what accounting method has been used by the taxpayer.

The method of retaining the accountant is important. The attorney must be careful to retain the accountant in a manner that will enable the taxpayer to claim the protection of the attorney-client privilege for the accountant's work papers and for any disclosures the taxpayer or the attorney make to the accountant. The Government may successfully subpoena these materials from the accountant unless the accountant is retained or the disclosures to the accountant are made in such a manner that the attorney-client privilege is preserved.

North Dakota has no statute granting privilege for accountant-client transactions. It is clear that in the absence of a statute granting such a privilege, no accountant-client privilege exists for communications to an accountant.[7] Any privilege that is to be attached in the absence of statute, therefore, must be derived from the attorney-client relationship.

In *Himmelfarb v. United States*,[8] the taxpayer's attorney informally employed an accountant over the telephone. The court assumed that the accountant was the attorney's agent but held that the disclosures made by the taxpayer at meetings between the attorney, the accountant and the taxpayer were not within the privilege because the accountant's presence was a mere convenience and not indispensible in order for the client to communicate with his attorney and thus ". . . secure the client's subjective freedom of consultation.' "[9] The court also held that no privilege would attach to communications made by the taxpayer to the attorney and then disclosed by the attorney to the accountant where, at the time he made the disclosures to the attorney, the taxpayer knew the attorney had retained an accountant because in that situation, the taxpayer would have ". . . impliedly authorized the attorney to make disclosures to the third person."[10]

In *United States v. Kovel*,[11] Kovel was an accountant employed by a law firm specializing in tax law. Kovel was subpoenaed to

7. *See generally* Annot., 38 A.L.R.2d 670 (1954).
8. 175 F.2d 924 (9th Cir. 1949), *cert. denied*, 338 U.S. 860 (1949).
9. *Id.* at 939. *See* 8 WIGMORE, EVIDENCE § 2311 (3rd ed. 1968).
10. Himmelfarb v. United States, 175 F.2d 924, 939 (9th Cir. 1949), *cert. denied*, 338 U.S. 860 (1949).
11. 296 F.2d 918 (Ad Cir. 1961).

testify against a client of the law firm at a grand jury. The court held that where the taxpayer communicates first to his own accountant, no privileges attach. But where the taxpayer consults with a lawyer with his own accountant present to assist in the consultation, or where the client communicates with his attorney through an accountant retained by the attorney as a listening post, the privilege attaches.[12] Specifically disagreeing with the language in *Himmelfarb,* the court stated:

> Accounting concepts are a foreign language to some lawyers in almost all cases, and to almost all lawyers in some cases. Hence the presence of an accountant, whether hired by the lawyer or by the client, while the client is relating a complicated tax story to the lawyer, ought not to destroy the privilege, . . . the presence of the accountant is necessary, or at least highly useful, for the effective consultation between the client and the lawyer which the privilege is designed to permit. By the same token, if the lawyer has directed the client, either in the specific case or generally, to tell his story in the first instance to an accountant engaged by the lawyer, who is then to interpret it so that the lawyer may better give legal advice, communications by the client reasonably related to that purpose ought fall within the privilege; . . . [13]

In *United States v. Judson,*[14] the taxpayers learned that they were under investigation by the Internal Revenue Service. They employed an attorney who advised them that he would require a net worth statement in order to carry on an adequate representation. The taxpayers then retained two accountants to prepare the statement. The court held, without mentioning the fact that the taxpayers and not the attorney had retained the accountants, that the Government could not subpoena the work papers, computations, memoranda and accounting worksheets prepared by the accountants which culminated in the net worth statement. The court held these documents constituted confidential communication within the attorney-client privilege stating:

> This statement was prepared at the attorney's request, in the course of an attorney-client relationship, for the purpose of advising and defending his clients. The accountants' role was to facilitate an accurate and complete consultation between the client and the attorney about the former's financial picture.[15]

12. It is clear, however, that the accountant's presence must be necessary to clarify information supplied by the client and to assist the attorney in advising the client. *Cf. In re* Bretto, 231 F. Supp. 529 (D. Minn. 1964).
13. United States v. Kovel, 296 F.2d 918, 922 (2d Cir. 1961).
14. 322 F.2d 460 (9th Cir. 1963).
15. *Id.* at 462.

A North Dakota attorney testified that he retained an accountant and sent the taxpayers over to talk to the accountant because: "I didn't understand accounting well enough to do the accounting angle myself and I wanted to retain Mr. Orser to assist me by doing accounting work for me so that I could properly advise [my clients] . . . ."[16] Thereafter, a special agent served a summons on petitioners requiring the accountant to bring to the special agent all of the documents the taxpayers had turned over to the accountant and all of the accountant's work papers. The court held that the accountant was the attorney's agent and that his services were necessary in order for the attorney to properly advise his client so that the attorney-client privilege applied to all communications between the taxpayer and the accountant.

