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Tax Prosecutions

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From the Editor-in-Chief

During the last several years, we have received numerous requests to dedicate an issue of the *Bulletin* to illegal tax protester cases. We approached the Tax Division with this concept, and they enthusiastically embraced the idea and have worked hard on this issue with us. We learned that there are a number of Tax Division attorneys who have traveled across the country trying various illegal tax protester cases. In preparation for this edition of the *Bulletin*, I attended a training lecture on illegal tax protesters given by Senior Trial Attorney Jen Ihlo of the Tax Division. Ms. Ihlo regularly makes this presentation at the Criminal Tax Institute. If your district suddenly finds itself in the middle of a group of illegal tax protester cases, I have been advised that the Tax Division may look favorably on sending Ms. Ihlo to your district to give this training.

Uniformity in tax prosecution philosophy was the reason for the creation of the Tax Division more than 60 years ago. One of Assistant Attorney General Loretta Argrett's priorities is to take the spirit of cooperation between the Tax Division and the United States Attorneys' offices to new heights. We hope you find this issue informative and helpful.

Our upcoming schedule of issues is printed on the back cover. Thanks to all of our contributors and, as always, keep those suggestions, criticisms, and contributions coming. We're listening.

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Interview with Assistant Attorney General Loretta C. Argrett, Tax Division



*Assistant Attorney General
Loretta C. Argrett, Tax Division*

Loretta C. Argrett has served as Assistant Attorney General of the Tax Division since November 19, 1993. As Assistant Attorney General she manages an organization of almost 600 employees and a budget of approximately \$60 million. In that capacity, she oversees civil and criminal tax litigation on behalf of the Federal Government in state and Federal district and appellate courts throughout the United States.

A former biochemist, Ms. Argrett received a Bachelor of Science Degree with honors in Chemistry from Howard University and received her law degree from Harvard Law School. Early in her career she became the first African-American member of the staff of the Joint Committee on Taxation of the United States Congress. Later, she joined the Washington, D.C., law firm of Wald, Harkrader and Ross, where she became a partner. At the time of her nomination, Ms. Argrett was a tenured professor at Howard University School of Law, where she taught courses in income taxation, business planning, and professional responsibility.

She has published several scientific and legal articles, addressing issues such as the tax treatment of education expenditures (arguing for the deduction of

certain post-secondary education costs) and the tax consequences of real estate ownership.

Assistant Attorney General Loretta C. Argrett (LA) was interviewed by Assistant United States Attorney (AUSA) David Nissman (DN), Editor-in-Chief of the *United States Attorneys' Bulletin*.

DN: You have been AAG of the Tax Division for a little over four years. Have there been any significant changes to the Tax Division during this period?

LA: We have made significant strides over these last few years in positioning the Division to move into the 21st Century, both programmatically and operationally. On the programmatic side, we have become more proactive, signaling to the Internal Revenue Service (the Service) that we are willing to invest our resources in certain kinds of cases that we believe are very important to tax enforcement. This has led to two major initiatives, the Tax Gap Project and the Tax Protester Initiative. Operationally, we are completing a restructuring of our workforce so that we can make the Division more efficient and take advantage of new technology that is now available to us. Pursuant to this restructuring, we have established uniform office structures, streamlined operating procedures, increased delegations of certain operational activities, revised position descriptions, and established meaningful criteria for evaluating employees' performance. In addition, we have increased paraprofessional support for our attorneys, expanded the role of paraprofessionals in the conduct of our litigation, and established career ladders for those employees. Finally, we have done this without affecting the historic high quality of the work product of our lawyers.

DN: You mentioned the Tax Gap Initiative. What is the Tax Gap?

LA: The tax gap is the difference between the amount of taxes that are due on legal source income and the amount that is actually paid. That gap is extraordinarily large—on the order of about \$100 billion per year. This gap arises in a number of ways. For example, some taxpayers who are not wage earners, or who have some

other outside source of income, may not report all of their income. Or, some taxpayers inflate deductions and reduce their taxable income. Corporate taxpayers may engage in convoluted and fraudulent transactions to reduce the amount of the corporation's income tax liability. We believe that prosecution of tax gap cases produces maximum deterrence. That is why we chose it as an initiative. This project would have been a meaningless initiative if the IRS and the U.S. Attorneys had not enthusiastically supported the goals of the project.

“We believe that prosecution of tax gap cases produces maximum deterrence. . . . This project would have been a meaningless initiative if the IRS and the U.S. Attorneys had not enthusiastically supported the goals of the project.”

Loretta C. Argrett

DN: How does the IRS begin to investigate the tax gap?

LA: It happens in many different ways. Sometimes, during the audit process, the Service refers a case to the Criminal Investigation Division (CID) because of information gained during the audit which leads the auditor to suspect criminal activity. Often, disappointed lovers, estranged spouses, angry business partners, or neighbors report suspected activity. Sometimes, the Service decides to determine the rate of compliance in a selected industry group and, through the audit process, suspected criminal activity is referred to CID. Frequently, CID may be investigating suspected criminal activity of one taxpayer and learn of the suspected criminal activity of another taxpayer.

DN: How does the Department of Justice assist in reducing the tax gap?

LA: We do it through our coordinated partnership with the IRS and the U.S. Attorneys' offices. As I mentioned earlier, we signaled to the Service that we consider this a high priority area. They responded with a significant increase (approximately 20 percent) in the number of referrals of tax gap cases to us. To speed up the processing of grand jury cases for U.S. Attorneys, we revised our procedures to provide for simultaneous review of cases by Chief Counsel and the Division.

Through a coordinated effort with the U.S. Attorneys' offices, we assist during all phases of the prosecution. If they request, we may litigate the case by cochairing or sometimes being lead or sole counsel.

DN: Is the tax protester movement growing?

LA: Unfortunately the movement appears to be growing, consequently increasing the number of such cases. That is why we chose it as one of our initiatives. Elsewhere in this issue, there are several articles describing how the tax protester movement has affected our workload and what actions we have taken to deal with the problem.

DN: Because both the United States Attorneys and the Tax Division represent the IRS in bankruptcy cases, the question arises whether there is some way of having one attorney represent the United States when multiple matters arise in the same bankruptcy, some normally handled by the Tax Division and some by AUSAs?

LA: In bankruptcy cases, there are a variety of scenarios that work well, depending on the combination of issues presented. The Tax Division attorney and the AUSA should, in all these cases, consult with each other and reach agreement on how to best represent the United States. It sometimes happens that one attorney or the other ought to take the lead in all pending matters in a particular case, and as a bankruptcy proceeds, the attorney taking the lead may change as the issues do. In other cases the Tax Division attorney and the AUSA will each continue to handle his or her own issues, making sure that the other is fully informed. And, sometimes an AUSA will handle a hearing in a Tax Division matter as long as the Tax Division attorney provides, orally or in writing, the necessary information and case law. The goal is to handle these matters not only knowledgeably but efficiently. Achieving that goal starts with a discussion and careful coordination by the attorneys involved. I am pleased to say that I hear of many arrangements being made which evidence a great spirit of cooperation between AUSAs and Tax Division attorneys to accomplish the mission in the best way possible.

DN: Do you see any particular issues emerging that will lead to any increase in cases for the Tax Division?

LA: I think we will be seeing many more cases involving international tax issues. The Tax Division has, for many years now, been litigating cases involving substantive interpretations of the international tax credit and related laws. The Service has recently announced that it is becoming increasingly concerned about the use of offshore schemes to avoid the assessment and collection of taxes. We are actively working with the Service to assist them with their problems in foreign evidence gathering and, in fact, are already seeing an increase in litigation referrals to obtain foreign evidence. The Service also is turning to the Division to assist in collecting assets that taxpayers are sending or keeping offshore to avoid the collection of their tax liabilities. The Service also has asked us to help identify litigation strategies that may be used to counter certain types of offshore vehicles used to frustrate the proper operation of the tax laws, such as some foreign trusts. These civil and criminal cases in the international arena will be important cases for tax administration in the future.

DN: In a recent news conference, the President fielded some questions about the complexity of the tax code. He went on record saying he would like to see it made more simple. He said he wasn't in favor of more tax cuts, but he was in favor of making this code more simple. Do you anticipate getting involved with any legislative changes or proposals?

LA: The Treasury Department, particularly the Assistant Secretary for Tax Policy, takes the lead in tax policy development through the legislative, as opposed to the litigative, process. We do get involved, however, in those specific areas which may directly affect our litigation. Senior Division management has worked hard over the years to maintain a working relationship with the Treasury Department so that a regular avenue is available for consultation and input.

DN: This Administration in the Department of Justice has been very proactive in a community outreach mentality and in raising the level of consciousness about the law, and certainly a lot of the Attorney General's speeches are directed there. She even meets and speaks with school age children. This must be a tricky issue. We have on the one hand a public outcry on the perception of the Internal Revenue Code and this recent legislation with IRS. At the same time, we want to get the message out that there are consequences if you don't pay your taxes. How do you craft this message so that it

raises consciousness among the American people so that they want to do the right thing, as opposed to reacting to what we're doing?

"We work very hard to be certain we are taking consistent positions in tax cases. . . . I know there can be, on occasion, disagreement between the U.S. Attorneys' offices and our office over the appropriate disposition of a case, and our position will largely be based on whether the particular taxpayer's proposed treatment will be similar to that of other similarly situated taxpayers."

Loretta C. Argrett

LA: Well, there are several things we can do. First, we must always convey, through our dealings with the public and with our advocacy, that we are being fair and uniform. The Division was created back in 1933 because there was a lack of uniformity in the treatment of taxpayers, as there were several offices throughout the Government that had responsibility for the enforcement of the tax laws. They often took inconsistent litigating positions. It was a major problem and caused taxpayers to lose confidence in the system. We work very hard to be certain we are taking consistent positions in tax cases. I cannot emphasize that too much. While I know there can be, on occasion, disagreement between the U.S. Attorneys' offices and our office over the appropriate disposition of a case, and our position will largely be based on whether the particular taxpayer's proposed treatment will be similar to that of other similarly situated taxpayers. Second, we must convince taxpayers that they will be sanctioned if they do not pay

their fair share of taxes. That is the reason we try to get maximum publicity for our criminal tax cases. Third, we must be courteous when we're dealing with taxpayers. How we act will likely leave a lasting impression. Finally, outside of our traditional work environment, we must exhibit a respect for the law, including the tax laws, and convey that we all benefit from this system—as imperfect as it may be. The nation's future depends on that. We don't want honest taxpayers to become disillusioned because they believe that dishonest taxpayers are ripping off the tax system by not paying their fair share, while at the same time enjoying the benefits of Government expenditures.

DN: Within the AUSA community, there is a very high level of respect for the capability of IRS agents. That raises this resource issue because it's hard to get IRS agents on your cases because they're spread so thin. Is this something that comes up in your discussions with the IRS Commissioner?

LA: All of us agree that CID personnel are top notch financial crimes investigators. So, I fully understand why the U.S. Attorneys and the Assistants desire to use CID agents on their cases. On the other hand, from our mission-oriented viewpoint, we believe their resources should be predominately directed to tax gap cases, which are those cases that are likely to have the greatest deterrent effect. After all, the CID is the only investigative body charged with investigating tax crimes. Diverting these scarce resources to the investigation of activities that do not have a tax crime as the linchpin of the activity is a detriment to the tax enforcement program. At the same time, we recognize the important contribution made by CID agents in other areas of law enforcement. It is crucial that a balance be maintained to give proper recognition to the importance of investigating tax gap cases. We have discussed these concerns with IRS management and I note that over the last few years the CID has committed to increasing the amount of time spent investigating tax gap cases.

DN: Are you satisfied with the performance of AUSAs working on tax cases?

LA: Oh yes. I think we have some of the most highly qualified and skilled lawyers in the United States. Obviously the U.S. Attorneys get some of the best people, as we do. I am very proud of the quality of our work force—that is, the Assistants and all of the personnel who work on tax cases.

DN: Do you have any message you'd like to send out to the AUSAs?

LA: Let's view our working relationship as a partnership. I know we do. We know that we cannot accomplish the Tax Division mission without the full support and fine work of the Assistants. I hope that the materials in this issue will help those Assistants who are

“Fortunately, we are organized geographically so that an Assistant in a particular office can really get to know the relevant people in the Tax Division. This makes it easier to pick up the phone and say, “You know, this may be a stupid question but I’m going to ask it anyway.” . . . Often in five minutes of conversation a problem can be resolved, or at least some clarity can be brought to the issues at hand.”

Loretta C. Argrett

not yet too involved with tax cases understand why these tax cases are so important. Second, I thank the Assistants for working with us to maintain and improve our working relationship with them. We are proud of the quality of that relationship. Let's keep it that way and work hard to make it even better. I urge Assistants to call us for assistance. Fortunately, we are organized geographically so that an Assistant in a particular office can really get to know the relevant people in the Tax Division. This makes it easier to pick up the phone and say, “You know, this may be a stupid question but I'm going to ask it anyway.” They're not stupid questions. They're questions that people really have concerns about. Often in five minutes of conversation a problem can be resolved, or at least some clarity can be brought to the issues at hand. ❖

Significant Cases

The Tax Division handles numerous complex civil and criminal tax cases. The following are some cases with record sentences or settlements, or that set a particularly important precedent or resolved unique issues:

Civil

- *United States v. Laddie Jose*, 131 F.3d 1325 (9th Cir. 1997): The Ninth Circuit, sitting *en banc*, held that a district court has no power to impose conditions on enforcement of an Internal Revenue Service (IRS) summons. This decision reversed prior adverse precedent in the Ninth Circuit.
- *In re Nelson Bunker Hunt and In re William Herbert Hunt*, Bankr. Nos. 388-35726 HCA-11 and 388-35725 HCA-11 (N.D. Tex. filed September 21, 1988): In two separate Chapter 11 bankruptcy proceedings, the Government obtained over \$120 million in satisfaction of individual Federal tax liabilities over a 10-year period.
- *Unum v. United States*, 130 F.3d 501 (1st Cir. 1997): The Government prevailed in this tax refund case of first impression involving the tax consequences of conversion from a mutual to a stock insurance company, thereby protecting the Treasury Department from a claimed refund of approximately \$80 million. Based on the taxpayer's claimed deduction of \$652 million (as described in the complaint), the total effect of the case on the taxpayer is estimated to be in the range of \$250 to \$400 million, including interest, with industry-wide consequences of over \$1 billion.
- *United States v. Mary Christine Harris*, No. 4:97-CV-02051-DJS (E.D. Mo. filed October 7, 1997): The Government repatriated over \$350,000 in proceeds from the sale of a wine collection auctioned by Sotheby's of London, which the Government alleges was shipped overseas by a convicted tax fugitive in order to evade collection of his civil tax liabilities.

Criminal

- *United States v. Brodin et al.*, No. CR-97-058-S-BLW (D. Idaho filed July 10, 1997): Six Idaho "constitutionalists" were convicted of conspiracy to defraud the IRS, filing false claims for tax refunds, mailing threatening communications, mail fraud, bank fraud, intimidating a judicial officer, extortion for filing false liens against Federal and state judges and IRS employees, and attempting to collect money on the false liens. Five of the six defendants were sentenced to 108 to 210 months' imprisonment. One defendant remains to be sentenced. The United States Attorney's office for the District of Idaho also participated in this prosecution.
- *United States v. Lawrence M. Harrison*, Nos. 96-10446 and 97-10311 (N.D. Tex. filed June 18, 1996, and March 28, 1997): In 1997, Harrison, admitted architect of motor fuel excise tax "daisy-chain" schemes which funneled approximately \$1 billion to organized crime, was convicted of conspiracy, wire fraud, and money laundering. Harrison was sentenced to 188 months in prison and ordered to pay \$442,000 in restitution. The United States Attorney's office for the Northern District of Texas also participated in this prosecution.
- *United States v. Christensen*, Nos. 97-10485, 97-10489, 97-10492, and 97-10493 (D. Nev. filed October 30, 1997): Christensen, a construction contractor, and two corporations were convicted of conspiring to defraud the United States and the state of Nevada for concealing over \$6 million of personal income and \$10 million in taxable purchases by the corporations. Christensen was sentenced to 110 months in prison and ordered, along with the corporations, to pay over \$8 million in fines and restitution.
- *United States v. Bennalack*, 106 F.3d 409 (9th Cir. 1996), *cert. denied*, 117 S. Ct. 184 (1997) (Unpublished opinion): Bennalack, a multimillionaire and president of a large roofing company, was convicted of cheating on employment, corporate, and individual taxes. Bennalack was sentenced to 51 months' imprisonment. ❖

Through the Looking Glass: Reconciling the Mission of the Tax Division with the Goals of the United States Attorneys' Offices in Tax Prosecutions

Mark E. Matthews
Deputy Assistant Attorney General
Tax Division

The Tax Division's criminal sections provide two basic criminal litigation roles: one is very popular; the other often decidedly unpopular. The popular role—our direct and indirect litigation assistance to United States Attorneys' offices (USAOs)—is the one described by AUSA Jonn Vaudreuil in his article, "An AUSA's Perspective on Working with the Tax Division." As AUSA Vaudreuil's comments show, the Tax Division provides very welcome and "user friendly" litigation assistance and expertise in evaluating and litigating tax cases. In fact, AUSAs are often thankful for the Tax Division attorney who is willing to wade into the mounds of paper in a complex tax case or the piles of frivolous motions filed by an illegal tax protester and for his or her contributions to the indictments, convictions, and sentences generated by complex tax litigation. In my four years as the Deputy Assistant Attorney General for the Tax Division, relatively little controversy has occurred when we perform these services.

