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Suppression of Evidence in Criminal Tax Proceedings

By Jacob W. Mayer

The first decision to be made by a taxpayer threatened with prosecution for federal tax fraud is whether to "cooperate" with the Internal Revenue Service by providing its agents with requested testimony or documents. A policy of nondisclosure may effectively prevent criminal prosecution, or it may only serve to jeopardize a subsequent claim of good faith. This paper is concerned with the extent to which a taxpayer can suppress various types of information which might be used against him in a criminal prosecution for federal tax fraud. No attempt will be made to consider the justifications for a decision to suppress or not to suppress, nor will consideration be given to problems involving evidence which is not to be suppressed as a matter of right but which may be inadmissible at a trial, for one reason or another.

Analysis of areas in which evidence may be suppressed requires examination of issues arising under the fourth and fifth amendments to the United States Constitution, problems created by the Internal Revenue Code of 1954, and problems which are created by the investigatory processes of the Internal Revenue Service in its examination of taxpayers suspected of tax fraud. To provide a description of the background in which these problems normally arise, the investigatory processes of the Internal Revenue Service will be considered first.

The Joint Investigation

The Intelligence Division of the Internal Revenue Service is primarily responsible for discovering tax frauds. Members of this division are known as "special agents;" they serve a


1 Tax fraud is being used here as a generic term for the offenses defined in §§ 7202-7214 of the Internal Revenue Code of 1954.
separate function from the more familiar revenue agents who are concerned with the routine audit of taxpayers' records. Special agents may become suspicious of taxpayers for any of a number of reasons. If they do, they are then charged with the duty of gathering the evidence to substantiate a criminal charge against the taxpayer. For both practical and theoretical reasons, the taxpayer will not be informed that he is under investigation. The special agent will first seek to gather what information he can obtain from other sources, such as bank records, without immediately employing his statutory right to issue a summons.\(^2\)

The joint investigation, which involves a revenue agent and a special agent working together, is the usual evidence-gathering technique. The revenue agent contacts and examines the taxpayer, without warning him that he is under investigation for suspected tax fraud, and then reports his findings to the special agent.\(^3\) If the joint investigation does not exonerate the suspected taxpayer, the special agent will then issue a statutory summons, returnable in ten days.\(^4\) During this period, the taxpayer has time to engage counsel.\(^5\)

**Statutory Protection from Unnecessary Examination**

Before proceeding to the problems which arise during the course of or after an investigation, consideration must first be given to the taxpayer's right, created by the Internal Revenue Code of 1954,\(^6\) not to be subjected to unnecessary examination. As a result of this provision, a taxpayer may be able to bar an investigation by insisting on his right not to have his records for a given tax year examined more than once.\(^7\)

The protection of section 7605(b) will not be available to all taxpayers under investigation and, even where available, will

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\(^3\) There is no duty to warn a taxpayer that he is being examined for the purpose of initiating a criminal prosecution. United States v. Burdick, 214 F.2d 768 (3d Cir. 1954); Montgomery v. United States, 203 F.2d 887 (5th Cir. 1953). Especially since prosecution may not be planned at the time of the investigation. Hanson v. United States, 186 F.2d 61 (8th Cir. 1950).


\(^5\) It is possible that even this protection may prove to be illusory if a revenue agent calls upon the taxpayer with a summons and claims the right to take papers of the taxpayer. In re Jack Klein, Ryan, D. J. (S.D.N.Y. 1956), M-18-304, not officially reported. For a discussion of the problem, see Kostelanetz & Bender, Criminal Aspects of Tax Fraud Cases 44 (1957).

\(^6\) Int. Rev. Code of 1954, § 7605(b).

\(^7\) See Pacific Mills v. Kenefick, 99 F.2d 188 (1st Cir. 1938).
probably prove to be only a source of delay. The restrictions imposed by this section may be removed if a written request is made by the Secretary of the Treasury or his delegate to the taxpayer stating that it is necessary to reexamine the taxpayer's records. An allegation of suspected tax fraud will be accepted as a justification for such additional examination, even with regard to years which would be closed by limitations in the absence of suspected tax fraud. The written request to the taxpayer probably does not have to allege the existence of evidence of tax fraud; a bare allegation that tax fraud is suspected should be sufficient. The requirement of only a bare allegation seems consistent with the language and intent of the statute, since it is difficult to argue that an investigation designed to uncover a criminal act is either "unreasonable" or "unnecessary." In any event, whether or not some existing evidence suggesting the possibility of tax fraud is requisite to issuance of a letter pursuant to section 7605(b), actual proof of fraud is not required.