With the exception of the *Himmelfarb* decision, the language and holdings of these cases suggest broad protection based upon the Sixth Amendment's right to counsel where the accountant's services are essential to the attorney's adequate representation of the taxpayer. Generally, an accountant's services are essential to an adequate representation of the taxpayer and the careful attorney can bolster the Sixth Amendment protection by drafting a written employment contract with the accountant. The attorney should retain the accountant directly by written agreement and pay him directly. The written agreement should state that the accountant is being retained for the purpose of facilitating communications between the taxpayer and the attorney and that the accountant is acting as the attorney's agent in receiving information from the taxpayer. In order to avoid any dispute as to whether the accountant's work papers, drafts, and computations are the property of the accountant or the client or the attorney, the written agreement should carefully specify that the accountant's work papers are the property of the attorney. This contract should also specify that the accountant shall not testify without the written consent of the attorney or a valid final order of court following the expiration of all rights of appeal.

INCRIMINATING DOCUMENTS

The Internal Revenue Service has been given sufficiently broad subpoena powers to determine the tax liability of any person "to examine any books, papers, records or other data which may be relevant or material. . . ."[17] These subpoenas are enforceable in the district court in which the person subpoenaed resides or is found.[18] This subpoena power, however, is subject to the taxpayer's

16. Bauer v. Orser, 258 F. Supp. 338, 340 (D. N.D. 1966).
17. 26 U.S.C. § 7602 (1964).
18. 26 U.S.C. § 7604 (1964).

constitutional right against self-incrimination. A problem that should be anticipated by the attorney, therefore, is how the taxpayer's Fifth Amendment privilege can be most effectively and legitimately utilized to prevent production of incriminating documents, including those possessed by third parties. Title and possession of documents containing incriminating statements is sufficient for the taxpayer to claim the privilege.[19] Even though the taxpayer has title, however, he may not be able to prevent one in possession of incriminating documents from producing them for the Government.[20] Prompt action should be taken to recover all of the taxpayer's papers and records in the hands of third persons. A special problem concerns those incriminating documents in the hands of third persons in which the third person has an ownership interest. The documents most often sought of this nature are work papers used by the accountant in preparing the taxpayer's income tax returns.[21] Such work papers are generally considered the accountant's property and if they remain in his possession the Government may successfully subpoena them from the accountant.[22]

It is not entirely clear from the cases what effective action can be taken by the attorney or taxpayer to recover or effectively retain and claim the privilege to incriminating documents in which third parties claim an ownership interest after the criminal investigation is underway.

In *United States v. Cohen*,[23] the defendants' accountant, Berke, had in his possession work papers pertaining to accounting services provided Cohen. On July 8, 1964, two special agents asked Cohen for his records pertaining to his tax liability for the years 1958 through 1963. Cohen told the agents his accountants had those records. The next day Cohen journeyed from Las Vegas to his accountant's office in Beverly Hills to request and obtain the work papers from Berke. Four days later, one of the special agents requested the work papers from Berke. Berke, at this special agent's insistence,

19. United States v. Zakutansky, 401 F.2d 68 (7th Cir. 1968); *Application of* House, 144 F. Supp. 95 (N.D. Cal. 1956).

20. "A party is privileged from producing the evidence but not from its production. . . . [I]f the documentary confession comes to a third hand *alio intuitu*, as this did, the use of it in court does not compel the defendant to be a witness against himself." Johnson v. United States, 228 U.S. 457, 458-59 (1913) (Mr. Justice Holmes); United States v. Cohen, 388 F.2d 464, 468 n.9 (9th Cir. 1967).

21. A recurring problem in this area is defining what are the accountant's work papers and what constitutes the taxpayer's property. In *United States v. Zakutansky*, 401 F.2d 68, 71 (7th Cir. 1968), the court stated: " 'Work papers' means any papers 'where you have records recorded on it and the common form of work papers are the Columnar column paper.' Memorandum sheets could be work papers and 'it might be almost anything from the taxpayer's books showing income or expenditures.' "

22. United States v. Zakutansky, 401 F.2d 68 (7th Cir. 1968); United States v. Boccuto, 175 F. Supp. 886 (D. N.J. 1959), *appeal dismissed*, 274 F.2d 860 (3d Cir. 1959); Falsone v. United States, 205 F.2d 734 (5th Cir. 1953). *See generally* Annot., 90 A.L.R.2d 784 (1963).