The more difficult aspects of our relationship arise in the review process. This second, occasionally contentious, role is critical to the Tax Division, but is often dreaded by the AUSA and case agent. The congenial relationship between the Tax Division and the local United States Attorney begins to deteriorate when we find it necessary to decline a case or a particular count or defendant. It becomes particularly more contentious when we decline to authorize a plea to a tax charge, which you believe would greatly simplify some difficult case in your district. This article attempts to explain what you might perceive as a schizophrenic Tax Division. How did the Division that produced an aggressive litigator who tried that difficult case for your district last year become such a meticulous, cautious

Mark E. Matthews has served as the Deputy Assistant Attorney General responsible for criminal matters within the Tax Division since February 1994. From August 1993 through February 1994, he served as the Director of the Treasury Department's Money Laundering Review Task Force and as a Senior Advisor to the Assistant Secretary for Enforcement, Ronald K. Noble. From 1988 to 1993, Mr. Matthews was an Assistant United States Attorney and then a Deputy Chief of the Criminal Division in the Southern District of New York. He has served in other governmental positions as a Special Assistant to Director William H. Webster, both at the Federal Bureau of Investigation and the Central Intelligence Agency.

reviewer, pointing out the problems in your case this year?

In the review process, the Tax Division spends a lot of time listening to the concerns of AUSAs regarding the "how to's" of handling tax cases and dedicates a lot of energy to figuring out ways to make cases fit within Tax Division guidelines and meet the AUSA's goals as well. Frankly, as a former AUSA, I think I can safely attest that, in relation to handling the complexities of a tax investigation and weighty case load, AUSAs don't spend much time worrying about the Tax Division's mission and concomitant problems. I hope that this article will provide a useful perspective for you or, at a minimum, help you to better evaluate your tax case's chances in the Tax Division.

The Tax Division review process can only be understood in terms of our mission. In all of law enforcement, we represent the extreme of general deterrence. We are trying to deter more taxpayers (over 200 million) with fewer prosecutions (approximately 1,500) than any other area of law enforcement. And, unlike other areas of law enforcement where the goal is usually to stop clearly unlawful conduct, we in the tax administration business have the goal of influencing hundreds of millions of Americans to take the affirmative steps of completing and filing often complex tax returns and making substantial payments to Uncle Sam.

This is a difficult mission by any measure, and we work hard to enforce compliance while ensuring uniform, fair enforcement in order to generate confidence in the system. One measure of our success is the “tax gap,” which is the difference between what should be reported as owing and paid to the Government each year versus what is actually reported and paid. That figure is currently estimated to be approximately \$100 billion per year. The Internal Revenue Service (IRS) estimates that the compliance rate is approximately 83 percent.

This tax gap is what causes us to place such a premium on every criminal tax case. Each tax case must be used to deter people who cheat or are willing to cheat on their taxes, but against whom we do not have the resources to investigate or prosecute. In these circumstances, it is easy to understand why we consider a tax case that is not publicized in any way a waste of resources. Even worse is a tax case that, if publicized, would undermine the voluntary compliance system. That can occur when the public perceives that the tax code has been used unfairly in some case, or more frequently, when the case and result is such that the public will perceive that perpetrators of tax crimes receive only a slap on the wrist, implying that tax crimes are somehow less serious than other Federal cases.

It is this phenomenon that sometimes challenges the relationship between a USAO and the Tax

Division. The USAO tends to view a case through a more narrow lens than the Tax Division. The AUSA is concerned with effectuating substantial justice vis-a-vis a particular defendant in a particular factual circumstance. While those concerns are important to the Tax Division as well, we are much more focused on the impact the case will have on the public at large and tax compliance more generally. The AUSA may have a more acute understanding of the judge selected to handle the tax case or the likely reactions of local jurors to particular facts and witnesses. Therefore, the USAO frequently comes to the Tax Division with particular plea or charging proposals based on their view of the case, the judge, and the defendant and his or her attorney. We are often presented with a view that a particular course is the most appropriate or best the Government can achieve under the circumstances. We give great deference to those views, and in the vast majority of cases, come to agreement without much difficulty. The problem comes when we conclude that, despite the great weight given local views, the proposal is unacceptable because of its potential to undermine tax compliance and uniformity.

The most dramatic example of this tension arises when a Title 18 investigation has become more complex than anticipated, and the Government is looking for an efficient and just way to dispose of the case. (Many criminal chiefs reading this will probably believe I am describing their case, but I promise that I have no particular case in mind). In this often-repeated theme, a Title 18 investigation has begun and perhaps even been indicted with great prospects. The IRS is probably not involved in the case or is the tail on the dog of a much bigger case. In many instances, the Title 18 investigation or prosecution has received media attention, perhaps based, in an indicted case, on a press release announcing the Government’s great efforts to address a particularly grave circumstance. Unfortunately, something has happened on the way to the jury. It could be the death of a witness; the unavailability of foreign evidence; the appearance of a dubious, but perhaps convincing alibi; the departure of the lead AUSA in a complex case; etc. The reason doesn’t really matter; we often will agree that a serious problem has occurred.

The difficulty for the Tax Division occurs when the prosecutor and the defense attorney come to an agreement that a tax plea is a graceful way out for both parties. Often, the defense attorney is content with this result because the proposed sentencing guidelines will allow for an “acceptable” sentence, frequently probation or home confinement. We often understand that the proposal, viewed narrowly within the confines of the particular case, represents the most attractive alternative from your perspective. But perhaps you can see the dark clouds beginning to form. When we evaluate this proposal in terms of our tax compliance mission, it presents us with great difficulty. We face the prospects of having the public perceive that a more “serious” Title 18 crime has been disposed of with a tax “slap on the wrist.” We can actually write the defense attorney’s statement to the media about how the Government, having utterly failed to prove the false and malicious charges against his or her client, has brought this “technical” tax case to which the client has reluctantly agreed to plead, particularly because no jail time is likely. We are concerned that taxpayers (who aren’t committing other Title 18 crimes) will receive an erroneous message from this result. They will perceive that if these bad folks committing other crimes are pursued for tax crimes and receive small sentences, that they will not be pursued and will certainly avoid any jail sentence. Such a result is particularly damaging to tax enforcement.

A corollary problem for the Tax Division is this—to endorse the proposed course means that scarce resources available to prosecute tax crimes will be spent on a case that actually undermines compliance. A Criminal Investigation Division (CID) agent will still have to generate a special agent’s report, and IRS counsel and Tax Division resources will be spent evaluating the plea. We have spent the last three years attempting to redress a sharp decline in CID resources directed to tax enforcement as opposed to narcotics and money laundering crimes. Plea agreements that do not take into consideration the tax enforcement mission of the Tax Division undermine these efforts.

As we begin to discuss these concerns with USAOs, we are sometimes confronted with an incredulous response along the following lines: “Would you rather have us let a criminal go completely free (or run a greater risk of an acquittal than normal)?” I hope you are beginning to anticipate the answer that starts to form in our minds. From the standpoint of the central mission of the Tax Division, the answer is “yes,” we sometimes see a greater harm to tax administration from accepting that plea than from failing to charge the defendant or from dismissing the case.

Now, the good news is that we only infrequently face these more dramatic examples of conflict. Tax Division attorneys work with AUSAs to find a way out of the dilemma whenever possible. Because we are willing to give substantial weight to the views and concerns of USAOs, we struggle for alternative solutions or modifications to cases that will conform to Tax Division guidelines.

Less dramatic cases arise every day, however. We are asked to approve a failure to file misdemeanor when the facts more clearly show felony conduct. Or we are asked to approve a tax plea before the factual basis has been developed. Or we are asked to authorize a *Spies* evasion when other taxpayers have been charged with a failure to file on similar facts. These kinds of cases raise not only the issues above with respect to tax compliance, but also raise another important issue for the Tax Division—the uniform treatment of taxpayers. Given the applicability of our tax laws to all Americans, it is exceedingly important that they perceive the system as fundamentally fair. This means that the Government must act uniformly and fairly, and that, all factors being equal, the taxpayer referred for criminal prosecution in District A gets the same treatment as the taxpayer referred for prosecution in District B.

A breakdown in uniform treatment through disparate prosecution decisions, declinations, or pleas can harm voluntary compliance in other ways. The tax defense bar is a close knit group that meets often and exchanges information at the national level. Actions in one seemingly remote case can quickly wind up being used affirmatively against the Government in another setting.

This uniform treatment is a hallmark of why the Tax Division was created. The lack of a nationwide clearinghouse could (and did) generate diverse results that could undermine tax compliance. You may present what looks like an acceptable tax charge, but the Tax Division may oppose it on uniformity grounds. It may be that you propose a case with dollar thresholds substantially below those normally used by the IRS and the Tax Division. Or you may propose a case where the evidence of willfulness, while not negligible, differs substantially from the degree of proof we have required against other taxpayers. Or you may propose a criminal prosecution in an area of the tax code that has not been criminalized before and where there has been no antecedent aggressive civil enforcement by the IRS. In all of these instances, depending on the facts and other circumstances, the Tax Division may be much less enthusiastic about your case as a matter of fundamental fairness to other similarly situated taxpayers.

A more dramatic example illustrates the tension. We occasionally see proposed tax investigations or charges that involve political or other public figures. The structure of the entire tax review system, including career professionals at the IRS Chief Counsel's office and in the Tax Division, ensures both the reality and the public perception that individuals charged with criminal tax violations are selected for the crimes they commit, not because of who they are. No one involved in these cases wants a case to be, or to be perceived to be, investigated or brought for improper reasons. The availability of Tax Division review helps prevent either occurrence.

We occasionally receive comments during a review process that note the expertise and freedom of USAOs in many other areas of complicated white collar crimes. We in the Tax Division recognize that expertise and struggle mightily not to convey the impression that we disagree because we are just wiser. It is simply that, unlike some USAOs, which at best see a couple dozen tax prosecutions a year, we see them all. We know precisely how we've handled similar matters in other districts. It is that experience that we bring to bear in the review process. I am quick to note, however, that the Tax Division and its prosecution policies have benefitted greatly from the contribution of AUSAs, particularly a core of very experienced and committed Federal prosecutors who are very enthusiastic about tax enforcement. Further, I encourage you to contact the Tax Division in the early stages of a case so that we can work together to resolve any issues concerning the appropriate disposition of the case.

My comments are intended merely to explain how different views arise at times between Federal prosecutors who are dedicated to doing the right thing every day. Likewise, I hope you have gained some appreciation of the Tax Division's mission and the impact of that mission on our prosecution policies. Despite our infrequent differences, there is no organization more supportive of and thankful for each USAO's efforts to enhance tax compliance than the Tax Division. ❖

An AUSA's Perspective on Working with the Tax Division

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A small dose of heresy from an Assistant United States Attorney: Tax Division lawyers are good people and can help an AUSA in the prosecution of criminal tax cases. Okay, I know you are probably thinking “this author is a brand new AUSA and probably was hired **from** the Tax Division.” Neither of these assumptions is correct. I was hired directly out of law school and have been an Assistant United States Attorney in the Western District of Wisconsin for 18 years. Suspend your prejudging for a moment and consider a few thoughts on how the experience of working with Tax Division lawyers can be both helpful and enjoyable.

The involvement of the Criminal Enforcement Sections of the Tax Division in partnership with the United States Attorney's offices (USAOs) in prosecuting tax cases can be broken down into three areas. First, review of the case and preparation of the prosecution memorandum. Second, assistance in the grand jury investigation. Third, assistance with the ultimate litigation. In each of these areas, Tax Division attorneys can bring technical expertise, a unique perspective, and, most fundamentally, another member to the prosecution team using existing Department resources.

Pre-Indictment Review

The Tax Division reviews all criminal tax cases from across the country. Therefore, Tax Division attorneys have a unique perspective in assessing the strengths and weaknesses of cases. They have seen much of it before and they are not reinventing the prosecutive wheel with every criminal tax case. Prior to the completion of Tax Division review and preparation of the prosecution memorandum, it can be helpful to discuss possible approaches to the case with the reviewing attorney. In a recent investigation, the Tax

Division attorney and I reviewed the Internal Revenue Service-Criminal Investigation Division (IRS-CID) referral and we came up with an approach to the case that will streamline the indictment and prosecution. By working together, we developed a prosecution memorandum that facilitated the Tax Division's review of the case and should help in the ultimate prosecution.

This recent experience also brings to mind another way in which the Tax Division can help out prior to indictment. Given their technical expertise, Tax Division attorneys are in a good position to assess the special agent's work product, to comment on any deficiencies and, if necessary, to suggest additional investigation, which leads to a stronger prosecutive product.

Interaction with the Tax Division attorney while the case is being reviewed can lead to a stronger prosecutive product. In addition, consider using the Tax Division prosecution memorandum as a tool for discussing the case with the special agent. This approach can assist the AUSA in discussing the special agent's report (SAR) without personalizing the issue. Egos aside, two heads are often better than one during the review process, especially when one of those heads has technical expertise and a national perspective regarding tax cases.

Grand Jury Investigation

Grand jury investigations in tax cases come up in a couple of different situations. First, and somewhat infrequently, a case may be referred for a grand jury investigation after the Tax Division review of the case. Second, and much more frequently in this district, the United States Attorney requests approval to initiate a tax grand jury investigation as part of an ongoing non-tax investigation. The USAO can request litigation assistance from the Tax Division during the grand jury phase and a trial attorney will be assigned to the case.

Since the USAO is requesting the assistance, the division of responsibility and assignment of duties really depends on how the USAO wants to run the case. The Tax Division attorney may be asked to assist as cocounsel, take the lead counsel position, or litigate the case in its entirety. These joint litigations are no different than any multi-prosecutor case; the responsibilities and duties of each attorney should be discussed and clearly resolved before proceeding forward with the case.

A Tax Division attorney assigned during the grand jury investigation can help the prosecuting AUSA by assisting with grand jury witnesses, organizing and reviewing documents, and reacting to specific tax defenses. If the attorneys take the time to develop a good working relationship, the division of responsibilities will make the end product that much better.

Litigation Assistance

The USAO can also request litigation assistance from the Tax Division. This assistance may be requested in a variety of forms. Some USAOs refer most, or all, of their tax cases to the Tax Division, which conserves the resources of the USAO for other priority cases in the district. Other USAOs request that a Tax Division attorney be assigned to work with an AUSA and to provide a second chair attorney with technical experience and expertise in tax cases. Still other USAOs mix these methods by farming some cases in their entirety out to the Tax Division, and by using the Tax Division to assist AUSAs at other trials and investigations.

To an AUSA the benefit from assigning a tax case in its entirety to the Tax Division is obvious: assign the Tax Division attorney the case, show him or her

the file, introduce him or her to the court, and go back to your office. There can also be benefits, however, from a joint trial.

First, as with the grand jury investigation, the Tax Division attorney brings technical expertise from criminal tax trials. Second, since the Tax Division is likely to have addressed many of the standard motions and pleadings in tax cases, the Tax Division attorney can handle pretrial motion work and document preparation. Third, the Tax Division attorney can bring fresh and different perspectives to the trial. Since the Tax Division litigates tax cases all over the country, its attorneys can bring helpful suggestions for presenting and framing tax issues, presenting tax case documents as exhibits, and handling certain types of tax case witnesses. Clearly, on occasion I have told the Tax Division attorney, "That's all well and good, but it won't work here with our judge." On the other hand, it is important to consider the fresh ideas brought from the Tax Division's experience in other jurisdictions. As with the joint grand jury investigation, to guarantee success in a joint trial, it is most important to delineate the roles and tasks clearly at the start and to take time to develop a sound working relationship between the attorneys.

Conclusion

In your next tax case, consider enlisting the assistance of the Tax Division while you are reviewing the case; using its technical expertise in devising a strategy and conducting a grand jury tax investigation; and, finally, consider using the technical expertise and fresh perspective that a Tax Division attorney can bring to the actual trial of the tax case. If you take the time to develop a good working relationship with Tax Division attorneys, I believe you will find their tax expertise and judgment helpful in achieving a successful prosecution.



House Counsel: The Roles of IRS's Office of Chief Counsel in Tax and Financial Crime Enforcement

Rich Delmar

Chief Counsel

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Every year over 100 million taxpayers have an obligation to compute and report their income and tax liability to the Internal Revenue Service (IRS). The vast majority do so completely and honestly. But millions either fail to file returns or file inaccurately. This universe of noncompliance yields a significant revenue shortfall and begets the question: Who should be investigated?