It seems clear that the failure of a taxpayer to prevent an investigation by claiming his section 7605(b) right should not preclude him from later asserting either his constitutional rights or any privileges available to him. Because of this, a claim of the section 7605(b) right may be made either in order to gain time or in the hope of obtaining information regarding the direction of the investigation.

CONFIDENTIAL COMMUNICATIONS

The taxpayer's attorney who has acted in a strictly professional capacity will fall within the scope of the usual sanction against revealing confidential communications with his client. Illustrative of the great scope which has been given to this privilege in the criminal tax area is Schwimmer v. United States. An attorney had left his office files with a storage company. A federal grand jury investigating tax frauds served a subpoena

13 232 F.2d 855 (8th Cir.), cert. denied, 352 U.S. 833 (1956).
duces tecum, upon the third party custodian in an effort to obtain the files, but the subpoena was quashed upon motion by the attorney, on the ground that it violated the fourth amendment since the files contained material within the scope of the attorney-client relationship.\(^{14}\)

A bona fide attorney-client relationship must have existed, and the matter sought to be protected must have resulted from it,\(^{15}\) if a claim of confidential communication is to be sustained. Thus, the testimony of an attorney who has acted solely as a repository for funds is not privileged.\(^{16}\) Likewise, an attorney who has acted only as an accountant cannot claim the attorney-client privilege to protect his work.\(^{17}\) However, the privilege may be sustained although only part of a communication contains privileged matters.\(^{18}\)

The services of a trained accountant are normally essential for both the preparation and trial of a tax case. Nonetheless, the federal courts in criminal tax cases have consistently refused to consider disclosures made to an accountant to be privileged as confidential communications.\(^{19}\) One obvious consequence of this rule is that the taxpayer's attorney in a tax fraud case must be sure that the taxpayer's accountant is not present at any meetings where confidential matters are to be discussed by the attorney and client, since the presence of the third party accountant may constitute a waiver of the attorney-client privilege.\(^{20}\) The accountant's inability to protect confidential communications obtained from the defendant poses substantial problems for the defendant's attorney, who must decide that infor-

\(^{14}\) Had the client deposited the documents with the storage company, it is doubtful if he could have asserted even a fifth amendment privilege. See 8 Wigmore, Evidence § 2264(a) (3d ed. 1940). As a matter of policy, it seems a questionable practice to protect records placed in the hands of an attorney if the client could not have claimed a privilege for the records. See Falsone v. United States, 205 F.2d 734, 739 (5th Cir., cert. denied, 346 U.S. 864 (1953).\(^{16}\)

\(^{15}\) See Remmer v. United States, 205 F.2d 277 (9th Cir. 1953), vacated on other grounds, 347 U.S. 227 (1954), rehearing granted, 348 U.S. 904 (1954).\(^{16}\)

\(^{16}\) Pollock v. United States, 202 F.2d 281 (5th Cir. 1953).\(^{17}\)

\(^{17}\) Olender v. United States, 210 F.2d 795 (9th Cir. 1954).\(^{18}\)


\(^{19}\) Falsone v. United States, 205 F.2d 734 (5th Cir. 1953), cert. denied, 346 U.S. 864 (1953); United States v. Stoehr, 100 F.Supp. 143 (M.D. Pa. 1951), aff'd, 196 F.2d 276 (3d Cir. 1952), cert. denied, 344 U.S. 826 (1952); Himmelfarb v. United States, 175 F.2d 924 (9th Cir. 1949), cert. denied, 338 U.S. 860 (1949).\(^{20}\)

\(^{20}\) Himmelfarb v. United States, 175 F.2d 924 (9th Cir. 1949), cert. denied, 338 U.S. 860 (1949).
mation can be entrusted to the accountant. Attempts have been made to avoid the difficulties inherent in dealing with the defendant's accountant on this basis, by the device of having the attorney retain an accountant directly, rather than having the taxpayer retain him. However, it appears that this tactic will be unsuccessful in the ordinary criminal tax case.\footnote{21}{Ibid. And see Gariopey v. United States, 189 F.2d 459 (6th Cir. 1951).}

A similar problem is presented in states which have enacted statutes extending a privilege to confidential communications with accountants. These statutory privileges have not been recognized in federal criminal tax proceedings.\footnote{22}{E.g. Falsome v. United States, \textit{supra} note 14.} The refusal to recognize privileges granted by state statutes is based upon Rule 26 of the Federal Rules of Criminal Procedure which provides, in pertinent part, as follows:

\begin{quote}
The . . . privileges of witnesses shall be governed by the principles of the common law as they may be interpreted by the Courts of the United States in the light of reason and experience.\footnote{23}{Id. at 285.}
\end{quote}

Since the common law did not recognize a privilege for confidential communications with an accountant, the question becomes whether the "reason and experience" requirement demands recognition of the privilege.

