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Lawyer Beware: The Use Of Counsel's Statements As Evidence Against His Client In Tax Fraud Cases

By LAWRENCE S. FELD and LEONARD R. ROSENBLATT

According to the authors, in criminal tax cases, in view of the language of the power of attorney and the multiple opportunities for the practitioner to make statements to government representatives during the investigation or the administrative review process, extreme care must be taken to avoid making statements that may be used as evidence against the taxpayer. Lawrence S. Feld is a partner in the law firm of Kostelanetz & Ritholz in New York City. Leonard R. Rosenblatt is an attorney specializing in criminal and civil tax litigation in New York City.

Among the hazards that a tax practitioner faces in representing a client during a tax fraud investigation is the danger that statements made by the attorney to government representatives during the investigation or the administrative review process within the Internal Revenue Service and the Department of Justice may be used as evidence against the taxpayer. The few reported cases on this subject support the admissibility of such statements by counsel as evidence against the taxpayer at the trial of the criminal tax case. Since there appears to be a growing tendency on the part of the Department of Justice to offer such statements as part of the government's proof at trial, it is essential that the tax practitioner be keenly aware that his advocacy of the taxpayer's cause before trial possesses the potential of being converted into an instrument for his client's conviction.

Administrative Conference Procedures

Criminal tax investigations and prosecutions are unique in certain respects. Perhaps the single most special aspect of a criminal tax case is the administrative conference procedure. Generally, taxpayers are afforded three conference opportunities before a case is referred to the local United States Attorney's Office for presentation to a

grand jury and indictment. Those conferences are conducted by the Criminal Investigation Division of the local IRS district, the corresponding Office of District Counsel, and the Criminal Section of the Tax Division of the Department of Justice in Washington, D. C.[1]

From the government's viewpoint, the conferences have two purposes: (1) to provide the taxpayer, or his authorized representative, with some limited information concerning the proposed prosecution and (2) to provide the taxpayer with an opportunity to explain why the prosecution should be avoided. From the defense lawyer's viewpoint, the conferences may offer an opportunity to gain some insight into the government's case and ascertain the "theory" of prosecution. However, many practitioners regard these conferences as opportunities to provide the IRS or Justice Department with factual material to defend questioned transactions or to challenge the accuracy of the government's evidence.

Practitioners who are not familiar with the procedures and possible pitfalls of these conferences may be eager to make representations of fact and advance arguments of fact and law as to why the taxpayer should not be prosecuted. On occasion, these statements and arguments may convince the IRS or Justice Department to abandon the criminal case. But there should be a keen awareness that statements made by well-intentioned practitioners during these conferences may ultimately be used against the taxpayer and perhaps provide the critical element of proof in an otherwise weak government case.

Agency and Scope of Employment

Statements of attorneys at pre-indictment conferences have been admitted into evidence against taxpayers as an exception to the hearsay rule.[2] Under the Federal Rules of Evidence, a statement is not hearsay if it is made "by [a party's] agent or servant concerning a matter within the scope of his agency or employment, made during the existence of the relationship." In essence, under Rule 801(d)(2)(D), a statement by an agent concerning a matter within his or her employment is deemed to be a statement, or admission, by his or her principal.

In several cases the courts have indicated that attorneys are "agents" of their clients for purposes of this rule. For example, in *United States v. Margiotta,*[3] the mail fraud and extortion prosecution of the Chairman of the Nassau County Republican Committee, the Court of Appeals for the Second Circuit, in broad and troubling terms, cautioned that statements "made by an attorney concerning a matter within his employment may be admissible against the party retaining the attorney."

In criminal tax cases, where the issues of the attorney's "agency" and "scope of employment" are addressed in the power of attorney required by the IRS, taxpayers generally have been unsuccessful in excluding the admission of such statements. In two decisions, *United States v. Dolleris,*[4] and *United States v. O'Connor,*[5] the Courts of Appeals stressed the importance of the language contained in the IRS power of attorney in sanctioning the admission of statements of taxpayers' attorneys.

In *O'Connor,* a failure-to-file prosecution, the taxpayer's attorney, acting under a power of attorney, attended an administrative conference where he admitted to IRS officials that his client had lied to them when the client insisted that he had filed his tax returns. In affirming the taxpayer's conviction, the First Circuit sustained the admission at trial of the attorney's statements and rejected the taxpayer's argument that his attorney had exceeded the scope of his authority. Whatever question the appellate court may have had about the scope of the attorney's authority was answered by the power of attorney, which stated that he had "full power and authority to do and perform all and every act or thing whatsoever required and necessary" in matters pertaining to federal taxes.