The process of deciding who should be investigated is crucial to effective tax administration, in terms of enhancing compliance and assuring fair and evenhanded treatment of taxpayers. The decision to investigate and prosecute a case criminally has an impact on tax collection because:

- Civil collection action is generally suspended while a case is being investigated by the IRS's Criminal Investigation Division (CID);
- The referral of a case to the Department of Justice (DOJ) with a recommendation for a grand jury investigation or for a prosecution forestalls the use of IRS's summons power with respect to the same tax and taxable periods (Internal Revenue Code (I.R.C.) § 7602(c));
- Referral of a criminal case to DOJ establishes its right to compromise the civil aspects of that case (I.R.C. § 7122(a)); and
- Information obtained by the grand jury regarding an asserted tax liability may not be available for civil tax collection purposes.

The IRS Office of Chief Counsel plays an important role in this process. Once CID has recommended a grand jury investigation or a prosecution in tax and tax-related cases, Department of the Treasury Directives

(e.g., Treasury General Counsel Order No. 4) require that the IRS's in-house lawyers evaluate the case and determine if it will be referred to DOJ for grand jury investigation and prosecution. This article describes Chief Counsel's work in this area and in related areas of criminal enforcement.

Counsel Structure and Operation

Pursuant to I.R.C. § 7801(b)(2), the Chief Counsel is the chief law officer of the IRS. The Office of Chief Counsel consists of approximately 1,600 attorneys posted in the National Office, 4 regional offices, and 33 district offices. Chief Counsel's Criminal Tax function is staffed at all three levels.

In the National Office, the Assistant Chief Counsel (Criminal Tax) is the Chief Counsel's criminal tax program manager. Criminal Tax provides advice to the Assistant Commissioner (Criminal Investigation), advises DOJ's Tax Division on appellate matters arising out of tax prosecutions, processes sensitive prosecution recommendations, provides advice on petitions for mitigation of forfeiture, evaluates sensitive search warrants and immunity requests, post-reviews field criminal tax work, coordinates criminal tax training, and serves on the Undercover Advisory Committee, which reviews most proposals for undercover activity submitted by the IRS.

At the regional level, the Assistant Regional Counsel (Criminal Tax) implement policy, review requests for grand jury investigations, and post-review field criminal tax work. At the district level, Chief Counsel attorneys provide advice to CID agents on pending tax, money laundering, Bank Secrecy Act

(BSA), and forfeiture matters, as well as on the appropriate use of investigative techniques. Chief Counsel attorneys also provide preliminary advice on search warrants and immunity requests and evaluate and refer proposed tax prosecutions.

Tax Administration Cases

Office of Chief Counsel attorneys provide advice to agents during the investigative phase on matters such as evidentiary issues, burden of proof, search and seizure, undercover and surveillance, and immunity. After CID makes its recommendations to refer suspected violations of the Internal Revenue Code or related statutes (e.g., 18 U.S.C. § 287 (false refund claims), § 371 (conspiracy), and § 1001 (false official statements)) to DOJ either for grand jury investigation or prosecution, they are reviewed by a Chief Counsel attorney in one of the district or regional offices, or in the Office of the Assistant Chief Counsel (Criminal Tax) in certain sensitive cases.

Treasury General Counsel Order No. 4 mandates that the Chief Counsel refer, pursuant to I.R.C. § 6103(h)(2), criminal tax cases recommended by the IRS to DOJ for prosecution or investigation. Money laundering (18 U.S.C. §§ 1956-1957) and Bank Secrecy Act (31 U.S.C. §§ 5311-5330) cases, and Organized Crime Drug Enforcement Task Force investigations are not, pursuant to Treasury delegations of authority, required to be referred by Chief Counsel.

In evaluating whether a proposed tax prosecution should be referred to DOJ, Chief Counsel applies the policy, shared by the IRS and DOJ's Tax Division, that criminal prosecution should only be recommended when there is evidence to prove guilt beyond a reasonable doubt and where there is a reasonable probability of conviction. In addition, IRS policy establishes dollar thresholds for cases to assure that the limited resources available for criminal enforcement* are focused on cases that provide maximum deterrent value and that warrant criminal treatment. Other policy concerns include dual

* Out of 130 million returns filed, with an estimated 85 percent compliance rate, CID has an annual processing capacity of approximately 1,500 tax prosecution recommendations.

and successive prosecution, voluntary compliance, and health and age considerations. Chief Counsel's evaluation of proposed tax prosecutions weighs all of these factors and recommends to DOJ those cases best suited for prosecution.

Non-Tax Financial Crimes

Chief Counsel also provides assistance to CID in non-tax financial crimes. Treasury Directive 15-41 delegates authority to the Commissioner of Internal Revenue to investigate many violations of the financial record keeping and transaction reporting requirements of the BSA. Treasury Directive 15-42 delegates authority to the Commissioner to investigate violations of 18 U.S.C. §§ 1956 and 1957 where the underlying conduct violates the I.R.C. or the BSA.

Chief Counsel provides training to agents in these laws, as well as assistance in developing cases for prosecution. Unlike tax crimes, however, it is the Commissioner and not Chief Counsel who actually refers most cases in these areas to DOJ for prosecution, grand jury investigation, or other judicial proceedings that arise during an investigation. This latter category includes applications to a court for a warrant to conduct searches, seizures, and surveillances.

Forfeiture

Forfeiture has become an important enforcement tool in the past decade. The IRS has authority to seize and forfeit property pursuant to I.R.C. §§ 7301-7302 and 18 U.S.C. § 981(a)(1)(A). These Code provisions allow forfeiture of property subject to excise tax that is held or transacted with intent to evade the tax, and property used or intended for use in violating any internal revenue law or regulation.

Pursuant to 18 U.S.C. § 981(a)(1)(A), the IRS can forfeit property involved in a transaction or attempted transaction that violates any of four predicate statutes. These statutes are 18 U.S.C. § 1956 (Laundering of monetary instruments), § 1957 (Engaging in monetary transactions in property derived from specified unlawful activity), 31 U.S.C. § 5313(a) (Reporting requirements for domestic currency transactions with financial

institutions), or § 5324 (Structuring transactions to evade reporting requirements prohibited). Forfeitures can be perfected administratively, by IRS officials, or judicially in a civil action in a Federal district court.

The Assistant Chief Counsel (Criminal Tax) is responsible for providing legal advice to CID on forfeiture matters, and for referring judicial forfeiture proceedings under the I.R.C. to DOJ. Criminal Tax attorneys in the field and in the National Office provide guidance to CID on pre-seizure planning and review, provide legal advice to District Directors and United States Attorneys on all proposed forfeitures, and provide advice to the Assistant Commissioner (Criminal

Investigation) on all petitions to remit or mitigate administrative forfeitures.

Conclusion

The IRS Office of Chief Counsel is responsible for determining which criminal tax cases and which tax-related forfeitures developed by CID are referred to DOJ for investigation and litigation. Chief Counsel provides advice to CID with regard to proposed money laundering-related cases. Chief Counsel attorneys are a valuable resource, and we encourage AUSAs and DOJ attorneys to consult with them. ❖

The Gold Fringed Flag: Prosecution of the Illegal Tax Protester

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Have you heard the one about the gold fringed flag? It goes something like this: “This court has no jurisdiction over me because the American flag in this courtroom has gold fringe on it.” And believe it or not, some defendants also argue—with a straight face no less—that he or she is not who the United States has alleged because their name is spelled in all capital letters! Illegal tax protesters routinely use arguments similar to this as they insist that the Federal Government, specifically Federal courts and the Internal Revenue Service (IRS), have no authority over them.

At one time or another, everyone complains about taxes. Because a cornerstone of our heritage is based on the right to free speech, simply expressing a disagreement with the tax laws or opposition to the enforcement of the tax laws is not actionable. As a result, only an “*illegal* tax protester,” one who steps outside the bounds of the First Amendment and commits a crime in furtherance of his or her tax protest beliefs, is subject to prosecution. It is only these illegal tax protesters that are the focus of this article.

The IRS identifies an illegal tax protester by the type of scheme employed to circumvent the payment of

taxes. An illegal tax protest scheme is any scheme, without basis in law or fact, designed to express dissatisfaction with the tax laws by interfering with their administration or attempting to illegally avoid or reduce tax liabilities.

As amazing as it may seem, illegal tax protesters have been making many of the same arguments for over 20 years, despite court opinion after court opinion striking down and declaring such arguments to be patently frivolous.¹ And, the number of illegal tax protesters is increasing. In fact, the number of criminal tax protest cases referred from the IRS to the Tax Division has doubled since 1994.

Technology is one factor that appears to be contributing to the increase in illegal tax protesters. The Internet has greatly increased the protesters’ audience by allowing virtually instantaneous communication of their ideas and beliefs. Technology has also increased the sophistication of their attempts to frustrate the IRS. Illegal tax protesters sell books, sponsor seminars, and maintain home pages on the Internet to publicize their beliefs and, in some instances, to further illegal tax protest schemes. In addition, the documents they

produce in support of their schemes, which range from bogus financial instruments to altered tax forms, are, at first glance, indistinguishable from legitimate documents.

The Schemes

The schemes illegal tax protesters develop, sell, or participate in to evade their personal income tax liabilities are numerous and are limited only by the imagination. Some schemes are eventually abandoned as failures. Others are simply improved upon or resurrected from time to time.

Church Schemes

The church schemes of the 1980s have been abandoned by the illegal tax protester movement. One such scheme involved the purported ordination of a so-called church and a “vow of poverty” by the taxpayer, with the resulting claim that all income earned by the taxpayer belonged to the church and, therefore, was not taxable. The “charitable contribution scheme” involved the claim that the taxpayer had donated all of his or her income to the church by depositing it into a bank account that the taxpayer had opened in the name of the purported church. The taxpayer then deducted this contribution (usually equal to all of the taxpayer’s income) on his or her income tax return, which resulted in no tax owed to the IRS.

These schemes were easily refuted and successfully prosecuted by simply proving that there was no real contribution because the taxpayer continued to use and enjoy all of the alleged church income for his or her personal benefit. The key was to focus on how the funds were spent rather than complicating the case by proving that the church was a sham or not legally tax-exempt.²

Harassment Schemes

Schemes to harass and intimidate tax enforcement officials have been the most consistently used, although with different techniques over the years. One of the earliest schemes involved the filing of a Form 1099 reporting amounts allegedly paid to an IRS employee, prosecutor, or judge. In this early scheme an illegal tax protester filed a Form 1099, which falsely reported that the named law enforcement official earned significant

income—usually in the \$1 million or more range. After the illegal tax protester filed the harassing Form 1099, he or she alerted the IRS to the allegedly unreported income. Sometimes the illegal tax protester even requested a reward for supplying this information. As a consequence, the illegal tax protester hoped that the resulting audit of the law enforcement official’s tax accounts would scare away the official from the case.

In the early to mid-1990s protesters became fond of filing liens against IRS employees. This was a common tactic of The Pilot Connection Society, an organization that was essentially put out of business in 1996 with the convictions and significant sentences of the group’s leaders in the Northern Districts of California and Texas.* Today, liens seem to have been replaced with other types of harassing documents such as “common law court” documents and “non-statutory notices of abatement.” Common law court and similar documents, including promissory notes and arrest warrants, are used by illegal tax protesters to obstruct tax audits or investigations and may well give rise to criminal charges under the “tax obstruction” statute—26 U.S.C. § 7212(a). Be aware, though, that the Tax Division has specific guidelines concerning the use of Section 7212(a), such as the requirement that the Tax Division must authorize Section 7212(a) prosecutions. *See* Tax Division Directive No. 77.

In some instances, the filing of common law court and other documents intended to harass or impede may not rise to the level of criminal prosecution. Even so, these documents can be relevant evidence of willfulness in the context of prosecuting other criminal tax offenses. For example, these documents might be used to show that failing to file a tax return was not a mistake or accident. They may also be used to justify a sentencing enhancement for obstruction of justice, particularly when the case agent, prosecutor, or trial judge is sued just prior to a hearing or the trial itself.

An example of the type of common law court documents illegal tax protesters use to harass prosecutors involves a case that I jointly prosecuted with an AUSA from the Western District of Texas. In this case, the defendant sent each of us a promissory note and claimed that each of us owed him \$2 million—in silver. The promissory notes also listed numerous offenses that we allegedly committed, including an assertion that we

*Members of The Pilot Connection Society were prosecuted in various jurisdictions across the country.

had acted in bad faith by representing a fictitious plaintiff—that plaintiff being the United States. The really cagey part, however, was that our names had been typed onto the line requiring our signatures, under which was cited “UCC 3-401.” Uniform Commercial Code (UCC) 3-401 provides that a typewritten signature suffices as a signature. Of course, as is typical of an illegal tax protester, the defendant picked the portion of the law he liked and ignored the parts he did not. In this case, he simply ignored the part providing that the party has to “adopt” the typewritten signature as his or her own.

Although illegal tax protesters are happy to sign *your* name to documents, they often insert a form of disclaimer before signing their own names to documents. The inclusion of “under duress,” “UCC 1-207,” or some other form of alteration of the jurat** is used by illegal tax protesters as an attempt to nullify their own signatures. One protester publication advised the reader to obtain a rubber stamp with the wording “without prejudice—UCC 1-207,” which, according to their theories, means that the signer is retaining the right to disavow what he or she signed—the “I didn’t really mean it” theory. These disclaimers are meaningless, of course, except perhaps as argument for the Government that the defendant acted willfully.

Do not fall into the trap of debating the UCC during a criminal trial. Illegal tax protesters will often try to question witnesses about the UCC. These questions are patently irrelevant and most judges will not hesitate to instruct the jury that the UCC has nothing to do with criminal law. During the Government’s case-in-chief, it is best to ignore the defendant’s use of UCC-based phrases. If, during cross-examination of a Government witness, the illegal tax protester is allowed to proceed with a UCC-based line of questioning, then, on redirect, simply ask the witness—usually an IRS representative—what effect the particular UCC phrase has if inserted on a tax return. The answer routinely will be that it has no effect whatsoever and is a well-recognized illegal tax protester tactic.

Bogus Financial Instruments

** The “jurat” on tax returns and other IRS documents is a certification, signed by a taxpayer under the penalty of perjury, that the information on the return is true and accurate.

One of the most well-publicized illegal tax protest schemes in recent years has been the promotion and use of bogus financial instruments, including certified money orders, certified bank checks, public office money certificates, and comptroller warrants. This scheme is an attack on both the IRS and the banking system, and arose out of the misguided theory that United States currency, “Federal Reserve Notes,” are not legal tender. According to illegal tax protesters, United States currency is worthless. As a result, illegal tax protesters theorize that they should have an equal right to create money; e.g., these fraudulent financial instruments. Of course, it is not only humorous but also good evidence of willfulness when the only form of payment illegal tax protesters will accept for the purchase of these bogus financial instruments happens to be that supposedly worthless United States currency.

Typically, an illegal tax protester will purchase a package of instructional materials that includes one or more of these bogus financial instruments. The instructions tell the purchaser to submit each bogus financial instrument for significantly more—usually double or triple—than the amount of any debt to the IRS or private creditor. The instructions also recommend that the bogus financial instruments be tendered with a “demand letter” requesting that the debtor’s account be zero-balanced and that a refund of any overpayment be issued to the debtor.

Bogus financial instruments presented to the IRS are typically prosecuted as a *Klein*³ conspiracy (18 U.S.C. § 371), if multiple parties are charged, or as a false claim for refund (18 U.S.C. § 287). In most cases, the bogus financial instrument is accompanied by a “demand letter,” as recommended in the instructions. In this manner, the illegal tax protester hopes to have his or her tax debt wiped out *and* get a refund. On rare occasions, the bogus financial instrument is not accompanied by a demand letter. This may present proof problems if your case involves a false claim for refund charge. By itself, the absence of a demand letter is not necessarily fatal to this charge. However, you must have some evidence to prove that the defendant knew that the bogus financial instrument was for an amount that exceeded the IRS tax debt and that he or she expected the difference to be refunded. Therefore, examine the defendant’s previously filed tax returns to see whether he or she received a refund. Also, look for any notices of deficiency, Federal tax lien(s), or other documents that notified the defendant of the amount he

or she owed to the IRS. In addition, the instructional materials included with the bogus financial instruments often contain a specific instruction that the IRS will automatically refund the difference between the defendant's IRS debt and the amount of the bogus financial instrument. Proof that the defendant received this instruction would make great evidence that the defendant intended to obtain a refund, despite his or her failure to send a demand letter.

In many bogus financial instrument cases, one defense tactic has been to call a former Federal Reserve lawyer as a defense expert. In those trials in which this individual has been called, cross-examination has proved that all he knows about the scheme is what the various defendants have told him when he was hired to testify. His testimony essentially consists of stating that he understands the theory. He admits, however, that he did not think the scheme would work. He has also testified that he would not accept any of these checks in payment of his expert witness fee.