A narrow construction of statutory privileges to limit their scope so far as possible has been adopted in applying Rule 26. A statement typical of this approach occurs in \textit{Pollock v. United States,}\footnote{24}{202 F.2d 281 (5th Cir. 1953).} as follows:

\begin{quote}
Congress has not given the states the power of prescribing the rules of evidence in trials for offenses against the United States. In criminal cases in the federal courts, the admissibility of evidence and the competency and the privileges of witnesses are governed, except when an Act of Congress or the Federal Rules of Criminal Procedure otherwise provide, by the principles of the common law as interpreted by the courts of the United States in the light of reason and experience.\footnote{25}{Id. at 285.}
\end{quote}

Another theory, which serves to avoid a state statutory privilege for accountants during the investigatory stage, was
adopted in the leading case *Falsone v. United States*. An internal revenue agent issued a statutory summons to require a Florida C.P.A. to produce records of a client who was not then under indictment, but who was being investigated for tax fraud, and to give testimony regarding them. The summons was issued despite the fact that Florida had enacted a privilege statute for communications with accountants. The C.P.A. claimed the statutory privilege on behalf of his client and moved to quash the summons, arguing that, in the absence of formal action by the Internal Revenue Service, the proceeding was civil rather than criminal and the state privilege statute must be respected. This argument was rejected on the theory that an investigation initiated by an agent's statutory summons is inquisitorial in nature and does not fall within the scope of the Federal Rules of Civil Procedure. The court then held that the state statutory privilege was not applicable and denied the motion to quash.

The suggestive case of *Brodson v. United States* deserves attention in considering whether the "reason and experience" requirement of Rule 26 should require recognition of a privilege for confidential communications with accountants, whether or not a state statute is involved. A jeopardy assessment was made against Brodson and liens were filed against his property. After the liens attached, an indictment was returned which charged Brodson with a willful attempt to evade the income tax and indicated that the government intended to prove the evasion by the "net worth" method. Defendant moved to dismiss the indictment arguing, among other things, that the initiation of the criminal prosecution during the pendency of the jeopardy assessment would deprive him of due

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26 205 F.2d 734 (5th Cir.), cert. denied, 346 U.S. 864 (1953).
27 A collateral determination made in this decision is also noteworthy. The C.P.A. was enrolled by the Treasury Department as an agent entitled to represent taxpayers, effectively on an equal footing with attorneys so enrolled. Accordingly, the accountant claimed that confidential communications between an enrolled agent and his client should be privileged. This argument was rejected on the grounds that the Treasury's Regulations did not extend such a privilege to enrolled agents and that, even if such a privilege were granted, it would be inconsistent with the statute which does not impose limitations on the information to be obtained by means of a revenue agent's statutory summons. Id. at 740-41. But see 8 Wigmore, Evidence § 2300(a) (3d ed. 1940).
process and the effective assistance of counsel, in violation of the fifth and sixth amendments to the United States Constitution, since he was unable to use his attached funds to retain an accountant to aid in meeting the government's net worth proof.

After a hearing on the motion to dismiss, the district court judge indicated that if the government did not see fit to release the liens in part to provide funds for defendant to retain an accountant, he would incline to the view that defendant was being deprived of a fair trial. The government informed the court that it was without authority to release the liens on any part of defendant's property. The district court thereupon dismissed the indictment, holding that defendant could not refute the government's net worth evidence without the services of a trained accountant.\(^2\)

The government appealed this decision to the Court of Appeals for the Seventh Circuit which reversed the district court in a 3-2 decision on rehearing following an initial 2-1 reversal.\(^3\)

The basis of the majority opinion was that the ruling of the district court was premature and speculative since it was not certain either that the defendant would not have the services of an accountant by the time of trial or that, even if he did not, his rights would necessarily be prejudiced by the lack thereof. However, the majority specifically refused to rule on the district court's determination that the services of an accountant were essential in providing an effective defense, since it was not necessary to reach the issue.\(^4\)