Similarly, in *Dolleris,* a tax evasion prosecution, an attorney's statements to IRS officials regarding the disposition of the cash proceeds of unreported scrap sales were admitted at trial against the taxpayer. The *Dolleris* court also stressed the broad wording of the power of attorney in rejecting the taxpayer's argument of lack of authority.

Power of Attorney

With a power of attorney on file with the IRS, a taxpayer will be hard pressed to argue that his attorney's statements were unauthorized. The typical power of attorney (Form 2848) provides:

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[1] See, generally, Fink, *Tax Fraud,* § 6.01.
[2] Rule 801(d)(2)(D), Federal Rules of Evidence.
[3] 662 F. 2d 131, 142-43 (CA-2 1981).
[4] 69-1 USTC ¶ 9289, 408 F. 2d 918 (CA-6), cert. denied, 395 U. S. 943 (1969).
[5] 70-2 USTC ¶ 9649, 433 F. 2d 752 (CA-1), cert. denied, 401 U. S. 911 (1970).

> The attorney(s)-in-fact (or either of them) are authorized, subject to revocation, to receive confidential information and to perform any and all acts that the principal(s) can perform with respect to the above specified tax matters. . . .

One can hardly imagine a broader authorization.

The particular language of the power of attorney is probably not determinative of the issue of whether the attorney's statements were within the scope of his authority. While it is certainly evidence of authority, express authorization as broadly worded as the provision quoted above may even be unnecessary to bind the taxpayer under the current Federal Rules of Evidence. Whereas the common law rule, under which *O'Connor* and *Dolleris* were decided, made the admissibility of such statements dependent upon whether the statements were *within* the scope of the agent's employment, the current rule looks to whether the statement *concerns* a matter within the scope of the agent's employment. As such, Rule 801(d)(2)(D) substantially broadened the traditional rule. As Chief Judge Jack B. Weinstein of the United States District Court for the Eastern District of New York has commented:

> Once agency, and the making of the statement while the relationship continues are established, the statement is exempt from the hearsay rule so long as it related to a matter within the scope of the agency.[6]

Compromise Negotiations

Taxpayers faced with the offer of statements made by their attorneys have advanced several arguments against admissibility. Some taxpayers have attempted to argue that the statements are inadmissible under Rule 408 of the Federal Rules of Evidence, which excludes evidence of offers in compromise.[7] However, taxpayers seeking to exclude statements under Rule 408 must overcome two obstacles. First, conferences with Special Agents and District Counsel attorneys are not generally understood to be "compromise negotiations." In fact, neither Special Agents nor District Counsel attorneys have the authority to compromise a criminal case. As one court has noted:

> . . . after a Special Agent of the CID is assigned, the taxpayer will at most be allowed to come in, and will be listened to, but no negotiations will be engaged in until after the investigation has been completed, and the internal reviews that follow have resulted in a decision (arrived at unilaterally by IRS and not by negotiation) not to refer to the Department of Justice. The consequence of this is that compromises can only be negotiated in cases where IRS has decided not to refer.[8]

Second, most conferences with Special Agents and District Counsel attorneys begin with the admonition that plea bargaining, civil settlement, negotiation and compromise will not be considered or discussed. In view of this warning, it would be extremely difficult, if not impossible, to argue that the taxpayer's attorney mistakenly believed himself or herself to be engaged in a compromise discussion.

With respect to conferences before the Tax Division of the Department of Justice, the conferee attorney may very well have the authority to "compromise" a criminal case. However, as in District Counsel conferences, defense attorneys at Tax Division conferences are customarily advised that plea bargaining and civil settlement will not be discussed.

Statements Made During Plea Discussions

Other taxpayers have argued that such statements are inadmissible under Rule 410 of the Federal Rules of Evidence, which excludes statements made during plea discussions with prosecuting attorneys. With respect to statements made to Special Agents and District Counsel attorneys, Rule 410 is not applicable because neither are attorneys for the prosecuting authority, i. e., the Justice Department. With respect to statements made to Department of Justice personnel, the warning that plea bargaining will not be discussed will usually preclude a taxpayer's reliance on Rule 410.