23. 388 F.2d 464 (9th Cir. 1967).

requested Cohen to return the work papers but Cohen refused. Cohen refused to comply with a subpoena to produce the work papers on the ground that to do so might tend to incriminate him. The district court quashed the summons which had been served on Cohen to compel him to produce the work papers. On appeal, the Ninth Circuit in a decision by Judge Browning, held that possession, not title, was the key to claiming the privilege stating:

> Possession of potentially incriminating documents is thus the necessary and sufficient condition of the privilege, for the compelled production, identification and authentication of incriminating materials by the possessor will incriminate him, whether or not the documents are his.[24]

The court rejected the Government's contention that the Fifth Amendment privilege did not apply because the papers were owned by another who had the right to demand their return. The court rejected the Government's argument further that Berke's request to return the papers rendered Cohen's possession "wrongful" and therefore insufficient to support a claim of privilege. The court stated:

> The exercise of governmental power which the privilege was intended to bar occurs whenever, without more, a person is compelled to identify, authenticate, and produce documents which may tend to incriminate him.[25]

The court also rejected the Government's contention that Cohen should be denied the privilege against self-incrimination as to the accountant's work papers because those documents were prepared by the accountant for his own use and therefore "did not constitute the personal private papers of the privilege-claimant."[26] Finally the court stated:

> We hold that as a general rule the Fifth Amendment privilege against self-incrimination permits a person in possession of potentially incriminating papers to decline to produce them in response to a summons; that the exception established by the Supreme Court's decisions in *Wilson* and *White* is limited to the records of impersonal organizations; and that if any other exceptions exist, based either upon the character of the papers or the nature of the claimant's possession, there is none which would bar assertion of the privilege by a claimant who is in possession, with the consent of an accountant, of work papers created by the ac-

24. *Id.* at 468.
25. *Id.* at 470.
26. *Id.*

countant from information supplied by the person claiming the privilege.[27]

Under the broad grant of Fifth Amendment privilege to third party documents possessed by the taxpayer in *Cohen*, it should make no difference that the accountant or the taxpayer knew the work papers were sought by the Government at the time the accountant transferred possession to the taxpayer. Should the accountant's "moral obligation" to provide the work papers to the Government rather than to the taxpayer bar the taxpayer's assertion of the privilege? The Seventh Circuit has recently held that it should. In *United States v. Zakutansky*,[28] the taxpayer's accountant, after twice frustrating subpoenas to produce his work papers used in preparing the taxpayer's income tax return, turned his work papers over to the taxpayer. Subsequently, subpoenas were served on both the accountant and the taxpayer to produce the work papers. The accountant was unable to comply because he no longer held the papers. The taxpayer claimed that since he had possession, the papers were privileged. The court held that at the ". . . critical time, when the subpoena of the Internal Revenue Service was served on Zakutansky, the papers being sought were not in the unlimited and rightful possession of the taxpayer."[29] Since the papers were transferred when the accountant was under at least a moral obligation to provide them to the Government, the papers were not in the " . . . indefinite and rightful possession of the taxpayer. . . ."[30] The issue was not raised, and the court did not discuss, whether the taxpayer could have successfully claimed the privilege had he gained *title* and possession to the papers by purchasing them from the accountant.

The Court of Appeals for the Eighth Circuit has not had this precise question before it. In *Bouschor v. United States*,[31] the Government conceded that Bouschor had rightful indefinite possession of the work papers and the primary issue was whether the taxpayer's attorney could claim the Fifth Amendment privilege on behalf of the taxpayer. Even so, the decision by Judge Blackman in *Bouschor* suggests that the Eighth Circuit's decision in that case was influenced in part by the fact that the attorney, at the time he requested the work papers, probably knew that the taxpayer was under criminal investigation. His request that the taxpayer's papers be turned over to the attorney could not " . . . in itself serve to thwart investigation by the Internal Revenue Service."[32] This

27. *Id.* at 472.
28. 401 F.2d 68 (7th Cir. 1968).
29. *Id.* at 72-73.
30. *Id.* at 72.
31. 316 F.2d 451 (8th Cir. 1963).
32. *Id.* at 459.

language suggests that the court would be more inclined to follow the *Zakutansky* rather than the *Cohen* reasoning.

If one is to faithfully follow the *Zakutansky* decision, it appears unlikely that the taxpayer or his attorney could effectively gain possession of incriminating documents owned by third parties and claim the Fifth Amendment privilege. Even if the taxpayer or his attorney are farsighted enough to gain rightful possession of the incriminating documents from the owners, the cases are split as to whether the taxpayer can claim the privilege after being served by a subpoena to produce them and after having been requested by the third party to return the papers.

In *Deck v. United States*,[33] the taxpayer's attorney requested the taxpayer's accountant to turn over the accountant's work papers relating to services he had performed on the taxpayer's books to the attorney. The accountant was apparently unaware of any investigation and it was apparently conceded that the taxpayer gained possession of the papers rightfully. The accountant was later subpoenaed to produce the work papers. The accountant twice made demands upon the taxpayer's attorney to return the papers so that the accountant could comply with the subpoena, but the attorney refused. The Internal Revenue Service then issued a subpoena to the attorney for the work papers. At the enforcement hearing, the taxpayer took the stand, claimed the papers as his property and asserted his privilege against self-incrimination. The taxpayer claimed that since he acquired possession rightfully, he could properly invoke the privilege. The court held that at the time the Government sought production neither the taxpayer nor his attorney could rightfully retain the papers stating:

> We think that one who holds papers against the owner's demands for their return cannot resist production by claiming the privilege against self-incrimination.[34]