The weight to be given the *Brodson* case is a matter for speculation, particularly since, as noted in the majority opinion, it has ramifications outside of the tax field in such matters as the right of an indigent defendant in a criminal proceeding to claim the services of a court-appointed psychiatrist to aid in preparing an "effective" defense of insanity. At the same time, the decision is noteworthy because it contains a measure of recognition of the essential role of the accountant in the defense of a criminal tax case. To the extent that this view of the accountant's role as essential is accepted, it appears that "reason

\(^{3}\) 234 F.2d 97, rehearing, 241 F.2d 107 (7th Cir. 1957).
\(^{4}\) 241 F.2d at 110.
and experience” require an interpretation of Rule 26 which would confer a privilege upon confidential communications with accountants, whether or not the applicable state law requires the recognition of such a privilege.

**FIFTH AMENDMENT PROBLEMS**

Fifth amendment problems arise as soon as the taxpayer is contacted by either a revenue agent or a special agent. The taxpayer who is called upon by a revenue agent may claim his privilege under the fifth amendment. However, if the taxpayer does not claim his privilege, there is no duty to inform him of his right to do so. Should the taxpayer attempt to conceal his previous offense by a misrepresentation to the agent, it is possible to treat this as a separate offense.

If the taxpayer is taken unawares by the revenue agent, he may make admissions which he later wishes to suppress. In this case, even though the taxpayer later claims his fifth amendment privilege, the agent is able to repeat a selection of the most damaging testimony. This poses a serious problem for the taxpayer’s attorney who may be unable to get a clear description before trial of what evidence his client has removed from the protection of the fifth amendment.

If the taxpayer’s statements to the revenue agent have been extensive enough, they may serve to waive completely his privilege against self-incrimination. However, since the taxpayer is so subject to being taken off guard in the investigatory process, the courts carefully scrutinize such statements. The government bears the burden of proving that a statement was made freely. If it appears that the taxpayer was induced to make a statement as a result of either coercion or a promise, it will be suppressed.

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33 United States v. Burdick, 214 F.2d 768 (3d Cir. 1954); Montgomery v. United States, 203 F.2d 887 (5th Cir. 1953); Hanson v. United States, 186 F.2d 61 (8th Cir. 1950).
37 Hanson v. United States, 186 F.2d 61 (8th Cir. 1950); United States v. Scully, 225 F.2d 113, 116 (2d Cir. 1955); Application of Russo, 19 F.R.D. 278 (E.D. N.Y. 1956).
38 In re Leibster, 91 F. Supp. 814 (E.D. Pa. 1950); but see Centracchio v. Garrity, 198 F.2d 382 (1st Cir. 1952). For an illustration of the problems involved with a corporation which can assert only a fourth amendment right against unreasonable searches and seizures, see United States v. Harte-Hanks Newspapers, 254 F.2d 366 (5th Cir. 1958).
The fifth amendment privilege must be affirmatively claimed by the taxpayer. Even if the taxpayer is responding to a summons, he must make a timely claim of his privilege against self-incrimination or it may be deemed to have been waived.39

A taxpayer may protect his personal records by asserting his fifth amendment privilege.40 However, it is doubtful how much further the fifth amendment privilege for records extends. It has long been settled that a defendant can not suppress corporate records which can incriminate him, even though he prepared the records himself.41 Between the clean-cut extremes of personal and corporate records lies the shadow of partnership records. It has been held that a partner in a small general partnership may claim the privilege against self-incrimination and suppress the records of the partnership.42 However, the privilege has not been extended to large "impersonal" partnerships and, in fact, recognition of a privilege to suppress the records of any partnership has been criticized.43

A limitation upon a taxpayer's ability to suppress even personal financial records has been threatening to develop on the basis of a group of cases originating in the extensive federal control required during World War II. At that time, various government agencies required private citizens to keep different types of potentially incriminating records and later successfully maintained their right to compel the disclosure of these records on the basis that they were quasi-public records.44 The objection to this development was made clear by Mr. Justice Frankfurter dissenting in Shapiro v. United States,45 as follows:

If Congress by the easy device of requiring a man to keep the private papers that he has customarily kept can render such papers 'public' and nonprivileged, there is little left to either the right of privacy or the constitutional privilege.46

41 Wilson v. United States, 221 U.S. 361 (1911).
45 335 U.S. 1 (1948).
46 Id. at 70.
In view of the present statutory requirement that taxpayers maintain records which are to be available for inspection, it is possible that they might be treated as quasi-public records not entitled to the protection of the fifth amendment. To date, most courts have refused to extend the reasoning of the Shapiro case into the criminal tax field. This reluctance has not been universal. In Beard v. United States, the Shapiro case was held to justify the limited infringement of allowing the government to comment on the defendant’s claim of privilege, and similar results have already been reached in other cases.