Unauthorized Statements

Another approach to the exclusion of such statements is to argue that they were in fact unauthorized. However, since such statements need only "concern" a matter within the scope of employment to satisfy Rule 801(d)(2)(D),

[6] 4 Weinstein's *Evidence*, ¶ 801(d)(2)(D)[01], p. 801-162.

[7] *E. g., Tony Abatti*, CCH Dec. 35,444(M), 37 TCM 1597 (1978), rev'd and remanded, 81-1 USTC ¶ 9442, 644 F. 2d 1385 (CA-9).

[8] *United States v. Garden State National Bank*, 79-1 USTC ¶ 9262, 465 F. Supp. 437, 439 (D. N. J.), aff'd on other grounds, 79-2 USTC ¶ 9632, 607 F. 2d 61 (CA-3).

the taxpayer would have to show that the specific statement did not concern his employment. If the attorney was retained, as is usually the case, to conduct the defense according to his own best judgment, it seems that such statements, even if they are later used as evidence against the taxpayer, are admissible. For example, the *Dolleris* court rejected the argument that the attorney's admission of his client's misconduct was unauthorized as follows:

> The attorney may well have thought that an explanation for the motive for his client's misconduct would constitute, over all, a net gain in the eyes of the Service, which already appeared to believe that the misconduct had occurred. It was clearly within the power and duty of the attorney to do what he could, in his own best judgment, to dispel the suspicions of the Internal Revenue Service and avoid indictment.[9]

Under this rationale, it seems likely that statements of counsel, even if they amount to a complete confession, will be considered by the courts to be authorized statements.

Policy

Despite the lack of success with which these arguments have met, there are substantial policy reasons why such statements should be excluded. First, the importance that a jury may place on the statement of a taxpayer's former lawyer may be unduly prejudicial. If a jury were to hear, for example, that the defendant's former lawyer admitted that unidentified deposits were "skimmed" business receipts, a jury may place less importance on other available evidence tending to establish a valid legal defense.

Moreover, the admission of an attorney's statements will undoubtedly result in the consumption of additional trial time to explore the circumstances under which the statements were made and the reasons why they were of significance at that time. These matters will divert the jury's attention from the government's burden of proving all the elements of the particular crime with which the defendant has been charged.

In addition, a defendant faced with the admission of such evidence may have to choose between calling his former lawyer as a witness to explain his statements, thereby possibly waiving the attorney-client privilege, or taking the witness stand himself, thereby risking cross-examination as to a prior criminal record or "similar act" evidence.

Suggested Solutions

One suggested solution to the problem has been to modify the language of the power of attorney to specifically exclude the authority to make factual admissions. By this modification, it is hoped that a trial court will be compelled to exclude statements made under the power of attorney as being unauthorized. However, there can be no assurance that the IRS will accept a power of attorney modified in this fashion. Moreover, the benefit of the suggestion may be illusory, since an attorney who provided the IRS with any factual information under such a power may subject himself to criticism or even disciplinary proceedings for having made an unauthorized disclosure on behalf of a client.

Another suggestion has been to refrain from making factual assertions and instead present all assertions of fact in hypothetical terms. In this fashion, it is hoped that whatever statements are made will be excluded as mere argument. While this approach may be helpful, caution must be exercised to prevent later disputes over what information was presented as "fact" and what as "argument." Moreover, the possibility exists that even a hypothetical assertion of fact, if determined by subsequent investigation to be materially false or misleading, may be admissible against a taxpayer at trial on the theory that it constitutes evidence equivalent to a false exculpatory statement.[10] Research has failed to locate any authority regarding the admissibility of such hypothetical statements.

Conclusion

In any criminal case, the decision to make factual representations should be approached with extreme caution. In criminal tax cases, in view of the language of the power of attorney and the multiple opportunities to make statements, extreme care must be taken to avoid making such statements and to insure that any statements made will not prejudice the client. ●

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[9] 433 F. 2d at 756.

[10] See, e. g., *United States v. Wilkins*, 67-2 USTC ¶ 9739, 385 F. 2d 465, 472 (CA-4), cert. denied, 390 U. S. 915 (1968) ("Subsequent acts of a defendant, such as the fabrication of evidence or false explanations which will aid his defense, are clearly admissible to prove his guilty state of mind.").