Non-Resident Aliens

Another scheme used by illegal tax protesters involves the individual claim that he or she is a "non-resident alien" of the United States. In this scheme, the illegal tax protester usually submits a false Form 1040NR (U.S. Nonresident Alien Income Tax Return), claiming exemption from the Federal income tax laws because he or she is the sovereign citizen of a particular state—not a United States citizen. Since the principal theory of this scheme is state citizenship, look for evidence that the illegal tax protester failed to file or pay state or other local taxes, such as school or personal property taxes. Other evidence showing the speciousness of the defendant's position could include a Federal voting record or application for a U.S. passport.

In non-resident alien scheme cases, the filing of a Form 1040NR is often used as an affirmative act of evasion. These forms are of two types: a false return or a false document. The distinction is important in how the case is charged and in how the document is characterized since tax *forms*, whether or not they contain any tax information, are commonly called "returns." However, simply "filing" an IRS form does not necessarily make that form a "return" for IRS purposes.

For example, tax forms that contain insufficient information from which a tax can be computed are *not*

returns.⁴ In some circuits, a tax form containing zeros on each line is not considered to be a return.⁵ The Ninth Circuit, however, has held that zeros themselves are numbers from which a tax could be computed and, if false, should be charged as a false return under 26 U.S.C. § 7206(1).⁶ On the question of whether a document constitutes a proper return, the courts are split as to whether this question should be for the court or the jury.⁷ In cases in which the filed document is not a return and that fact is important to the theory of your case, refer to the tax form as *a false document, not a return!*

Warehouse Banks

One tax avoidance scheme that has been resurrected from the mid-1980s involves the use of a warehouse bank to hide assets. The operation of the current scheme is essentially the same as the old—the warehouse bank offers depositors absolute banking privacy through the use of numbered, not named, accounts. Depositors have access to their money in two ways: (1) upon request, the warehouse bank will send cash to a depositor via registered mail and (2) a bill-paying service of the warehouse bank will write checks on the warehouse bank account to creditors of depositors.⁸

In the mid-1980s, most of the accounts were held by individuals. The current schemes also involve the use of trusts and unincorporated business organizations (UBO) to protect the identity of the individual. For example, a defendant will have all of his or her income paid to a trust or fictitious UBO. The income of the trust or UBO is then deposited into the warehouse bank account. As a result, the paper trail becomes much more complex and the identity of the taxpayer is further insulated.

In the past, the operators of this scheme have been prosecuted on *Klein* conspiracy charges, while the account holders were charged with tax evasion. Make sure the facts clearly support any decision to charge warehouse bank operators and account holders in the same conspiracy. Otherwise, you might end up with an unwanted severance of defendants and indictment counts. If you are prosecuting a *Klein* conspiracy, you must prove that there was a tax motive to the conspiracy.⁹

Trusts

Another well-known and frequently promoted illegal tax protester scheme involves the use of trusts to hide assets and property. Sham trusts, both foreign and domestic, have been used by illegal tax protesters for years. Once a trust is identified, proving it is a sham can be simple. Just look to see who is spending and controlling the money and assets. Show the jury that the defendant did not intend for the property to be held in trust because he or she still controlled the use of the funds. In many instances, the money and property will be controlled no differently than if the defendant had never formed a trust. It is easier to prove who spent the money than it is to prove whether the form of the trust was fraudulent.

Tactics and Defenses

The often patently frivolous arguments routinely made by illegal tax protesters are not confined to oral representations. Illegal tax protesters are renowned for their penchant to inundate prosecutors with paper—frivolous motion after frivolous motion. Illegal tax protesters often represent themselves, making motion practice even more difficult. As a result, trying to figure out *what* their arguments are can be a difficult task.

Most of the common tactics and defenses used by illegal tax protesters have been routinely dismissed by the courts. Illegal tax protesters, however, ignore these decisions and claim that no one from the Government will answer their questions. Some of the more common tactics and defenses that have been raised by illegal tax protesters and rejected by the courts are: (1) the income tax is voluntary,¹⁰ (2) wages are not income,¹¹ (3) the Sixteenth Amendment was never properly ratified,¹² and (4) the IRS has the duty to prepare tax returns for the taxpayer.¹³

One defense that must be carefully handled is the “good faith” defense, which is used to refute willfulness. Illegal tax protesters routinely attempt to prove that they “believed” they did not have to file tax returns or pay taxes. Many of the reasons they use, such as the ones mentioned above, may seem unbelievable. Nevertheless, this is an issue that must go to the jury. In the seminal case of *Cheek v. United States*, 498 U.S. 192, 201

(1991), the Supreme Court held that a taxpayer’s “belief” that he or she was not required to file a tax return, however incredible such a misunderstanding of and beliefs about the law might be, does not have to be objectively reasonable.[†] Rather, the standard is a subjective one. Still, this defense is not insurmountable.

In an attempt to present a good faith defense, most illegal tax protesters will attempt to introduce copies of the Constitution, the IRS *Special Agents’ Handbook*, various court decisions, protester publications, as well as other documents. The admissibility of these documents is generally left to the discretion of the court.¹⁴ To limit or prevent an illegal tax protester from introducing these documents into evidence, consider arguing that (1) the content of these documents are more prejudicial than probative¹⁵ and (2) the admissibility of these documents invades the province of the court to instruct the jury on the law.¹⁶ The key is to distinguish between a *misunderstanding of the law* versus a *disagreement with the law*. Whether to object to the admission of these protester documents, however, is a trial strategy that varies from case to case and circuit to circuit.

Whether or not the documents themselves are admitted into evidence, a defendant will generally be allowed to testify about his or her beliefs during the prosecution period and what he or she relied on to form those beliefs.¹⁷ Evidence about what the law *is* or *should be* may be excluded. However, evidence that is relevant to a jury’s determination of what a defendant *thought the law was* may *not* be excluded.¹⁸ A defendant who testifies that he or she knew the law, but disagrees with—or does not like—the law, is not entitled to a good faith instruction.¹⁹

If legal documents, protester publications or similar protester-type documents are introduced or if the defendant is allowed to testify about what the law is, ask for a limiting instruction. Such an instruction should remind the jury that the document/statement is the defendant’s understanding of what the law was; that the jury is the judge of the facts, not the law; and that the document/statement was admitted solely for the purpose of showing the defendant’s state of mind and not to

[†] Cheek claimed that he did not file tax returns because he believed that he was not a taxpayer within the tax laws, that wages are not income, that the Sixteenth Amendment does not authorize the taxation of individuals, and that the Sixteenth Amendment was unenforceable. *Cheek*, 498 U.S. at 195.

prove the actual requirements of the law. If the document/statement is a misstatement of the law, ask the court to instruct the jury with a correct statement of the law.

Finally, because illegal tax protesters do not limit their illegal schemes to the Federal arena, do not forget to look for documents that may be on file with a state or county government, such as state tax returns or property tax filings. These records, or the lack thereof, may serve as evidence of willfulness in the Federal case.

Coordination and Communication

As important as coordination and communication have been to the expansion of the illegal tax protester movement, both have been critical to the United States' attempt to bring illegal tax protesters into compliance with the tax laws. Providing coordination and promoting communication is a principal role of the Tax Division. With roughly 20 years of experience in prosecuting these cases, the Tax Division has amassed a collection of responses to the motions filed by illegal tax protesters and is currently developing a motions bank of these materials. Identification of nationwide schemes to avoid overlap and successive prosecution issues is also one of the Tax Division's core functions.

Tax Division trial attorneys personally litigate many of these cases, often working in partnership with AUSAs. A recent example of the effectiveness of coordination and cooperation between the Tax Division and AUSAs is the *Marsh* case.²⁰ By working together, a successful prosecution with significant sentences for the leaders of this nationwide tax protest scheme was achieved.^{††} The trial team, consisting of attorneys from both the Tax Division and the Northern District of California, was presented the John Marshall Award for Litigation by the Attorney General.

Conclusion

^{††} Philip Marsh was sentenced to 17½ years, while his wife, Marlene, was sentenced to 14 years. These defendants were leaders of The Pilot Connection Society.

Given the absurdity of many illegal tax protester arguments, the potential for danger and the inevitability of being buried under tons of paper, what will you do when you find yourself assigned to prosecute an illegal tax protester for criminal violations of the internal revenue code? Hopefully, you will roll up your sleeves and prepare yourself for the deluge of frivolous motions. You can also call the Tax Division with any questions you have and take advantage of the experience we have amassed.

As time consuming as the investigation, trial preparation, and trial of these cases can be (and yes, illegal tax protesters will appeal and appeal and appeal), pursuit of the illegal tax protester can result in some of the more rewarding tax trials you may have. The bizarre theories keep the cases more interesting than other tax cases and often provide great stories. Their unyielding opposition to any form of governmental authority also makes these defendants a unique brand of white collar criminal, and the completion of a successful prosecution against them provides much satisfaction. ❖

1. *See, e.g.*, In re Robnett, 165 B.R. 272, 274 (9th Cir. 1994); *United States v. Connor*, 898 F.2d 942, 943 (3d Cir.), cert. denied, 497 U.S. 1029 (1990); *Lonsdale v. United States*, 919 F.2d 1440, 1448 (10th Cir. 1990); *United States v. Sloan*, 704 F. Supp. 880, 881 (N.D. Ind. 1989).

2. *See, e.g.*, *United States v. Ebner*, 782 F.2d 1120 (2d Cir. 1986); and *United States v. Dube*, 820 F.2d 886 (7th Cir. 1987).

3. *United States v. Klein*, 247 F.2d 908 (2d Cir. 1957), cert. denied, 355 U.S. 924 (1958).

4. *See United States v. Porth*, 426 F.2d 519, 523 (10th Cir.), cert. denied, 400 U.S. 824 (1970); *United States v. Daly*, 481 F.2d 28, 29 (8th Cir.), cert. denied, 414 U.S. 1064 (1973); *United States v. Schiff*, 612 F.2d 73, 77 (2d Cir. 1979); *United States v. Green*, 757 F.2d 116, 121 (7th Cir. 1985); *United States v. Kimball*, 925 F.2d 356, 357 (9th Cir. 1991) (*en banc*); and *United States v. Moore*, 627 F.2d 830, 835 (7th Cir. 1980), cert. denied, 450 U.S. 916 (1981).

5. *See United States v. Mosel*, 738 F.2d 157, 158 (6th Cir. 1984); *United States v. Smith*, 618 F.2d 280, 281 (5th Cir.), cert. denied, 449 U.S. 868 (1980); *United States v. Rickman*, 638 F.2d 182, 184 (10th Cir. 1980).

6. *United States v. Long*, 618 F.2d 74, 75 (9th Cir. 1980).

7. *See* United States v. Goetz, 746 F.2d 705, 707 (11th Cir. 1984) (holding that the issue of whether a document is a proper return is a jury question); and United States v. Grabinski, 558 F. Supp. 1324, 1332 (D. Minn. 1983) (holding that the determination of what is an adequate return is a legal question).

8. *See* United States v. Becker, 965 F.2d 383, 385 (7th Cir. 1992), *cert. denied*, 507 U.S. 971 (1993); and National Commodity and Barter Ass'n v. United States, 951 F.2d 1172, 1173 (10th Cir. 1991).

9. United States v. Pritchett, 908 F.2d 816 (11th Cir. 1990).

10. *See, e.g.*, United States v. Richards, 723 F.2d 646, 648 (8th Cir. 1983); United States v. Tedder, 787 F.2d 540, 542 (10th Cir. 1986).

11. *See, e.g.*, United States v. Becker, 965 F.2d 383, 389 (7th Cir. 1992), *cert. denied*, 507 U.S. 971 (1993); United States v. Connor, 898 F.2d 942, 943-44 (3d Cir.), *cert. denied*, 497 U.S. 1029 (1990); United States v. Burton, 737 F.2d 439, 441 (5th Cir. 1984).

12. *See, e.g.*, United States v. Benson, 941 F.2d 598, 607 (7th Cir. 1991); United States v. Collins, 920 F.2d 619, 629 (10th Cir. 1990), *cert. denied*, 500 U.S. 920 (1991); *In re Becraft*, 885 F.2d 547, 548-549 (9th Cir. 1989); and United States v. Sitka, 845 F.2d 43, 44-47 (2d Cir.), *cert. denied*, 488 U.S. 827 (1988).

13. *See, e.g.*, United States v. Stafford, 983 F.2d 25, 27 (5th Cir. 1993); United States v. Powell, 955 F.2d 1206, 1213 (9th Cir. 1992); and United States v. Barnett, 945 F.2d 1296, 1300 (5th Cir. 1991), *cert. denied*, 503 U.S. 941 (1992).

14. United States v. Willie, 941 F.2d 1384, 1398 (10th Cir. 1991), *cert. denied*, 502 U.S. 1106 (1992); and United States v. Payne, 978 F.2d 1177, 1182 (10th Cir. 1992), *cert. denied*, 508 U.S. 950 (1993).

15. *See* Payne, 978 F.2d at 1182; and United States v. Barnett, 945 F.2d 1296, 1301 (5th Cir. 1991), *cert. denied*, 503 U.S. 941 (1992).

16. *See* Willie, 941 F.2d at 1396.

17. *See* Payne, 978 F.2d at 1182; and Barnett, 945 F.2d at 1301.

18. Stafford, 983 F.2d at 27; and Powell, 955 F.2d at 1214.

19. *See* United States v. Dack, 987 F.2d 1282, 1285 (7th Cir. 1993); United States v. Powell, 955 F.2d 1206, 1212 (9th Cir. 1992); and Willie, 941 F.2d at 1392.

20. United States v. Marsh, Nos. 96-10287 through 96-10293 (9th Cir. argued March 9, 1998).

Appointment of Special Counsel For Illegal Tax Protest Matters

In 1996, the Tax Division saw an increase in the number of investigations, prosecutions, and civil litigation arising out of illegal tax protester activity. In June 1996, this trend led Assistant Attorney General Loretta C. Argrett to develop the Illegal Tax Protest Initiative (the "Initiative"). The purpose of the Initiative is to oversee and coordinate illegal tax protester litigation efforts nationwide and to develop a method for sharing the extensive experience of Tax Division attorneys in combating the illegal tax protester movement.

The appointment of two Special Counsel for Illegal Tax Protest Matters—one for criminal and one for civil—was the first step in realizing the Initiative. Jen E. Ihlo and Brian J. Feldman, appointed in June 1996, are charged with developing and implementing the goals of the Initiative. Ms. Ihlo and Mr. Feldman have extensive experience with the Tax Division. Ms. Ihlo is a two-time recipient of the Tax Division's Outstanding Attorney Award, while Mr. Feldman has won that award three times in his career with the Tax Division.

Ms. Ihlo, Special Counsel for Tax Protest Matters (Criminal), has been a trial attorney with the Tax Division for eight-and-a-half years. Prior to coming to the Tax Division, she served as Counsel to the U.S. House of Representatives Committee on the Judiciary, Subcommittee on Administrative Law and Governmental Relations, and prosecuted Texas state crimes as an Assistant Criminal District Attorney in Beaumont, Texas.

Ms. Ihlo vigorously confronts the challenges of this position, bringing both enthusiasm and considerable experience to the project. Since her appointment as Special Counsel, Ms. Ihlo has taught the art of investigating and litigating criminal tax protester cases to Internal Revenue Service (IRS) personnel at IRS conferences and seminars and to Assistant United States Attorneys at the Criminal Tax Institute. She has given presentations on the history, tactics, and rhetoric of the illegal tax protester to audiences ranging from Tax Division summer interns to the Attorney General. Ms. Ihlo is organizing a motions bank of illegal tax protester materials that will be a valuable tool for the effective and efficient prosecution of illegal tax protester cases. Ms. Ihlo also provides litigation guidance and assistance to Federal and state prosecutors.

Brian Feldman, Special Counsel for Tax Protest Matters (Civil), has been a civil trial litigator with the Tax Division since 1988. Also a Certified Public Accountant, Mr. Feldman's prior experience includes two years with Price Waterhouse. Mr. Feldman brings extensive litigation experience to this position, which enables him to coordinate closely with the IRS to develop ideas for limiting and defending the lawsuits filed by illegal tax protesters against the United States. Mr. Feldman has proposed creative legislative ideas to combat frivolous bankruptcy filings and harassment suits against IRS personnel. Mr. Feldman also participates in conferences and training seminars, sharing his experience and insight with the participants. He has compiled a collection of briefs and legal memoranda which address many of the illegal tax protester issues.