In *Cohen*, the Ninth Circuit specifically rejected the argument that production of the work papers could be compelled from the taxpayer's possession after the accountant had made a formal request for their return from the taxpayer. Even in *Cohen*, however, the court noted that so long as the accountant retained title to the papers, there would be nothing to bar an accountant from suing to recover possession from the taxpayer and turning the papers over to the Government.[35] The obvious motivations for an accountant

33. 339 F.2d 739 (D.C. Cir. 1964), *cert. denied*, 379 U.S. 967 (1965).
34. *Id.* at 740-41. *See also In re* Fahey, 300 F.2d 383 (6th Cir. 1961).
35. United States v. Cohen, 388 F.2d 464, 469 (9th Cir. 1967). Of course, the accountant also has a right to claim the Fifth Amendment privilege if the work papers might tend to incriminate him.

to sue for possession, such as vindication for unpaid services or cooperation to gain forgiveness for able assistance in the taxpayer's alleged fraud, all suggest that, if possible, the accountant's ownership interest should be removed.

It has been suggested that a written sale agreement for the documents is the ultimate solution.[36] It is difficult to see how the mere fact that the accountant and taxpayer have executed a written contract would have any practical effect on the result in *Zakutansky* where the court's decision was based upon the fact that it considered the possession "wrongful" because the accountant and the taxpayer violated a "moral obligation" in transferring possession to the taxpayer after learning of the Government's interest in the documents. Realistically, a sale, which no doubt would be conveniently termed a sham, should have no effect if one is to faithfully follow the spirit of *Zakutansky*.[37]

The answer lies, perhaps, in the fact that *Zakutansky* is poor constitutional law. Possession, whether "rightful" or "wrongful" or "indefinite" or "definite" should have no effect on the taxpayer's ability to attach the privilege to his present possession. The court's reasoning in *Cohen* is the best constitutional law and finds impressive support from Judge Learned Hand. He stated:

> For instance, suppose that A., knowing that B. has papers which would incriminate him, gets wrongful possession of them from B., whom they do not incriminate. If B. is content, and leaves A. in possession, I do not understand that it would be any answer whatever to A. to say: 'You cannot keep these back, because you came by them wrongfully, or at least you have no right to them now.' All the law considers is whether A. has got possession in fact, and whether the documents actually will tend to incriminate him. To get them in evidence the law would have to force him to bring them out of a possession which is good enough against any one but B. Certainly, I can find nothing in the books which suggests such a distinction, and it contradicts the whole history of the matter. For the privilege runs along side by side with the power to compel production, and that power depends only upon serving the actual possessor. There are cases to be sure where one having custody is not required to produce, but it is only because his custody is so subordinate as not to justify his meddling with documents even to bring them to court. Certainly, a full possessor of the documents is always subject to subpoena, whether his possession is lawful or unlawful, and regardless of ownership.[38]

36. Lofts, *Procedural Aspects of Tax Fraud Investigations*, 45 TAXES 508, 512 (1967).
37. United States v. Baldridge, 281 F. Supp. 470 (S.D. Tex. 1968), *vacated as moot*, 406 F.2d 526 (5th Cir. 1969).
38. *In re* Grant, 198 F. 708, 709 (S.D. N.Y. 1912), *aff'd*, 227 U.S. 74 (1913).

Regardless of the ultimate result reached when the conflict between the circuits in this area is resolved, the attorney should urge the taxpayer to do everything he can to gain rightful possession of all incriminating documents. As to those documents in which a third party might have a basis for claiming an ownership interest, the attorney should draft a written sale agreement covering the documents and the agreement should be executed for at least a nominal consideration transferring title and possession to the taxpayer. Even if the attorney or taxpayer already have such papers, the sale agreement should still be executed to remove the ownership interest. At the very least an executed agreement will bar a disgruntled or nervous accountant from suing for possession and turning the documents over to the Government.

CLAIMING THE FIFTH AMENDMENT PRIVILEGE

A question closely associated with whether the Fourth and Fifth Amendment privileges attach to incriminating documents is whether the taxpayer must himself assert the privilege. It is certainly true that an attorney can waive his client's constitutional rights. Surprisingly, however, there is a split of authority concerning whether an attorney can assert the taxpayer's constitutional rights when documents incriminating to the taxpayer are subpoenaed from the attorney's possession. When the accountant turns his work papers over to the taxpayer's attorney and the Government then attempts to subpoena these documents from the attorney, may the attorney successfully refuse production because to do so would violate the Fifth Amendment's privilege against self-incrimination on the part of the taxpayer? The Eighth Circuit has held that the attorney cannot assert the privilege on behalf of the taxpayer because the guaranty against self-incrimination is a "personal" privilege.[39] The same result has been reached in the Sixth Circuit although in that case the court would probably have compelled production even if the taxpayer himself claimed the privilege because the possession was merely "temporary."[40]

The Supreme Court has indeed stated that the privilege against self-incrimination is a "personal" privilege, but not in the context that it could not be raised by an attorney on behalf of his client, but in the context that it could not be asserted by an "impersonal" corporation.[41]

39. Bouschor v. United States, 316 F.2d 451 (8th Cir. 1963).

40. *In re* Fahey, 300 F.2d 383 (6th Cir. 1961). *See also* United States v. Boccuto, 175 F. Supp. 886 (D. N.J. 1959), *appeal dismissed,* 274 F.2d 860 (3d Cir. 1959).