**Fourth Amendment Problems**

Fourth amendment problems frequently arise in the same situations which present fifth amendment problems, since often the government is concerned with obtaining the taxpayer’s records rather than his direct testimony. Of course, the scope of fourth amendment is limited since only “unreasonable” searches and seizures are prohibited. If a taxpayer is able to establish that seized records are entitled to the protection of his fourth amendment privilege, the usual federal rule will allow them to be suppressed. Evidence developed with the seized records should also be suppressed.

A revenue agent has a statutory right to inspect a taxpayer’s books in order to determine the correctness of a tax return. However, the agent has no right to inspect the taxpayer’s books without permission, nor does he have the right to seize them after his inspection. The permission granted to a revenue agent to enter a taxpayer’s premises in order to inspect his books is not an invitation to go beyond the designated records; thus, in United States v. Guerrina, an agent who was provided with

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48 Application of House, 144 F.Supp. 95 (N.D. Cal. 1956); Blumberg v. United States, 222 F.2d 496 (5th Cir. 1955); United States v. Lawn, 115 F. Supp. 674, 677 (S.D. N.Y. 1953).
50 Smith v. United States, 236 F.2d 260 (8th Cir. 1956), cert. denied, 352 U.S. 909 (1957); Falsone v. United States, 205 F.2d 734 (5th Cir. 1953); Olson v. United States, 191 F.2d 985 (8th Cir. 1951); Myres v. United States, 174 F.2d 829 (8th Cir. 1949), cert. denied, 338 U.S. 849 (1949).
51 Murby v. United States, 243 Fed. 849 (1st Cir. 1923).
52 Silverthorne Lumber Co. v. United States, 251 U.S. 385 (1920).
facilities on the taxpayer's premises could not introduce evidence which he discovered while rummaging through a desk in the taxpayer's absence.

The scope of the Guerrina case is limited to the type of extreme situation presented in it. This seems unfortunate since many times it is more convenient for all parties to allow the revenue agent to conduct his investigation on the taxpayer's premises. However, in order to follow this expedient practice, it seems necessary that the taxpayer be sure that the agent will not treat his presence on the premises as an invitation to ransack them.

A taxpayer can waive his fourth amendment rights. Further, since only unreasonable searches are prohibited, it would seem that an agent of the taxpayer might waive his fourth amendment privilege without the taxpayer realizing it. A taxpayer who does not immediately claim his fourth amendment privilege may later do so, but will not be protected from evidence uncovered earlier.

CONCLUSION

The previous discussion has not attempted to emphasize broad policy considerations, but it seems clear that suppression of evidence problems in the criminal tax field are dominated by the fundamental conflict between the government's need to enforce the revenue laws and the society's need to protect the individual citizen. Proceeding from these conflicting policies, it is possible to suggest the areas in which the courts may give greater emphasis to the demands of one policy rather than the other.

The statutory protection against unnecessary examinations, granted by section 7605(b), was not enacted to aid defendants in criminal cases and has not generally been given that effect. Further, it does not seem reasonable to expect courts in the future to interpret it in any different manner.

The type of concealed investigation typified by the joint investigation —
vestigation is inherently controversial since it frequently involves the development of evidence obtained from an unwarned and unsuspecting taxpayer. The abuses which can flourish if such a technique is applied with excessive zeal, at the expense of the individual under investigation, will no doubt continue to be a matter of concern to courts in the future as in the past. However, so long as revenue must be collected, it is only reasonable to predict that some such investigatory technique will be tolerated by the courts.

There are obvious inconsistencies in the area of confidential communications since a taxpayer may communicate freely with his attorney but must deal with his accountant at his own peril. The specialized character of tax proceedings, demanding the services of skilled accountants, furnishes a persuasive argument for extending a privilege to communications with accountants but there is, as yet, little indication that such a privilege will be recognized.

The relevant constitutional problems are not uniquely those of the tax field, although the question of suppression of incriminating documents reaches its greatest importance in this area. The great unanswered question is the effect to be given the Shapiro doctrine as a possible limitation on the right to withhold incriminating documents. As yet, there is little indication that Shapiro will shape the law in the tax field, but it is necessary to recognize that it is available to courts which may wish to apply it.

60 E.g., United States v. Lipschitz, supra note 56.
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