According to Assistant Attorney General Argrett, "Ms. Ihlo and Mr. Feldman have worked tirelessly to implement the Illegal Tax Protest Initiative. Their hard work, creative ideas, and guidance, coupled with their enthusiasm and experience, have made this project a success since its early stages. I encourage anyone who is faced with a case involving an illegal tax protester to call on them." ❖

Illegal Tax Protesters: Abuse of the Judicial Process

Brian J. Feldman

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Tax Division, Western Civil Trial Section

Introduction

The Department of Justice's Tax Division (Tax Division) typically has approximately 700 civil cases involving "illegal tax protesters" pending in the United States district courts, bankruptcy courts, and courts of appeal. Other illegal tax protester cases are handled in the United States Tax Court by Internal Revenue Service (IRS) attorneys. Many more illegal tax protester cases are handled by Assistant United States Attorneys (AUSAs) nationwide. These numbers indicate the scope of the problem and the magnitude of the costs associated with illegal tax protester activity. These costs include the toll on the judicial system and the obvious loss of revenue that result from having a segment of the citizenry opt out of the Federal tax system. Other costs range from the financial fraud perpetrated by individuals promoting or selling tax protester materials to the harassment and intimidation of Government officials through the use of civil lawsuits and other tactics, such as bogus lien filings. In a broader sense, the illegal tax protester problem represents contempt for, and a challenge to, the rule of law that no government should tolerate.

Civil cases involving illegal tax protesters can be exceedingly time consuming. The civil litigation arena provides a relatively easy forum for illegal tax protesters to become "paper terrorists" through the use of civil discovery and pleadings that tend to be lengthy treatises of "canned" materials. In a climate where courts tend to liberally construe pleadings filed by *pro se* litigants, Government attorneys are often forced to address frivolous, incomprehensible arguments put forth by tax protesters.

Moreover, the number of illegal tax protest groups espousing antigovernment rhetoric is likely to increase. Due to the Internet and other technological advances, groups that promote and disseminate tax protester materials and other antigovernment rhetoric are finding it easier than ever to mass-market their message. The Southern Poverty Law Center, an organization that monitors the activities of illegal tax protest groups, reports that the number of so-called Patriot groups has doubled in the last two years.* It is, therefore, increasingly likely that those who tangle with illegal tax protesters will find themselves engaged in some battle with these individuals, either in the context of a civil litigation or as a victim of illegal harassment.

The Tax Division has decades of experience in responding to the myriad arguments put forth by illegal tax protesters, some of which are discussed below. I regularly answer questions about civil tax protester litigation from Tax Division attorneys, AUSAs, and IRS attorneys, and frequently provide briefs or direct the questioner to another attorney who has handled a similar issue.

* Southern Poverty Law Center, *Klanwatch & Militia Task Force Active Patriot Groups*, on worldwide web at <http://www.splcenter.org/klanwatch.html>.

Civil Litigation and Other Tactics to Thwart Collection Action and Harass and Intimidate Government Officials

Common Illegal Tax Protester Arguments Used in Civil Cases

Historically, illegal tax protesters have filed “Notices” or “Declarations of Quiet Title” with Federal officials asserting their new status as a “sovereign citizen,” “freeman,” or “nonresident alien.” To illegal tax protesters, these declarations mean they are no longer part of the Federal system, they do not have to pay taxes, and all other Federal laws are equally inapplicable to them. Based on these views, illegal tax protesters file frivolous “quiet title” actions in which they seek to have tax liens removed from their property on the grounds that (1) they are not subject to the Federal tax system, (2) their property is not subject to the Federal tax liens that have been asserted against the property, (3) the required assessment and collection procedures have not been followed by the IRS, or (4) the IRS officials with whom they have come into contact lack the requisite authority to carry out their duties.

Other common illegal tax protester arguments include (1) filing a tax return violates the Fifth Amendment since putting information on a tax return may incriminate the protester; (2) compelled compliance with the Internal Revenue laws is a form of servitude in violation of the Thirteenth Amendment; (3) the Sixteenth Amendment to the Constitution is invalid; (4) wages and other compensation are not income since there is no taxable gain when a person exchanges his labor for money; (5) filing a tax return is a voluntary matter left to the discretion of the taxpayer because the taxation system is based upon voluntary assessment and payment; (6) individuals can “opt out” of the contractual agreement with the IRS by revoking their Social Security numbers and previously filed returns, or by removing themselves from the jurisdiction of the IRS; and (7) the Internal Revenue Code (I.R.C.) was not enacted by Congress since Title 26 is not listed as one

of the titles enacted into “positive law,” as used in the preface to the United States Code.

All these arguments have been made—and rejected—time and again. Because the Tax Division has numerous briefs that address these and similar contentions, they are not specifically addressed in this article.

Damages Suits Against Government Officials in Their Individual Capacity

The Tax Division has experience with lawsuits filed against Government officials that seek damages from the officials in their individual capacities for alleged constitutional rights violations under *Bivens v. Six Unknown Named Agents of the Federal Bureau of Investigation*, 403 U.S. 388 (1971). Illegal tax protesters use these lawsuits as a common harassment tactic intended not only to impede IRS audit and collection activities, but to harass and intimidate Government officials. The Tax Division typically obtains representation requests from and represents Government officials in these lawsuits. With rare exception, these cases are resolved in favor of the Government official by way of a motion to dismiss or a motion for summary judgment.

Although IRS employees are a common target for these lawsuits, all Government employees face exposure to being sued for damages under *Bivens*, and many of the arguments used by the Tax Division to dispose of these cases apply with equal force to *Bivens* suits brought against non-IRS Government employees. Thus, AUSAs defending damages lawsuits against Government officials have a vast array of *Bivens*-related materials available to them from the Tax Division.

Suits Commenced Under “Taxpayer Bill of Rights” Provisions

In recent years, Congress has provided taxpayers with additional civil remedies against the United States in response to perceived IRS abuses. Illegal tax protesters frequently use these provisions, such as the “Taxpayer Bill of Rights,” as vehicles to get an audience with a Federal judge and to abuse the judicial

process with frivolous damages actions. For example, I.R.C. § 7432 of the Internal Revenue Code provides that the United States shall be liable for damages if an IRS employee negligently fails to release a lien on property of a taxpayer. I.R.C. § 7433 provides that the United States shall be liable for damages of up to \$1 million if an IRS employee recklessly or intentionally disregards the Internal Revenue Code or any IRS regulation while collecting taxes. From the standpoint of an illegal tax protester who asserts that he or she is not subject to the collection provisions of the Internal Revenue Code, it is not a leap in logic to conclude that these “Taxpayer Bill of Rights” remedies apply to legitimate IRS collection actions and that a damages suit may be commenced against the United States under these provisions. *Larue v. Collector of Internal Revenue*, 95-2 U.S.T.C. (CCH) 50,568 (C.D. Ill. 1995), *aff’d*, 96 F.3d 1450 (7th Cir. 1996); *Springer v. Collector of Internal Revenue*, 95-1 U.S.T.C. (CCH) 50,220 (N.D. Okl. 1995).

IRS Summons Enforcement Cases

United States Attorneys’ offices are responsible for handling IRS summons enforcement matters referred to them by the IRS, a number of which are directed to illegal tax protesters. Moreover, illegal tax protesters often file petitions in district court seeking to quash IRS summonses on a variety of grounds.

A common tactic used by illegal tax protesters to resist enforcement of an IRS summons is to make a blanket invocation of the Fifth Amendment privilege. Such blanket invocations of the Fifth Amendment have consistently been rejected by the courts. *United States v. Edelson*, 604 F.2d 232, 234 (3d Cir. 1979); *United States v. Roundtree*, 420 F.2d 845, 852 (5th Cir. 1969). The issue of blanket Fifth Amendment claims is a special problem addressed by Charles E. Brookhart and Rachel D. Cramer in their article on summons enforcement, which is included in this publication.

Two additional arguments cited by illegal tax protesters in support of their attempts to quash IRS summonses are (1) that an IRS summons is invalid without an Office of Management and Budget control number and (2) the IRS lacks authority to enforce the IRS summons because no Treasury Delegation Orders were published in the Federal Register. Not surprisingly, these arguments have been uniformly rejected by the

courts. *See United States v. Saunders*, 951 F.2d 1065, 1066-68 (9th Cir. 1991); *see also Lonsdale v. United States*, 919 F.2d 1440, 1445 (10th Cir. 1990).

Common Law Courts and the Bogus Lien Filing Problem

A notable current antigovernment movement that cannot easily be separated from the illegal tax protester movement is the so-called “common law court” movement. This relatively new phenomenon appears to be gaining momentum around the country and has given rise to new types of harassment tactics by illegal tax protesters.** The common law court movement is premised on a philosophy that supreme authority rests in “the people” and that Federal laws and actions taken by the Government, including the IRS, are unconstitutional and wholly null and void. The common law court movement essentially involves setting up a bogus court system for the purpose of addressing grievances with the Government and anyone else with whom the followers disagree. These courts are viewed as an alternative form of government that derive their authority from “principles” contained in the Bible, the Magna Carta, the Declaration of Independence, the Federalist Papers, and other documents.

**The Southern Poverty Law Center reports that common law courts now appear, in one form or another, in 40 of the 50 states. Another organization that monitors extremist activity, the Coalition for Human Dignity, has documented efforts by common law court leaders to coordinate their activities on a national level. *See D. Burghart & R. Crawford, Coalition for Human Dignity, Guns & Gavels: Common Law Courts, Militias & White Supremacy* (1996).

These bogus common law courts have issued arrest warrants and summonses to IRS and other Government officials. Many common law courts conduct “trials” resulting in default judgments or “common law liens” against Government officials. These common law liens often look valid, are typically for an astronomical sum in the range of millions of dollars, and are often personally served upon the named target. Because the liens are often filed with a county clerk against the property or personal assets of the Government official, they can create personal financial and legal difficulties for the victims even though the liens have no legal basis.

When the victim is an IRS employee, the Tax Division usually will commence an action in a United States district court on his or her behalf, seeking to remove or expunge the spurious liens and to enjoin the illegal tax protester from filing similar liens against the IRS employee in the future. Needless to say, all Government employees have cause for concern about becoming the victim of a bogus lien filing. As a result, Government officials across the country have been working to come up with ways to address this problem. Unfortunately, nothing has been done on the national level and only a handful of states have enacted any legislation directed at the problem.

Most states that have addressed the issue legislatively authorize county recorders to refuse to file a common law lien against Government officials based on the performance or nonperformance of that official’s duties. If a lien has been accepted for filing, these statutes generally provide for expedited nonjudicial remedies that make it much easier to remove or expunge these bogus liens from the county records. In some states, treble damages can be recovered against the person filing the bogus lien. Some states have criminal sanctions for knowingly filing a false document with the county recorder or knowingly filing or recording a false or fraudulent writing with the intent to intimidate or hinder a public servant in discharging his or her duty. *See* Washington Rev. Code § 60.70.030; Idaho Code § 45-1702; Montana Code Ann. § 30-9-432; Ohio Rev. Code §§ 111.24, 317.08, 317.32, 317.41, 2701.20, 2921.52; Hawaii Rev. Stat. § 507D-1; Tex. Stat. Ann. §§ 51.902, 51.903.

The legislation enacted in these states is a very encouraging first step in making it a far more costly endeavor for illegal tax protesters to harass and intimidate Government officials through the use of

bogus documents, such as bogus liens. However, similar provisions are clearly needed in all 50 states, as well as at the Federal level, in order to eliminate this problem.

A Practical Suggestion to Alleviate the Illegal Tax Protester and Related Common Law Lien Filing Problems

Most of the civil tax protester litigation is initiated by the illegal tax protesters as opposed to the Government, leaving Government attorneys continually on the defensive in these matters. There are, however, affirmative tools that have been successfully used by Tax Division litigators, most notably civil injunctions, often combined with monetary penalties, to enjoin individuals from engaging in illegal tax protester activity and to deter the proliferation of such activity.

The imposition of monetary penalties against the promoters of abusive tax shelter schemes and the aggressive use of the Government’s civil injunction powers under I.R.C. §§ 7402(a) and 7408 are powerful tools for shutting down illegal tax protester promoters, or enjoining those who repeatedly engage in frivolous litigation. Section 7408 authorizes the United States to commence a civil action to enjoin any person from engaging in any conduct that is subject to penalties under I.R.C. § 6700. Under Section 6700, a civil penalty is imposed on any person who participates in the sale of a plan or arrangement in which the person makes knowingly false statements regarding the tax benefits to be derived from the plan or arrangement. Section 7402(a) authorizes civil injunctions “as may be necessary or appropriate for the enforcement of the internal revenue laws.” The language of Section 7402(a) encompasses a broad range of powers necessary to compel compliance with the tax laws. For example, injunctions have been issued to enjoin an individual’s harassment of IRS agents, to enjoin the promotion and sale of tax evasion trust plans, and to enjoin the dissemination of tax protester materials encouraging taxpayers to file improper tax returns. *See, e.g., United States v. Hart*, 701 F.2d 749 (8th Cir. 1983); *United*

States v. Landsberger, 692 F.2d 501 (8th Cir. 1982); *United States v. May*, 555 F. Supp. 1008 (E.D. Mich. 1983). Unlike Section 7408, which requires the Government to establish that a violation under Section 6700 has occurred, there need not be a showing that a party has violated a particular Internal Revenue Code section in order for an injunction to be issued under Section 7402(a). The use of civil injunction suits is particularly effective when the individuals who have purchased the materials can be notified that the materials contain erroneous information and that reliance on such information could subject them to a variety of penalties.

Today, many illegal tax protest leaders are mass-marketing tax protester and common law court materials nationwide. These packages of information contain form letters to the IRS, legal pleadings, and step-by-step instructions on how not to pay Federal taxes and how to set up common law courts. Promoters often charge several thousands of dollars for each packet. Promoters of one large illegal tax protester organization not only convinced over 8,000 individuals to initiate illegal tax protest activity, but persuaded these individuals to pay over \$3 million for help in doing it. This translates into 8,000 individuals armed with illegal tax protester pleadings that could give rise to untold numbers of frivolous civil lawsuits in Federal court. Given the ability of these schemes to reach vast audiences, the logical starting point in combating illegal tax protesters and the closely-related common law court and bogus lien filing problems is to attack them at their source; i.e., the promoters.

Aggressive use of civil injunction suits to halt the sale of illegal tax protester schemes is an effective means of protecting the public treasury by alerting taxpayers who might otherwise be duped by these illegal fraudulent schemes. The issuance of an injunction also may contribute to the overall reduction in the number of individuals who obtain, or have access to, the boilerplate illegal tax protester

pleadings and common law court documents. If you become aware of the existence of a promotion scheme that is in your judicial district or have identified a situation where an injunction would be appropriate, contact the local IRS Examination Division.

Conclusion

The growing illegal tax protester movement must be dealt with by the Government in a comprehensive and coordinated manner. Rather than addressing illegal tax protest issues on an ad hoc basis, Department attorneys and AUSAs can use the Tax Division's institutional knowledge simply by contacting the Tax Division for assistance when litigating a civil case involving illegal tax protest issues or dealing with related issues such as initiating an action to expunge a bogus lien. ❖

Follow That Lead! Obtaining and Using Tax Information in a Non-Tax Case

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Introduction

In any criminal case where financial gain is the prominent motive, tax returns and return information can provide some of the most significant leads, corroborative evidence, and cross-examination material obtainable from any source. Title 26, United States Code, Section 6103, enacted by Congress after the abuses of Watergate, continues to be the principal instrument to protect the confidentiality of tax returns and return information. The statute recognizes, however, that tax information, properly obtained and used, can play an important role in criminal investigations of non-tax crimes.

Assistant United States Attorneys (AUSAs) and Federal agents must carefully follow Section 6103 if they want to avoid exposure to criminal and disciplinary sanctions.* This article discusses some of the reasons for seeking disclosure of tax information and the proper procedures for obtaining and using tax information for investigations, at trial, and in ancillary proceedings. It also discusses some strategic considerations in adding tax charges to non-tax cases, and the procedures for doing so. Although this article summarizes relevant provisions of Section 6103(b), (c), (e), (h), (i), and (p), the reader should become familiar with these provisions and with the Department of Justice (DOJ) publications and policies on maintaining the confidentiality of tax records.

* Willful, unauthorized disclosure of tax return information is a felony, carrying a maximum statutory penalty of five years of incarceration, a \$250,000 fine, and termination of employment. 26 U.S.C. §7213(a) (1994). Section 7431 provides that the United States may be sued for civil damages for unauthorized disclosure of tax returns and return information by a Federal employee.

Why Obtain Taxpayer Return Information?

A review of the Section 6103(b) definitions of “return,” “return information,” and “taxpayer return information” makes clear that, except as expressly provided under the disclosure provisions, all information filed with or provided by the taxpayer to the Internal Revenue Service (IRS) is protected from disclosure by Section 6103.** This includes all information relating to the taxpayer received by the IRS from third parties (including informants) and all information derived from those submissions, including the work product of the IRS in determining, assessing, and collecting taxes or investigating the taxpayer criminally. “Disclosure” means “the making known to any person in any manner whatever a return or return information.” 26 U.S.C. § 6103(b)(4)(8).