41. *See* Hale v. Henkel, 201 U.S. 43 (1906); McAlister v. Henkel, 201 U.S. 90 (1906); United States v. White, 322 U.S. 694 (1944).

In *United States v. Judson,* the Ninth Circuit held that the attorney could assert his client's Fifth Amendment privilege to resist production of documents from the attorney's possession which incriminated the taxpayer.[42] In *Judson,* the taxpayers turned over to their attorney cancelled checks and bank statements and thereafter the Government issued a subpoena to the attorney directing him to produce those items before the Grand Jury.[43] The court rejected the Government's contention that the attorney could not assert the privilege noting that it was a *non sequitur* to say that the privilege was "personal" and therefore could not be asserted by the attorney on behalf of his client. The court stated further:

> Clearly, if the taxpayer in this case, . . . had been subpoenaed and directed to produce the documents in question, he could have properly refused. The Government concedes this. But instead of closeting himself with his myriad tax data drawn around him, the taxpayer retained counsel. Quite predictably, in the course of the ensuing attorney-client relationship the pertinent records were turned over to the attorney. The Government would have us hold that the taxpayer walked into his attorney's office unquestionably shielded with the amendment's protection, and walked out with something less. The way was clear, according to appellant, for an enforcement officer to gather up the evidence which otherwise would have been beyond his reach.[44]

The Second Circuit has also indicated that an attorney can assert the Fifth Amendment privilege on behalf of his client and thus resist production of incriminating documents within the attorney's possession but not within the attorney-client privilege.[45]

Until the Eighth Circuit decision is overruled, however, the attorney in the Eighth Circuit will have difficulty successfully claiming the Fifth Amendment privilege on behalf of his client in enforcement proceedings where the client is not a party or when production of the papers demanded by the Government would not violate the attorney-client privilege.[46] When the attorney is subpoenaed to produce documents in his possession incriminating to the taxpayer, the taxpayer should intervene in the enforcement proceedings and claim the privilege.[47]

In *Bauer v. Orser,*[48] Judge Register allowed an attorney to

42. 322 F.2d 460 (9th Cir. 1963).
43. The Government's demand that the attorney produce the work papers of an accountant retained by the taxpayer to assist in preparing a net worth statement, which the taxpayer's attorney required to adequately represent the client, was rejected because those work papers constituted a confidential communication within the attorney-client privilege.
44. United States v. Judson, 322 F.2d 460, 466 (9th Cir. 1963).
45. Colton v. United States, 306 F.2d 633, 639 (2d Cir. 1962).
46. Bouschor v. United States, 316 F.2d 451, 458 (8th Cir. 1963).
47. *See* Reisman v. Caplin, 375 U.S. 440, 445 (1964), discussed further *infra.*
48. 258 F. Supp. 338 (D. N.D. 1966).

claim the privilege on his client's behalf during enforcement proceedings against the taxpayers' accountant where the attorney had been expressly directed and authorized to do so by the taxpayers' letter to the attorney in which they affirmatively claimed their constitutional privilege against self-incrimination. At the enforcement hearing, the letter was admitted as an exhibit. The court considered the appearance by the taxpayers' attorney and the filing of the letter as an exhibit as substantially the same as intervention by the taxpayers stating:

> By virtue of Exhibit A, the Court has had its attention called to the fact that Petersons have asserted—and do assert—their constitutionally guaranteed privilege against self-incrimination, with regard to the production of subject records and documents.[49]

THE INTERNAL REVENUE SERVICE SUMMONS

In addition to the broad powers it has to examine books and records, the Internal Revenue Service may also examine witnesses, including the taxpayer, under oath.[50] The Supreme Court has recently held that these code provisions for administrative summons and interrogation do not *per se* violate the Fourth or Fifth Amendment.[51] This is true even though the summons may be used to obtain information for a subsequent criminal prosecution so long as there is a possible civil liability to which the summons might relate.[52] If the sole objective of an investigation is to obtain evidence for use in a criminal prosecution, this purpose is not legitimate and enforcement will be denied.[53]

RESPONSE AND CONTEST OF SUMMONS TO TAXPAYERS

The procedure for responding and contesting the Internal Revenue Service summons was considered by the Supreme Court in the case of *Reisman v. Caplin*.[54] Only those procedures allowed by the *Reisman* decision will be effective to contest the summons. A misstep here could result in the taxpayer being held in contempt or criminally prosecuted for his illegal resistance.