Section 6103(i)(1)(A), in relevant part, permits the IRS, upon the entry of an *ex parte* order by a Federal district court judge or magistrate judge, to disclose tax returns and return information to employees of

** Section 6103(b)(1) defines “return” as “any tax or information return, declaration of estimated tax, or claim for refund . . . which is filed with the [IRS] . . . and any amendment thereto, including supporting schedules, attachments” . . . which are made a part of the return. Subsection (b)(2) defines “return information” to include all the information on the return, any information regarding the examination or processing or investigation of the return, and any data collected or received by the IRS from any source with respect to “the determination of the existence, or possible existence, of liability (or amount thereof) of any person . . . for any tax, penalty, interest, fine, forfeiture, or other imposition or offense,” and background files “relating to such determination.” Subsection (b)(3) defines “taxpayer return information” as taxpayer information “filed with or furnished to the [IRS] by or on behalf of the taxpayer to whom such return information relates.”

any Federal agency personally and directly engaged in—

- (i) preparation for any judicial . . . proceeding pertaining to the enforcement of a specifically designated Federal criminal statute (not involving tax administration) . . . to which the United States . . . is or may be a party.
- (ii) any investigation which may result in such a proceeding, or
- (iii) any Federal grand jury proceeding pertaining to enforcement of such criminal statute to which the United States or such agency may be a party,

solely for the use of such officers and employees in such preparation, investigation, or grand jury proceeding.

26 U.S.C. § 6103(i)(1)(A).

In even the most straightforward fraud case, the usefulness of tax returns should be apparent. For example, in a false bank loan application prosecution under 18 U.S.C. § 1014, examination of the target's filed individual, partnership, or corporate tax returns may reveal a sharply different picture of the target than the one he or she has painted in the loan application. In this instance, the tax return information provides a statement under penalty of perjury which may either serve as circumstantial evidence of the target's misrepresentations of his economic status or as helpful cross-examination material. If the target submitted purported tax returns with the loan application that do not match the filed returns, the filed returns are direct evidence of the fraud.

Just as loan applications often exaggerate assets, bankruptcy petitions often conceal them. An examination of filed returns from several prior years may reveal substantial leads to concealed assets or to assets recently transferred. Tax disclosure may uncover interest income on concealed bank accounts or depreciation schedules for concealed or transferred equipment or rental property. Disclosed transfers of property for the exact amount of the depreciated basis may lead to discovery of assets siphoned off to other companies controlled by the defendant. As is the case with bank loan applications, purportedly filed tax returns submitted to

the bankruptcy court may turn out to be different from those actually filed with the IRS. Tax disclosure should, therefore, be an early part of every bankruptcy fraud investigation.

It is common for the target of a financial, political corruption, or even a narcotics investigation to argue that excess cash discovered during the investigation is the "proceeds" of legitimate activity. For example, a target may argue that kickbacks are "commissions," political bribes are "consulting fees," or drug proceeds are profit from "jewelry sales." The failure to report the fact and purported source of those moneys on the filed return will seriously undermine the defense. If the target is so law-abiding and the source of funds so innocent, why wasn't the income declared on the appropriate returns and schedules?

Disclosure of tax returns may also provide critical leads and impeachment material in a political corruption investigation. For example, a public employee's tax returns may show mounting yearly interest from an increasing number of certificates of deposit (CDS), the purchase of which is inconsistent with his or her slowly-rising salary and other declared income. Consider obtaining the requisite disclosure orders to pursue whether the undeclared source of funds for the purchase of the CDS was taxable and illegitimate. Similarly, if you have evidence of cash payments to a public official, a tax return showing only Form W-2 income and small amounts of interest may be used as evidence of cover-up and guilty knowledge of the illicit source of the cash income. As a final example, a tax return showing below market interest on claimed "loans" to a public official may support the inference and corroborate the proof that the "loans" were extorted under color of official right in violation of 18 U.S.C. § 1951(b)(2).

Sometimes, even when a potential defendant has declared substantial income on the tax return to keep the IRS at bay, he or she will have misdescribed the income source on the filed return. For instance, a drug dealer may report a jewelry business to explain the presence of large amounts of cash. The Schedule C or corporate tax returns, however, may show the business operated over a substantial period without significant profit, without a large cost of goods sold, or without a substantial business expense for insurance or other normal expenses of the type of business claimed. Consider, for example, a politician on the take who decides to declare his bribes as "commissions" on his real estate sales, but shows little expense for advertising and no expense for

a real estate license and professional associations. Your ability to impeach the claimed legitimate business explanation for the income may significantly improve your case.

How to Obtain Disclosure of Tax Information

Applications for disclosure orders under Section 6103(i)(1)(A) are made *ex parte*, under seal, because of the grand jury secrecy requirements of Fed. R. Crim. P. 6(e) and the general proscription against disclosure of criminal investigations. Applications must comply with the conditions set forth in Section 6103(i)(1)(B), which states that the application may be made by the Attorney General, Deputy or Associate Attorney General, any Assistant Attorney General, or any *United States Attorney*.

In the view of IRS Chief Counsel, each application should contain the signature of the United States Attorney or someone expressly designated to act as United States Attorney for that particular purpose. If the application contains only the signature of an AUSA who is not designated to act in these matters, it will not meet the statutory requirement. Though cumbersome, such supervisory review of tax disclosure applications assures compliance with the requirements of Section 6103(i)(1)(B). Supervisory review also provides a means for centralizing the tax disclosure records to assure that the requirements of Section 6103(p)(4) and the DOJ for safeguarding tax materials are met. *See United States Attorneys' Manual (USAM)* at Section 3-6.300 (October 1997); *see also* Executive Office for United States Attorneys (EOUSA) Memorandum of August 23, 1996, entitled "*Maintenance of Tax Returns and Return Information*."

Sections 6103(i)(1)(B)(i) through (iii) require that each disclosure application contain facts establishing (i) the reason to believe a violation of a specific criminal statute has been committed, (ii) how the return or return information . . . "is or may be relevant to a matter relating to the commission of such act," and (iii) that "the return or return information is sought exclusively for use in the Federal criminal investigation or proceeding relating to such act" and cannot "reasonably be obtained . . . from another source."

When crafting a Section 6103(i)(1)(B)(i) application for a disclosure, make sure the information provided on the alleged violation is substantial and not conclusory. To the extent possible, provide concrete facts describing the history of the crime and transactional relationships between your subjects. In this manner, the Government will be in a better position to argue for broad disclosure of tax information under Section 6103(i)(1)(B)(ii).

As stated, at this stage, the Government need only show how the tax returns and return information "are *or may be* relevant to a matter relating to commission" of the non-tax criminal offense. Each application turns on its own facts. Nevertheless, there are reasons common to many cases that may be used to explain the need for returns and return information. For example, if the investigation shows a target received ill-gotten moneys, then your application can state that examination of the tax returns may reveal whether those moneys have been declared and, if so, how they have been described. Further, any omitted or misdescribed information may be relevant as evidence of concealment and guilty knowledge.

As further example, if the target has engaged in extravagant spending, tax returns may show whether the declared sources of income, independent of the alleged illicit source, support the documented expenditures. If the target is spending cash, and bank account information reveals few checks to "cash," few ATM withdrawals, and no cash back on deposits, you can explain that the tax returns may show whether there is a declared source of cash.

Tax returns may also provide leads to the existence of interest-bearing accounts and stocks, partnerships, Schedule C businesses, Subchapter S corporations and trusts, real estate, depreciable business property, etc. This information may reveal the disposition of illicit proceeds. The returns likewise may suggest the existence of inflated or concealed assets. Tax returns and return information may also provide leads to business associates and loan officers who, in turn, may provide historical context for the subject fraud and information about the tax preparer.

In the disclosure application, explain that IRS examination or collection records are necessary because they may provide additional evidence of false statements and help to identify assets relevant to the investigation. During an audit, the taxpayer may have made direct representations about the amounts and sources of

income, expenses, and the manner in which his or her records were maintained. Examination records often provide an account of a sustained, closely-documented contact with the subject/target by a revenue or collections officer. The records may also include substantial third-party information, including financial records no longer available from the financial institution or corporate source, and leads to or reports of interviews with third parties.

Under Section 6103(i)(1)(B)(ii), the more thorough your explanation of the relevance of tax-related information, the broader the disclosure allowance is likely to be. Ask for tax disclosure of all relevant returns and related schedules for each year under investigation, including Forms 1040, any corporate, partnership, and trust returns relating to the target and his or her associates, and those returns relating to withholding and payroll taxes. If the facts justify it, ask for tax returns and “return information” for a sufficient number of years to provide a profile of the target’s declared financial status and activity before and after the crime.

In your disclosure application, consider asking for all “information returns,” which are the filings that the IRS requires third parties to make to report financial transactions with a taxpayer. These include Forms 1099 (dividends, interest, miscellaneous, pension distributions), Forms 1098 (real estate transactions, mortgage interest paid, etc.), Forms W-2 (wages), and Forms K-1 (partnership, trust and Form 1120S distributions), all of which carry over onto the individual income tax return. Also consider asking for Forms 8300, which are used to report cash transactions greater than \$10,000. Look in the various IRS publications describing filing requirements or consult with an IRS revenue agent for information about which “information returns” might be relevant to your case.

Do not forget to ask for all computer-generated transcripts of account for your subject. The “RTVUE transcripts,”*** which IRS maintains for the current and two prior years, reflect the information from each line of the Forms 1040 series and their accompanying schedules and forms in transcript form. The “complete” transcripts include not only most of the information on the particular returns you request, but also a record of payments and indications of any pending administrative

*** *IDRS Command Code Formats*, IRS Training Pack 2545-003 (rev. Nov. 1996)(“a transcription of the line by line tax return information posted to the Individual Master File”).

actions or criminal investigations that may prompt requests for further disclosure. From the transcripts, you can reconstruct what form notices the taxpayer has received. An added advantage of requesting transcripts is that they can be provided through the IRS disclosure officer, once the *ex parte* order has been entered.† The turnaround time for transcripts is usually very quick and the information provided may then give direction to the investigation while you await remaining tax disclosures.

Disclosure orders are strictly construed. If you want tax materials which become available while the IRS is carrying out its search for requested tax information, you must fashion your application and proposed tax disclosure order to expressly cover that period. This step is particularly important if you anticipate that the past year’s returns will be filed or become due after your request. Remember, too, that you may seek additional tax disclosure orders if it “reasonably appears” that additional materials are relevant or you need to update prior disclosures.

The Section 6103(i)(1)(B)(iii) requirement—that the tax information sought “cannot reasonably be obtained, under the circumstances, from another source”—is easily satisfied. You can state that the use of another source (for instance, a direct subpoena to a cohort or employee) would tip the target to the nature or scope of the investigation. You can add that the information in the return is unique because it is a statement on the relevant matter under penalty of perjury. Of course, you can state in the application that the “return information” sought (the work papers which the IRS has generated through its examination of the return and contact with the taxpayer) necessarily can only be obtained from the IRS because of the nondisclosure laws.

Section 6103(i)(1)(B) applications should specify the name of the AUSA, agent, and any supervisor who will be receiving and using the disclosed tax materials in connection with the criminal investigation. This requirement, however, does not mean other AUSAs, employees, or agents cannot have access to the materials without another order. If an AUSA, agent, employee, or

† Be sure to include a cover memorandum to the disclosure officer with the signed tax disclosure order requesting that the transcripts be provided as they become available. Do not ask IRS Criminal Investigation Division agents to access this information for a non-tax case. Only the disclosure officer can provide the information.

supervisor becomes “personally and directly engaged in the preparation of the judicial proceeding, the investigation, or the grand jury proceeding,” including cocounsel, supervisors, and colleagues from whom guidance is routinely and regularly sought on tax issues, then they are automatically covered by Section 6103(i)(1)(B)(iii). It is a good idea to keep a list of those to whom disclosure is made and, if challenged, to be able to articulate the reasons for the disclosure. Finally, in writing, caution those named in the disclosure orders of the statutory requirements for handling return-related materials. Make sure that those handling tax return information know that the gratuitous discussion of the tax information (as contrasted with consultation in preparation of the case) is forbidden.

One special word of caution is warranted here. Many AUSAs are involved in “joint task force” investigations which may include the cooperation of state and local law enforcement authorities. It is critical to note that *Section 6103(i) does not authorize tax disclosure to non-federal investigators, even if they are formally assigned to a Federal task force, unless they qualify as Federal employees.* Note, however, that state revenue investigators participating in a joint task force may be able to have access to the information under separate mutual, state-Federal revenue assistance agreements, provided for under Section 6103(d).^{††}

Because of the general proscription against sharing tax information in a joint Federal-state investigation and the advantages of obtaining as much helpful tax information as possible outside the proscriptions of Section 6103(i), consider whether any cooperating witnesses have the power under Section 6103(e) (“disclosure to persons having a material interest”) to obtain disclosure of the tax returns in which you are interested. Those same persons, under the provisions of Section 6103(c) (“disclosure of returns and return information to designee of taxpayer”), can give written consent for you and your agents to have access to the tax returns.

Thus, under Section 6103(c), in combination with Section 6103(e)(1)(B), a cooperating estranged spouse can consent to disclosure of jointly filed returns because he or she was a “taxpayer” on the return. Similarly, in a

fraud investigation, under Section 6103(c) and Section 6103(e)(1)(C) or (F), a disenchanted cooperating partner or trustee can describe to you the relevant partnerships or trusts through which the fraud operated and designate you, the case agent, and others working under your direction on the investigation, to receive the returns for purposes of the investigation.

You may also want to consider requesting Section 6103(c) written consent to disclosure as part of a proffer agreement with cooperating defendants/witnesses. Consent, however, must be voluntary and not a condition of the proffer, which might vitiate the consent. *See Tierney v. Schweiker*, 718 F.2d 449 (D.C. Cir. 1983) (Social Security Administration’s obtaining disclosure by compelling SSI recipients to sign Section 6103(c) consents held invalid). Once consent is given and the return information disclosed, examine these materials as part of your evaluation of the witness’s proffered testimony.

Tax returns disclosed to the Government under Section 6103(c) are subject only to the conditions placed on the disclosure by the consenting taxpayer. Of course, evidence which contains tax information but which has not been filed with the IRS, including retained copies of tax returns and accountant work papers, may be obtained by grand jury subpoena or directly from the taxpayer or a third party witness (the preparer). Tax information so obtained is not protected by Section 6103, although other confidentiality provisions such as Rule 6(e), Fed. R. Crim. P., may apply and limit the Government’s disclosure options.

Why Add Criminal Tax Charges to a Non-Tax Criminal Case?

Expanding a grand jury investigation to include authority to investigate Title 26 charges takes time and the efforts of IRS Criminal Investigation Division (CID) agents, IRS District Counsel, and Tax Division attorneys. Therefore, as soon as possible after receiving tax disclosure, determine whether there are apparent tax violations and whether the evidence supports the addition of tax charges to the Government’s case.

The decision to add tax charges is strategic. Because the Government has already received tax disclosure, consider meeting with the IRS agents to

^{††}Smith v. United States, 964 F.2d 630, 633-37 (7th Cir. 1992) provides a helpful discussion of tax disclosure made possible among Federal and state revenue department agents under provisions of Section 6103(d).

discuss the significance of the information contained in the disclosed returns. You can also get their advice on whether the information developed in the grand jury, in combination with the tax disclosure material, suggests a viable tax prosecution.

In determining whether to add tax charges, consider not only the strength of your proof but also whether these charges will add or detract from the case. The most obvious case in which to add tax charges is one where tax disclosure reveals that illicit proceeds were not reported. Not only is this a significant tax crime worthy of prosecution, but this evidence may enhance the prosecution of the underlying conduct because the concealment of income can be argued as evidence of the defendant's knowledge of the illegal nature of that income. For example, in a political corruption case, the amount of provable direct cash bribes may be small and the tax loss smaller still. Nonetheless, if the evidence suggests that the public official was spending undeclared cash with no other likely source for that cash, the tax proof (using the cash expenditures method) will corroborate your bribery testimony.^{†††}

In another example, the decision to add willful failure to file charges to a continuing criminal [narcotics] enterprise prosecution in violation of 21 U.S.C. § 848 might seem odd since there would be no impact on the length of the sentence. The failure to file charge, however, provides a vehicle for introducing all evidence of expenditures in the relevant years and all evidence showing the defendant's relative poverty before the enterprise began. Here, the use of summary testimony portraying the defendant's newly acquired wealth through his documented cash expenditures for cars, jewelry, and other luxury goods significantly enhances the narcotics trafficking evidence. It also allows you to argue that if the income was from a legitimate source, it would have been declared.

The Seventh Circuit, in upholding denial of a motion to sever tax and narcotics counts in *United States v. Wilson*, 715 F.2d 1164, 1171 (7th Cir. 1983), discussed the mutually reinforcing effect of tax and non-tax charges, stating:

The elements of proof for failure to file an income tax return include that the defendant had sufficient income that filing was necessary, and that the defendant failed to file a return. Proof of a continuing criminal enterprise requires evidence of substantial income therefrom. Clearly these offenses involved introduction of common proofs.

Evidence of large expenditures tended to show that [the defendant] had sufficient income to necessitate filing of a tax return. Evidence that he failed to file such a return led to the permissible inference that he had no bona fide income source to support these expenditures.

Factors which might cause you to forego tax charges include the case where the proof of the tax charges would bog down in legal issues as to whether the funds received are "income." For example, "loans" extorted by a judge who never intended to repay them could be held to be income in a civil tax case. But charging the loans as income in a criminal case could distract a jury from focusing on the corruption charges which were the central purpose of your prosecution. *See, e.g., United States v. Holzer*, 816 F.2d 304, 310-11 (7th Cir. 1987). Another example of a case in which you would not want to add tax charges would be when severance of the tax charges is likely. You certainly would not want two trials, and you would not want to have the tax case take place first.

Once the decision is made to add tax charges to your criminal case, remember that it is almost always preferable to charge false statement under 26 U.S.C. § 7206(1) or (2), rather than tax evasion under 26 U.S.C. § 7201. The use of false statement charges allows the jury to focus its attention on the fact that the defendant, under penalty of perjury, omitted, mis-described, or minimized income, or falsely described expenses on an underlying schedule, or lied about the source of his or her income. Conversely, the use of tax evasion charges requires the Government to prove all income (including legitimate income), deductions, credits, and tax due, which may distract the jury from the main purpose of the tax charges—to show that the defendant is a liar.

^{†††} *United States v. Hogan*, 886 F.2d 1497, 1505-1511 (7th Cir. 1989) provides an excellent discussion of the cash expenditures method of proof and the interplay of tax and non-tax charges.

How to Expand a Non-Tax Grand Jury Investigation to

Include Authority to Investigate Criminal Tax Charges

To the AUSA accustomed to receiving allegations of criminal conduct and immediately beginning a grand jury investigation, the procedure for expanding a non-tax case to include Title 26 charges may appear mind-bending. Section 6103(h)(3) does not permit the investigation of tax charges unless the criminal case first has been referred to the United States Attorney's office (USAO) by the IRS. The expansion process, therefore, requires the United States Attorney to write a letter to the IRS-CID Chief describing the non-tax investigation, explaining the basis to believe that tax charges may be appropriate, and requesting IRS referral of the subject(s) and assignment of IRS-CID agents to assist in the investigation. A copy of this letter must be sent to the Tax Division and a copy should be sent to IRS District Counsel as a courtesy. *See USAM*, Section 6-4.122 (October 1997).

IRS participation brings significant benefits to the investigation.[‡] Once Title 26 expansion is authorized, the IRS may disclose relevant tax information without a court order. This includes not only information relating to the particular taxpayer, but also third-party tax information if an item on that return is relevant to a matter at issue or to a transactional relationship between the third party and the target(s). *See* 26 U.S.C. § 6103(h)(2).

Your request for IRS assistance in a case involving non-tax charges represents a solemn promise to pursue tax charges if the evidence supports them. This means that you must coordinate the efforts of the IRS agents with those of other agencies involved in the investigation to assure that you will not be pressured to indict the non-tax charges before the tax charges are ready. You should take into account the time the agent will need to prepare the Special Agent's Report (SAR) and the time required for IRS District Counsel and Tax Division to review and approve the proposed tax charges. This process can be streamlined by working

[‡]Because 40 percent or less of IRS-CID investigative resources are available for non tax-gap investigations and prosecutions, USAOs should be judicious in their requests for IRS-CID resources on Title 18 and other non-Title 26 cases.

with the IRS-CID agent so that he or she understands what tax charges supported by the evidence best relate to and enhance the non-tax charges in the Government's case. Review a draft of the SAR before it is submitted for agency review to be sure that it is not inconsistent with your view of the case. If necessary, provide the Tax Division with any supplementary materials that show how the tax case fits with the non-tax case and explain the USAO's strategy for prosecuting the same.^{‡‡}

Handling Tax Information During the Investigation

In most grand jury investigations, it is not practicable to completely isolate the tax information from the other proof to which it relates. Nevertheless, all tax information must be maintained in accordance with the requirements of the *USAM* at Section 3-6.300 (October 1997), DOJ Order 2620.5A (February 23, 1981), and the memorandum from the EOUSA Director entitled "*Maintenance of Tax Returns and Return Information*" (August 23, 1996). The presence of tax information in files or boxes should be clearly marked.^{‡‡‡} Tax information also must be secured in a locked office or file cabinet. The secure perimeter of the particular USAO, together with that locked office or locked file cabinet, provides the security required by the IRS. If you have tax information from sources other than the IRS, it makes sense to mark it in some distinguishing manner as to its source. When the case is complete, before closing the file for transmittal to the Federal Records Center, all tax information obtained under Sections 6103(h) or (i) must be extracted and a record made of its return to the IRS or its destruction by cross-cut shredding. Agents who have tax information in their working files to carry out their investigatory responsibilities for the grand jury must maintain the

^{‡‡}When necessary, this whole review process can be expedited, but one should not impose on the IRS and Tax Division unless the need is critical; for instance, when the tax charges add substantially to your case and the five-year statute of limitations is running on the non-tax criminal charges.

^{‡‡‡}In the Northern District of Illinois, we keep tax information in red file folders and stamp the folders and boxes with the legend "Contains Tax Information."

same strict security procedures and, at the end of a case, return the materials to the AUSA for proper disposal.

Disclosure of Return Information in Discovery, at Trial, and in Related Proceedings

In a case without tax charges, preindictment disclosure authority under Section 6103(i)(1) does not permit the post-indictment disclosure of tax return(s) and return information during discovery proceedings or trial without first meeting the separate requirements of Section 6103(i)(4) (pertaining to non-tax cases). The conditional language which allowed review of tax material at the investigatory stage (that the return or return information “*may be relevant . . .*”) becomes more commanding after indictment. Section 6103(i)(4)(A) permits the disclosure of tax returns and return information “in any judicial or administrative proceeding” relating to a specified non-tax crime or related civil forfeiture proceeding:

(i) *if the court finds* that the return or taxpayer return information *is probative* of or relevant to matters establishing the commission of a crime or liability of a party; or

(ii) to the extent required by order of the court pursuant to Section 3500 of Title 18 . . . or Rule 16.

26 U.S.C. §6103(i)(4)(A)(i)-(ii).

To satisfy the requirement that the court make findings *before* disclosure, the Government must submit a separate *in camera* filing. The motion must set forth the facts justifying the disclosure. To the extent the disclosure under Section 6103(i)(4)(A) involves tax returns and return information of persons or entities other than the defendant, the submission must also be *ex parte* to protect the confidentiality of those returns from unauthorized disclosure to the defendant and counsel. Of course, once the tax disclosure is authorized, tax

information can be provided in accord with ordinary rules of discovery.^{††††}

When negotiating a plea in a non-tax criminal case, consider whether it will be useful to include any defendant or third-party tax information you have received as relevant evidence to the crimes being admitted in the plea agreement. If so, craft a Section 6103(i)(4)(B) motion to establish the relevance of the tax information so it may be disclosed.

To assure that the probation officer in a non-tax case will have access to accumulated tax returns and tax information relating to the defendant, consider incorporating into the plea agreement the defendant’s voluntary consent to disclosure under Section 6103(c). Some probation officers routinely require defendants to sign Section 6103(c) authorizations to allow for a more complete profile of the defendant’s financial ability to pay fines, restitution, and costs of confinement or supervision. But there is some case law saying that such a requirement vitiates the consent required by Section 6103(c). *See Tierney v. Schweiker*, 718 F.2d 449 (D.C. Cir. 1983). By contrast, in a case involving both Title 26 and non-tax crimes, the IRS is permitted under Section 6103(h)(4) to make disclosure to the probation officer because the disclosure relates to “tax administration”—namely, the sentencing phase of the tax case.

Obtaining State Tax Returns and Return Information

One final area of tax disclosure is worth a brief mention. Many state tax returns are also protected by anti-disclosure laws closely patterned after

^{††††}In the Northern District of Illinois, at the request of the trial judges, all *ex parte* motions setting forth the facts of prosecution to establish the probative value of the third-party tax materials are made to the Chief Judge or the Magistrate Judge he designates.

26 U.S.C. § 6103. Therefore, the state returns may not be available through subpoena and the AUSA's access to them may not be covered by exceptions to the state disclosure laws. Nonetheless, access to state income tax, personal property, and sales tax returns may significantly advance a Federal criminal investigation and result in additional Title 18 charges or provide relevant evidence of Title 26 charges. Consider making a motion to the Federal district court for a disclosure order under the All Writs Act, 28 U.S.C. §1651 and the Supremacy Clause, and carefully articulate your need for state tax returns and return information. This effort may bring you what you need.

Conclusion

Section 6103 may seem daunting. However, it becomes easier to explain the illegal conduct of a defendant when you have more information about the defendant's handling of business and personal affairs. Once you become familiar with the quirky procedures and forms, the investigative advantages of having tax returns and return information for use in a criminal case make the disclosure process worthwhile. ❖

Excise Tax Prosecutions—Planes, Trains, and Automobile Air Conditioners

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Introduction

A common concern after receiving a new tax case to prosecute is whether the traditional opening, "Ladies and gentlemen, this is a tax case," may cause the jury to react in much the same manner as if one opened with, "I'm from the Government and I'm here to help you." While jurors recognize the necessity of raising revenue, it is not likely that they actually enjoy paying income taxes. For this reason, among others,

organizing and presenting a tax case often requires the prosecutor to invest effort beyond that required in a routine bank robbery or drug case.

Income taxes, however, do not make up the entire universe of Federal taxes or Federal tax prosecutions. In 1995, the last year for which data is available, the

Internal Revenue Service (IRS) collected* approximately \$45 billion in various excise taxes. While this is less than 10 percent of the nearly \$590 billion in individual income taxes collected in 1995, it is still significant revenue. The variety of excise taxes, combined with the amount of money involved, present significant opportunities for criminal fraud.

In general, an excise tax is a type of sales tax paid by a manufacturer or importer of goods, or provider of services. A glance at the IRS's recent excise tax statistics indicates that there are more than 80 varieties of Federal excise taxes being collected. Internal Revenue Service, *Statistics of Income Bulletin*, 168-176 (Fall 1996). Federal excise taxes are imposed on items as varied as gasoline, diesel fuel, commercial aviation fuel, fishing rods, telephone services, automobile tires, airline tickets, coal, bows and arrows, and chemicals considered deleterious to the earth's atmosphere—including "Freon," a refrigerant gas that was widely used in automobile air conditioner units until the early 1990s. Evasion of any one of these taxes is punishable as a felony. Moreover, in addition to these Federal excise taxes, there are often parallel state excise taxes that "piggyback" on the Federal excise tax, the most familiar example being the state excise taxes imposed on gasoline.

Unique Aspects of Excise Taxes

One of the unique aspects about an excise tax case is that the crime involves victims other than the Federal Government. Perpetrators of Federal excise tax fraud are not likely to pay state taxes on the "taxed" product. Nonetheless, state excise taxes are important sources of state revenue and the assistance of state law enforcement in joint Federal-state task forces is a common phenomenon in motor fuel excise tax investigations. Recognizing that state governments are often victimized by the same conduct involved in the Federal excise tax fraud scheme, the Fifth Circuit

recently upheld a district court's decision to include the amount of evaded state excise taxes as relevant conduct in determining the ultimate excise "tax loss" for Federal sentencing purposes. *See United States v. Powell*, 14 F.3d 655 (5th Cir. 1997).**

As a practical matter, excise taxes are ultimately paid for by the consumer at the retail level. This means that a gasoline retailer who purchases "hot" or untaxed gasoline at a discounted rate has an unfair price advantage over a gasoline retailer who purchases properly taxed gasoline because both retailers are charging their customers a price for the gasoline that includes the Federal excise tax. The availability of untaxed gasoline at the wholesale level may be the reason why one gasoline station is able to price its gasoline consistently lower than surrounding stations. In these circumstances, station owners who pay the full "tax-paid" price for gasoline are just as victimized by excise tax fraud as are the Federal and state governments.

The compromises between conflicting policies embodied in the excise tax laws are also unique to excise tax cases. On the one hand, Congress imposes excise taxes to raise revenue and the law may direct that the proceeds of a particular excise tax be deposited into accounts designed to defray the costs of Government projects related to the taxed activity. For example, much of the proceeds of the motor fuel excise taxes are deposited into the Highway Trust Fund and distributed to the states to improve the highway system. Likewise, the proceeds from the excise tax on sport fishing equipment are deposited into the Aquatic Resources Trust Fund to aid the states in fish restoration and costal wetland protection.

On the other hand, Congress may specifically exempt certain uses and users of the good or service from the excise tax. A good example of this is the diesel fuel excise tax. Although diesel fuel used in highway vehicles is identical to home heating oil, only the former is taxed. Until recent changes in the law, most purchases and sales between motor fuel wholesalers and distributors were exempt from excise taxes to avoid

* Although the word "collected" is used in this article, for purposes of 26 U.S.C. § 7202, excise taxes are not considered "collected" taxes. *See United States v. Musacchia*, 955 F.2d 3 (2d Cir. 1991).

** Be aware that the Powell result is limited to excise tax cases and Assistant United States Attorneys should contact the Tax Division before making a similar relevant conduct argument in other tax cases.

undue interference in the motor fuel distribution network.

The tension between conflicting policies—Congress' desire to raise revenue and its desire to exempt certain transactions and parties from the excise tax—provides the basis for excise tax fraud. The schemes may be as simple as a fraudulent claim of exemption from the tax or as complicated as a multitiered conspiracy employing shell companies and numerous conspirators.

Over the last decade, the Tax Division has seen an increase in complicated motor fuel excise tax fraud involving elements of organized crime. In addition, there has been a recent surge in excise tax crime involving Freon, particularly in Southern states where the demand for this outmoded refrigerant gas is high during the summer months. Both of these areas of excise tax fraud deserve a closer look.

Motor Fuel Excise Tax Fraud

Motor fuel excise taxes imposed on gasoline and diesel fuels used for transportation by automobiles, trains, boats, and aircraft are intended to raise revenue. Collections from motor fuel excise taxes exceeded \$27 billion in 1995, or more than half of all excise tax collections. Given the amount of illicit profit available, it is not surprising that motor fuel excise tax has been a tempting target for tax fraud schemes.

Russian and traditional organized crime have been linked to the untaxed sale of motor fuels. In 1994, during his testimony before Congress, Federal Bureau of Investigation (FBI) Director Louis J. Freeh described a scheme involving Russian emigres working with La Cosa Nostra organizations to sell more than 50 million gallons of untaxed gasoline a month. 1994 W.L. 241502 (F.D.C.H.), *Statement of the Director Louis J. Freeh Before the Permanent Subcommittee on Investigations, United States Senate Governmental Affairs Committee*, May 25, 1994. Director Freeh further testified that the profits from this illegal scheme were funneled overseas to import/export companies and to an organized crime figure in Moscow, Russia. *Id.*

The role played by members of La Cosa Nostra and Russian organized criminal enterprises is only part of

the picture. The IRS estimates the annual revenue losses from fraudulent excise tax schemes to be over \$1 billion. *Id.* The perpetrators of excise tax fraud schemes often use false IRS tax exemption forms^{***} or rely on forged invoices and thinly-capitalized shell corporations to create a false appearance that motor fuel excise taxes have been paid. Other perpetrators smuggle motor fuel or serve as “splash blenders” or “cocktailers,” who dilute diesel fuel with substances like mineral oil or flammable toxic waste and sell the increased volume of diluted fuel without paying the applicable excise taxes.

For example, on May 23, 1994, following a four-week trial in Philadelphia conducted by the USAO for the Eastern District of Pennsylvania with the Tax Division's assistance, three individual defendants and one corporate defendant were convicted of motor fuel excise tax evasion, wire fraud, and conspiracy stemming from a 97-count indictment charging the evasion of over \$14 million in Federal and state diesel fuel excise taxes. The scheme involved the use of a series of sham companies referred to as a “daisy chain.”[†] During the trial, the Government proved that the daisy chain was run by a group of Russian immigrants based in New York City, who used their ties to the Russian immigrant community to recruit others to run sham oil companies. *See United States v. Dobrer, et al.*, No. 93-00147 (E.D. Pa. filed May 26, 1993).

Freon Excise Tax Fraud

The excise tax applied to Freon, a refrigerant gas known generically by its chemical abbreviation “CFC-12,” is designed to end the use of this gas by making it

^{***} *See United States v. Townsend*, 31 F.2d 262, 267 (5th Cir. 1994), *cert. denied*, 513 U.S. 1100 (1995).