---

49. *Id.* at 345.
50. The special agent's authority to issue the administrative summons is conferred by the provisions of 26 U.S.C. § 7602 (1964). Judicial enforcement of such summons is conferred by 26 U.S.C. § 7604(a) (1964).
51. Justice v. United States, 390 U.S. 199 (1968).
52. United States v. First Nat'l Bank of Pikeville, 274 F. Supp. 283 (E.D. Ky. 1967), *aff'd sub. nom. per curiam,* Justice v. United States, 390 U.S. 199 (1968); Daly v. United States, 393 F.2d 873 (8th Cir. 1968); Wild v. United States, 362 F.2d 206 (9th Cir. 1966).
53. United States v. Powell, 378 U.S. 48 (1964); Reisman v. Caplin, 375 U.S. 440 (1964); Wild v. United States, 362 F.2d 206 (9th Cir. 1966). *See* Lipton, *Constitutional Rights in Criminal Tax Investigation,* 45 F.R.D. 293 (1968).
54. 375 U.S. 440 (1964).

The individual summoned must appear at the time and place designated in the summons and there present any objections to the summons that he may have such as improper service or constitutional privileges.[55] Once having appeared and having stated his objections to the summons, the taxpayer can refuse to produce the various documents that may have been requested and he can refuse to give any testimony. No criminal or quasi-criminal action can be taken against a witness who appears at the hearing and refuses in good faith to answer questions or produce documents.[56] Only if the person summoned "neglects to appear" before the Hearing Officer may he be criminally prosecuted.[57] The summary enforcement measures may be applied only to those persons who "wholly make default or contumaciously refuse to comply."[58]

If the witness or taxpayer refuses to cooperate and testify under the summons, the agent, generally through the United States Attorney, must seek an enforcement order in the district court. The United States Attorney files a petition to enforce the Internal Revenue summons in the district court. The district court then orders the witness or taxpayer to appear and to show cause why he should not be compelled to obey the summons. At this hearing, all objections to the summons can be raised. If the district court orders compliance with the summons, that order is an appealable one.[59] Indeed, the only method of attacking the enforcement order is to appeal that order to the court of appeals. The witness or taxpayer cannot refuse compliance with the enforcement order and then attempt to collaterally attack the enforcement order on appeal from the resulting contempt conviction.[60] Only a failure by the witness or taxpayer during the enforcement proceedings to obey a district court order will subject the witness or taxpayer to any possible penalty. If the district court does hold a witness in contempt for his continuing refusal to answer questions, the witness can obtain a stay of execution and appeal the contempt ruling to the court of appeals.[61]

There is obviously great potential for delaying the investigation and criminal process simply by tying up the summons enforcement proceedings with appeals. Only when his final appeal from the contempt proceedings is unsuccessful need the taxpayer concern

55. A motion by the taxpayer to quash the summons is no longer an appropriate method of contesting the summons. Lesser v. United States, 230 F. Supp. 817 (E.D. N.Y. 1964).
56. Reisman v. Caplin, 375 U.S. 440 (1964).
57. 26 U.S.C. § 7210 (1964).
58. Reisman v. Caplin, 375 U.S. 440, 448 (1964). 26 U.S.C. § 7402(b) (1964).
59. Reisman v. Caplin, 375 U.S. 440, 449 (1964); Bouscher v. United States, 316 F.2d 451 (8th Cir. 1963).
60. *See* Daly v. United States, 393 F.2d 873 (8th Cir. 1968).
61. Reisman v. Caplin, 375 U.S. 440 (1964); Daly v. United States, 393 F.2d 873 (8th Cir. 1968).

himself with complying or going to jail. In one recent case, a taxpayer tied up the investigation in this manner for nearly two years even though he missed one round of appeal by neglecting to seek reviews of the enforcement order.[62]

UTILIZE DISCOVERY PROCESS BEFORE COMPLYING WITH SUMMONS

The Federal Rules of Civil Procedure become effective if enforcement proceedings of the administrative summons are sought by the Government.[63]

This period during enforcement proceedings is probably the best opportunity for the taxpayer to institute effective discovery proceedings under the liberal discovery provisions of the Rules of Civil Procedure. The discovery process, however, cannot be used to obstruct and delay the enforcement proceeding. The rules contemplate that in any particular enforcement proceeding, the court may modify or limit the applicability of the Federal Rules.[64] Thus, the scope of discovery is discretionary with the district judge along with the time to be allowed for taking depositions and concluding discovery. The basis for limiting discovery, however, is not to speed up the enforcement proceedings but to prevent the taxpayer from obstructing those proceedings. The concern of the district judge over whether the discovery process will delay the enforcement proceedings must be balanced with the right of the taxpayer to a meaningful adversary hearing. "The standard, as we see it, is that [the] taxpayer must be afforded a meaningful adversary hearing of legitimate challenges."[65] The trend is to allow sufficient time for broad discovery depositions.

Along with the taxpayer's answer to the Government's complaint to enforce the Internal Revenue Service summons, the taxpayer can attach his interrogatories to the Government.[66] The taxpayer is also entitled to take the depositions of the special agent and the revenue agent.[67] While this is a new area, certainly the discovery can include all issues raised by the pleadings. In *Kennedy v. Rubin*,[68] the court allowed the taxpayer to depose the special agent on the following issues:

1) What is the chief purpose of the investigation?

62. Daly v. United States, 393 F.2d 873 (8th Cir. 1968).
63. FED. R. CIV. P. 81(a)(3). *See* United States v. Powell, 379 U.S. 48, 58 n.18 (1964).
64. *See* 1946 Committee Note. 7 J. MOORE, FEDERAL PRACTICE, 91 81.01[6] (2d ed. 1968). *See also* United States v. Benford, 406 F.2d 1192 (7th Cir. 1969).
65. United States v. Benford, 406 F.2d 1192, 1194 (7th Cir. 1969); *accord,* United States v. Hayes, 408 F.2d 932, 935 (7th Cir. 1969).
66. United States v. Nunnally, 278 F. Supp. 843 (W.D. Tenn. 1968).
67. *Id.;* United States v. Moriarty, 278 F. Supp. 187 (E.D. Wis. 1967); Kennedy v. Rubin, 254 F. Supp. 190 (N.D. Ill. 1966).
68. 254 F. Supp. 190, 194 (N.D. Ill. 1966).

2) Has a good faith determination been made that a second examination is necessary?

3) Does the Internal Revenue Service already have in its knowledge and possession the information it seeks?

4) Was this investigative proceeding instituted to obtain evidence against respondent for use in a criminal prosecution?[69]

It is apparent that one of the primary considerations in determining whether the taxpayer will cooperate with the Government in its investigation and appear and answer questions in accordance with the Internal Revenue Service summons is that by his cooperation, the taxpayer will waive, in effect, the broad discovery process that will be open to him if the Government determines to seek enforcement proceedings. It would appear to be a rare case where the benefits of cooperation will outweigh the benefits of discovery that could result during the subsequent enforcement proceedings if the taxpayer determines not to cooperate.

CONTESTING SUMMONS TO THIRD PARTY— INTERVENTION AND RESISTANCE

It is to be expected that during the investigation third parties will be subpoenaed to appear before the special agent and testify and produce records. For example, a summons could be directed to the treasurer of a corporation with which the taxpayer has a close relationship directing the treasurer to testify before the agent and produce the "books and records, cancelled checks, minute books and stock books" relating to the operation of the corporation. The Internal Revenue Service is probably not required to give the taxpayer advance notice of the examination of the third party where none of the materials sought belongs to the taxpayer or represents his attorney's work product.[70] What action can the taxpayer take if he does learn of the investigation?

The Supreme Court, in two decisions, has allowed the third party to intervene and contest the summons and production.[71] In the *Reisman* case which concerned individual taxpayers, the Court stated:

> Both parties summoned and those affected by a disclosure may appear or intervene before the District Court and challenge the summons by asserting their constitutional or other claims.[72]

69. *Id.*
70. *See In re* Cole, 342 F.2d 5 (2d Cir. 1965).
71. United States v. Powell, 379 U.S. 48 (1964); Reisman v. Caplin, 375 U.S. 440 (1964).
72. Reisman v. Caplin, 375 U.S. 440, 445 (1964).

The Court stated further:

> In addition, third parties might intervene to protect their interests, or in the event the taxpayer is not a party to the summons before the hearing officer, he, too, may intervene.[73]

The circuits have not consistently applied *Reisman* in allowing the taxpayer to contest the summons directed to third parties. In *Justice v. United States,* where the summons was directed to two banks and called for the production of certain bank records relating to transactions between the banks and the individual taxpayers, the Sixth Circuit held that the taxpayers were entitled to intervene and raise constitutional challenges to the production along with challenges based upon their rights and privileges under the various Internal Revenue statutes.[74] In *Application of Cole,* where the summons directed the bank to produce its records and files concerning transactions with the individual taxpayers, the Second Circuit held:

> The taxpayer, under circumstances where only books, records and other papers belonging to the third party are the subject of the summons, has no standing to object to the summons.[75]

The court felt these facts brought the case outside of the reach of the holding in *Reisman.* The First Circuit has agreed that the taxpayer has no standing to object to a summons directed to a bank.[76]

Citing *Cole,* the Eighth Circuit in a case charging that defendant did by use of the mails in the offer and sale of securities unlawfully, wilfully and knowingly employ a scheme to defraud, held that the defendant had no standing to assert Fourth and Fifth Amendment rights with respect to summoned bank records.[77]

In *United States v. Bank of Commerce,* the Third Circuit held that the taxpayer had standing to raise Fourth Amendment objections to a summons by the Internal Revenue Service upon a bank to produce bank records relating to transactions between bank and taxpayer.[78] In *United States v. Benford,* the Seventh Circuit held that the taxpayer could intervene and contest a summons directed to the treasurer of a corporation to which the taxpayer was closely connected which directed the treasurer to produce books and records relating to the operation of the corporation.[79] Referring to the decisions in *Powell* and *Reisman,* the court stated:

---

73. *Id.* at 449.
74. 365 F.2d 312 (6th Cir. 1966).
75. 342 F.2d 5, 8 (2d Cir. 1965), *cert. denied,* 381 U.S. 950 (1965).
76. O'Donnell v. Sullivan, 364 F.2d 43 (1st Cir. 1966).
77. Dosek v. United States, 405 F.2d 405, 409 (8th Cir. 1968).
78. 405 F.2d 931, 933 (3d Cir. 1969).
79. 406 F.2d 1192, 1194 (7th Cir. 1969).

> The opinions did not expressly, and, as we read them, did not impliedly, limit the taxpayer's right to intervene in enforcement proceedings to situations where a legally protected interest in the records could be shown. Had the court intended simply to hold that the particular interests of the taxpayers involved in those cases were sufficient bases for intervention, the opinions would doubtless have made that evident. We interpret them as adopting the judicial policy with respect to I.R.S. inquisitorial summonses that the person whose tax liability is the subject of the investigation can intervene and challenge enforcement if he sees fit.[80]

The language and result of *Benford* is the necessary result of a faithful application of the *Reisman* decision. While it can be argued that the intervention will ultimately serve no purpose other than delay, that does not justify denying intervention in every case and thus prevent an adversary hearing of the privileges and rights claimed.

Where the summoned party indicates an intention to voluntarily comply with the summons, it will be unavailing for the taxpayer to attempt to quash or bring some other action in an attempt to avoid enforcement of the summons.[81] The court in *Reisman* suggested that the taxpayer's procedure was to "restrain" the witness from complying, thereby forcing the commissioner to bring an enforcement action. In such enforcement proceedings, the taxpayer could then intervene. As a practical matter, while the court in *Reisman* apparently was referring to non-judicial action by the taxpayer, the restraint could also be accomplished by bringing an action to enjoin the third party from complying with the summons. That action and the Government enforcement action could then later be consolidated.[82]

TRANSCRIPT OF EXAMINATION

The Internal Revenue Service has a stenographer present to transcribe all of the examination of the summoned witness or taxpayer. Only after the witness or taxpayer has signed the transcription, however, do the Internal Revenue Service regulations allow the taxpayer or witness to be given a copy of this testimony.

The attorney should consider, therefore, bringing his own stenographer or court reporter to record the examination. There is, how-

---

80. *Id.*

81. Reisman v. Caplin, 375 U.S. 440 (1964); Chakejian v. Trout, 295 F. Supp. 97 (E.D. Pa. 1969).

82. *See* Chakejian v. Trout, 295 F. Supp. 97 (E.D. Pa. 1969).

ever, a split of authority over the question of whether an attorney is entitled to have his own reporter transcribe the examination.

One district court has held that a witness is not entitled to bring his own stenographer nor is that witness entitled to be represented by the same lawyer that represents the taxpayer.[83] Another district court decision has agreed that the witness or taxpayer is not entitled to have his own stenographer present at the examination.[84] This decision, however, held that the policy of the Internal Revenue Service in refusing to provide the witness or taxpayer a copy of the transcript of the examination is unwarranted and contrary to the Administrative Procedure Act. Thus, while the court refused permission for the witness to have his own stenographer present at the examination, the court ordered that the witness be given a copy of the transcript of the examination even though the witness refused to sign the original copy of the transcript. A third district court decision has allowed the witness to bring his own stenographer to the examination.[85]

Certainly the taxpayer or witness should avoid making any statement while not required to do so by a proper summons. The Administrative Procedure Act does not apply to volunteered statements.[86] The taxpayer can thus be denied copies of his voluntary statements prior to his indictment. Of course, after the indictment or information has been filed, the taxpayer is entitled to move under Rule 16 of the Federal Rules of Criminal Procedure for the production of his volunteered statements.[87]

CONCLUSION

This article has presented some of the most obvious and necessary actions any attorney should take on behalf of any client who is under an investigation that could lead to criminal indictment by the Internal Revenue Service. The most important goal of the attorney at this point should be the preservation of constitutional rights. Opportunities to meet informally with the Internal Revenue Service should be used to explain the taxpayer's position and remove the possibility of criminal indictment.

The attorney should be well-informed of the most effective means of claiming all of his client's rights. He should also be prepared to intervene in any subpoena directed to the taxpayer's bank or other third parties.

---

83. Torras v. Stradley, 103 F. Supp. 737 (N.D. Ga. 1952).
84. *In re* Neal, 209 F. Supp. 76 (S.D. W.Va. 1962).
85. Mott v. MacMahon, 214 F. Supp. 20 (N.D. Cal. 1963).
86. *See* United States v. Murray, 297 F.2d 812, 820-21 (2d Cir. 1962), *cert. denied,* 369 U.S. 828 (1962).
87. United States v. Gleason, 259 F. Supp. 282 (S.D. N.Y. 1966).

Finally, while each case will be different, the attorney should have in mind that if he recommends that his client cooperate with the Internal Revenue summons, the client will likely be waiving an opportunity for extensive discovery procedures. The discovery work at this stage can be invaluable during any later criminal trial.