[†] In a “daisy chain” or “burn company” scheme, under-funded shell companies are created on paper and used to make it appear as if the relevant excise tax has been paid. When the IRS attempts to collect the excise tax from the shell company, there are no assets or funds from which to satisfy the tax. To extend the scheme and attempt to avoid detection, the parties continuously form new “burn companies” and discard the old ones. A classic example of the “daisy chain” scheme is described in *United States v. Aracri*, 968 F.2d 1512 (2d Cir. 1992).

prohibitively expensive in comparison to other chemicals that are less harmful to the earth's stratospheric ozone layer. The tax complements the Clean Air Act's prohibitions on certain classes of Ozone Depleting Chemicals (ODCs).^{††}

Although the revenue raised from ODC excise taxes is minuscule in comparison with motor fuels—approximately \$500 million was collected in 1995—the potential for illicit profit is sufficiently large to attract a number of players. CFC-12 excise tax schemes include variations of the daisy chain scheme and involve the use of under-funded shell companies to import and distribute the CFC-12 gas. The CFC-12 schemes are perpetrated by individuals who smuggle CFC-12 into the United States through concealment or misdescription. The perpetrators typically use false documents purporting to show tax-exempt sales of the CFC-12 for “re-export” when the CFC-12 is in fact being distributed domestically.

Miami's “Operation Cool Breeze,” a multiagency task force comprised of AUSAs and Tax Division attorneys and agents from the U.S. Customs Service, IRS, and Environmental Protection Agency, uncovered several excise tax fraud schemes involving the smuggling of massive quantities of CFC-12 into the United States. One such scheme resulted in the convictions of nine individuals and a corporation for excise tax fraud and related charges. The largest task force case involved a tax loss to the United States of approximately \$31 million during 1994 alone, with much of the illicit profit being laundered through nominee accounts at financial institutions located in overseas tax haven jurisdictions such as the Turks & Caicos Islands, the Isle of Jersey, and Switzerland. *See United States v. Refrigeration U.S.A., Inc., et al.*, No. 96-0267 (S.D. Fla. filed August 3, 1996).

^{††}The ODC provisions of both laws implement the Montreal Protocol on Substances that Deplete the Ozone Layer (TIAS 11097), an international treaty to which the United States is a party. *See* 26 U.S.C. §§ 4681-4682; 42 U.S.C. §§ 7671-7671q; S. Rep. No. 101-228 at 377-88 (1990), *reprinted in* 1990 U.S.C.A.A.N. 3760-3771; CCH Federal Excise Tax Reporter ¶ 33,700 at 15,702-06 (1997).

The Future of Excise Tax Fraud

Many of the loopholes in the area of excise tax fraud have been closed. Gasoline and diesel fuel are now taxable at the time they leave the terminal (at the latest), and the IRS's new rules now firmly fix the responsible party for the tax. 26 C.F.R. §§ 48.4081-1 and 48.4081-2 (1997). While there are still exemptions for certain users and uses of diesel fuel, recent Federal regulations requiring untaxed diesel fuel to be dyed red for easy identification are an attempt to minimize the illicit highway use of the untaxed fuel. 26 C.F.R. §§ 48.4082-1 to 48.4082-2 (1997). CFC-12 excise tax fraud schemes should likewise become less problematic because of the strict ban on imports of newly-made CFC-12, effective January 1, 1996, and because of the gradual replacement of CFC-12 with less deleterious substitute gases, such as HCFC 34a.

Rule changes and shifting market demands may lessen the attraction for excise tax fraud, but the schemes are unlikely to disappear as long as the potential for large-scale illicit profit exists. In the motor fuel area, anecdotal evidence suggests that these changes have engendered new methods to evade the taxes. In particular, the diversion of dyed (non-taxed) diesel fuel to taxable uses after its removal from the terminal will likely be a problem area because control over its actual use is not possible.

While complicated and time consuming, excise tax cases raise unique problems and interesting issues that are not encountered in the typical income tax case. These issues—together with the amount of money involved—should help to engage the jury's interest even after they hear those fateful words in opening, “Ladies and gentlemen, this is a tax case.” In any event, experienced Tax Division attorneys are available for consultation and assistance should you have the opportunity to investigate and prosecute an excise tax case involving taxes that relate not to income, but to planes, trains, and automobile air conditioners. ❖

Summons Enforcement: Some Special Problems

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The United States' system of taxation relies on the good faith and integrity of taxpayers to completely and honestly disclose to the Internal Revenue Service (IRS) all information relevant to their tax liabilities. In almost all circumstances, taxpayers have more information about their financial situation and tax liabilities than does the IRS. Thus, in order to effectively conduct investigations of tax liabilities, it is necessary for the IRS to obtain information from taxpayers or third parties in possession of relevant information. Normally, the IRS seeks additional information from the taxpayer or relevant third party to determine: (1) the accuracy of a tax return or information return that has been filed; (2) whether a return should have been filed and, where necessary, to make a substitute for return where none has been filed; (3) whether a taxpayer has committed an offense connected with the administration of the Internal Revenue laws; and (4) whether there are assets the IRS can pursue to collect properly assessed taxes. In most cases, the IRS is able to obtain the information it needs by asking for it informally.

If a taxpayer or relevant third party refuses to produce information informally, the IRS's only means of compelling the production of the information (short of referring the case for a grand jury investigation) is the service and subsequent enforcement of an administrative summons. Generally, an administrative summons requires the taxpayer or third-party to appear at the time and place specified on the summons (sometimes referred to as the return date) to give testimony and produce documents. If the principal object of the summons is testimony, a court reporter will be present to transcribe the taxpayer's or third party's testimony.

This article provides an overview of summons enforcement procedures and specifically addresses two problems that frequently arise in summons enforcement cases, particularly those involving illegal tax protesters: (1) using post-enforcement remedies when a summoned party refuses to comply with the summons and (2) making an adequate record for appeal when the

summoned party refuses to comply with the summons by asserting his or her Fifth Amendment privilege against self-incrimination. A complete discussion of summons enforcement law, including extensive case citations, can be found in *A Primer on IRS Summons Enforcement* (the *Primer*) by Charles E. Brookhart.

Summons Enforcement Generally

Because IRS summonses are not self-enforcing, the IRS must refer the summons to the Department of Justice (DOJ) to obtain an order of enforcement when a summoned party either refuses to appear or appears but refuses to produce the summoned information. The United States Attorneys' offices (USAOs) and the Tax Division share the responsibility of bringing summons enforcement actions and defending petitions to quash summonses. The IRS generally refers requests for enforcement of routine IRS civil examination and collection summonses directly to the USAOs. Similarly, petitions to quash summonses served on third party record keepers under 26 U.S.C. § 7609 are often referred directly to the USAOs.

The Tax Division also litigates summons enforcement cases involving summonses issued to or involving the tax liabilities of tax-exempt organizations and churches or members of the clergy (except third party record keeper summonses for bank records); summonses to attorneys for any purpose; summonses that seek accountants' "audit work papers" or "tax accrual work papers;" designated summonses issued under 26 U.S.C. § 6503(j); summonses for tax return preparation software; summonses for information necessary to complete Form 8300, "Reports of Cash Payments Over \$10,000 Received in a Trade of Business;" and summonses for records outside the United States.

In order to initiate a summons enforcement proceeding in district court, the United States generally files a petition to enforce, supported by a sworn declaration of the IRS employee who issued the summons. At a minimum, the declaration must state that the IRS has complied with the requirements for enforcement established in *United States v. Powell*, 379 U.S. 48, 57-58 (1964). The declaration must establish that (1) the summons is issued for a proper purpose (which generally means that the information is being sought as part of a legitimate IRS investigation), (2) the material sought is relevant to that purpose, (3) the information sought is not already within the Commissioner's possession, and (4) the administrative steps required by the Internal Revenue Code (I.R.C.) have been followed. Additionally, because a summons cannot be enforced if the matter has been referred to DOJ for criminal prosecution, the declaration should also state that no criminal referral has been made with respect to the individual whose tax liability is being investigated. The declaration serves as the Government's *prima facie* showing that the summons is enforceable. The Government's burden is a slight one because an enforcement action is a summary proceeding, which is brought only at the investigative stage of an action against a taxpayer.

Along with the petition, the Government generally files a draft order to show cause and proposes a date by which the summoned party must make a written response raising any defenses he or she may have for failing to comply with the summons. The draft order should also propose a hearing date for the court's consideration of any defenses raised by the summoned party. Usually the order to show cause directs that a copy of the order, along with the Government's petition and supporting declarations, be hand-served on the summoned party within a set number of days. It is often easiest to have the revenue agent or revenue officer, whose declaration supports the petition, personally serve the respondent.

In addition to affirmative summons enforcement litigation, the Government also defends against petitions to quash filed by "third party record keepers"* relating

* As defined in Section 7609(a)(3), the term "third party record keepers" means: (A) any mutual savings bank, cooperative bank, domestic building and loan association, or other savings institution chartered and supervised as a savings

to the service of IRS summonses. Summonses issued to banks or other third party record keepers concerning the tax liability of another are governed by Section 7609. Generally, if a summons served on a third-party record keeper seeks records pertaining to a person other than the record keeper, then that other person (a "noticee") must be served a timely notice of the summons.** Upon his or her receipt of proper notice, the noticee acquires certain procedural rights, including the right to file a petition in the district court to quash the summons. See Section 7609(b)(2). Under Section 7609(b)(2)(A), the petition to quash must be filed within 20 days of the date notice is given. This filing provision is strictly construed and the jurisdiction of the district court to entertain a petition to quash ends when the 20-day period has run out. *Faber v. United States*, 921 F.2d 1118, 1119 (10th Cir. 1990). The timely filing of a petition to quash prevents the Commissioner from examining any summoned records during the pendency of the proceedings. Section 7609(b)(2).

While a noticee's petition to quash is procedurally different from a Government enforcement action, the respective burdens of proof on the parties are essentially the same in both actions. Therefore, when responding to a petition to quash a summons, the Government must submit a declaration demonstrating that the *Powell* requirements have been met. Indeed, in most cases instituted by taxpayers/noticees under Section 7609, the Government will counterclaim for enforcement of the summons pursuant to Section 7609(b)(2)(A).

and loan or similar association under Federal or State law, any bank (as defined in Section 581), or any credit union (within the meaning of Section 501(c)(14)(A)); (B) any consumer reporting agency (as defined under Section 603(d) of the Fair Credit Reporting Act—15 U.S.C. 1681a(f)); (C) any person extending credit through the use of credit cards or similar devices; (D) any broker (as defined in Section 3(a)(4) of the Securities Exchange Act of 1934—15 U.S.C. 78c(a)(4)); (E) any attorney; (F) any accountant; (G) any barter exchange (as defined in Section 6045(c)(3)); and (H) any regulated investment company (as defined in Section 851) and any agent of such regulated investment company when acting as an agent thereof.

** Timely notice is "notice given within three days of the date the summons is served and no later than the 23rd day before the return date specified on the summons." 26 U.S.C. § 7609(a)(1).

In order to resist enforcement of the summons, the respondent (or in the case of petitions to quash third party record keeper summonses, the noticee) must either rebut some part of the Government's *prima facie* case, demonstrate that enforcement of the summons would be an abuse of the court's process, or show that the summoned material is subject to a valid claim of privilege. Because summons enforcement proceedings are summary in nature, the respondent must make a substantial showing that there is a reason to question the enforceability of the summons before being entitled to an evidentiary hearing. *Hintze v. IRS*, 879 F.2d 121, 126 (4th Cir. 1989). The taxpayer or third party challenging the summons bears the "heavy" burden of rebutting the Government's *prima facie* showing for enforcement of a summons. *United States v. Jose*, 131 F.3d 1325, 1328 (9th Cir. 1997) (*en banc*). The contesting party must allege specific facts and introduce evidence to support the allegations that the summons is not enforceable. Mere allegations of wrongful conduct are insufficient. *Jose*, 131 F.3d at 1328.

Although the hearing set by the order to show cause is usually confined to legal argument, it is advisable to have the revenue agent or revenue officer prepared to testify in support of the declaration if necessary. Also, even though the court does not generally order the Government to respond in writing to the respondent's opposition to enforcement, it is often a good idea to file a brief in support of enforcement prior to the hearing. The *Primer* is a good resource when drafting these briefs.

The court's role in a summons enforcement proceeding is limited to determining whether the particular summons is a legitimate exercise of the IRS's investigation authority. *Jose*, 131 F.3d at 1329. The court is not empowered to second-guess the wisdom of the IRS's investigative decisions. In *Powell*, the Supreme Court specifically held that a district court should not inquire into the strength of the Commissioner's reasons for believing that the

summoned material will contribute to a redetermination of tax liability. 379 U.S. at 56. Indeed, the Supreme Court held that a summons can be enforced even after the normal statute of limitations for assessment of taxes has expired because there is no statute of limitations on fraud. 26 U.S.C. § 6501(c). Moreover, the Government need not make any probable cause showing that fraud, or any other deviation from the I.R.C., is suspected in order to obtain enforcement of a summons. *Powell*, 379 U.S. at 56.

If the court orders an evidentiary hearing, the Government must, at a minimum, make the issuing revenue agent or revenue officer available for cross-examination. Discovery is not usually permitted in summons enforcement cases, although this is a matter left to the judge's discretion. *United States v. McCoy*, 954 F.2d 1000, 1004 (5th Cir. 1992). Even those courts that have permitted limited discovery have generally only done so after a hearing where the issuing revenue agent or revenue officer has been subject to cross-examination, and then only if such cross-examination shows that there is a substantial reason to question the enforceability of the summons. *United States v. Kis*, 658 F.2d 526 (7th Cir. 1981), *cert. denied*, 455 U.S. 1018 (1982).

Very often summons enforcement proceedings are referred to magistrate judges. It is important to remember that a magistrate judge cannot enter a binding order enforcing a summons. A magistrate judge can only issue a report and recommendation to a district judge who, in turn, can issue a final and appealable order. *United States v. First National Bank of Atlanta*, 628 F.2d 871, 873 (5th Cir. 1980); *United States v. Jones*, 581 F.2d 816 (10th Cir. 1978). The report and recommendation of the magistrate judge is subject to exceptions by either party. Fed. R. Civ. P. 72 (b). The magistrate judge's recommendation is then subject to *de novo* review by the district judge who enters the final and appealable order granting or denying enforcement. *United States v. Mueller*, 930 F.2d 10 (8th Cir. 1991). Unless the respondent obtains a stay of the enforcement order pending appeal, the Government can begin contempt proceedings while the appeal is pending. *United States v. Lawn Builders of New England, Inc.*, 856 F.2d 388, 394-395 (1st Cir. 1988).

Post-Enforcement Remedies or What to Do When They Still Will Not Comply

When a court orders enforcement of a summons, the respondent is usually required to make arrangements with the IRS to appear and comply with the summons within a set time, i.e., 30 days. In most instances, the respondent does comply and that is the end of the matter. In some instances, however, particularly in cases involving illegal tax protesters, the respondent will refuse to comply even after being ordered to do so. If the respondent refuses to comply, the Government may seek a finding of civil contempt, as well as sanctions to compel compliance. These sanctions may include monetary fines for continued noncompliance, compensatory attorney's fees, costs for the Government, and incarceration. In fact, where the IRS has already made large tax assessments against the respondent, as is often the case in the context of a collection summons, incarceration may be the only sanction that holds any possibility of achieving compliance.

The recipient of an IRS summons has an affirmative duty to preserve and retain possession of summoned records, and to produce them when ordered by the court. The duties and obligations of the parties are fixed as of the date the summons is served, and a party cannot avoid compliance by transferring records to someone else after the summons is served. *Couch v. United States*, 409 U.S. 322, 329 n.9 (1973). On occasion, summoned parties will transfer otherwise unprivileged records to an attorney in order to make the claim that the records are covered by the attorney/client privilege. The Supreme Court has explicitly disallowed this practice. *See Fisher v. United States*, 425 U.S. 391, 396-401 (1976).

If the Government brings a contempt proceeding to enforce the court's summons enforcement order, then it is only required to establish a *prima facie* case of contempt. To do so, the Government must demonstrate that certain conduct was required (or prohibited) by a previous court order (i.e., compliance with the summons) and that the alleged contemner failed to comply with the same. *See, e.g., United States v. Hayes*, 722 F.2d 723, 725 (11th Cir. 1984). A *prima facie* case for contempt may be made using affidavits attached to

the petition or sworn testimony presented in open court. In several recent cases, illegal tax protesters have filed pleadings explicitly stating that they refuse "without dishonor" (which apparently derives from some misinterpretation of the Uniform Commercial Code) to accept the court's decision.

The show cause order places the burden of proof on the alleged contemner (respondent). In this regard, he or she must bring forth facts showing why he or she should not be held in contempt for not complying with the court's enforcement order. In a contempt proceeding, it is not necessary for the Government to establish that the respondent has the capacity to comply. Rather, the contrary burden is on the respondent who must show why he or she is unable to comply. *United States v. Rylander*, 460 U.S. 752, 757 (1983).

In the context of summons enforcement cases, the burden is on the respondent to produce evidence not only of his or her present inability to produce the requested information, but that he or she has taken all steps that are legal and necessary to obtain and produce the summoned records. *Hayes*, 722 F.2d at 726; *United States v. Drollinger*, 80 F.3d 389, 393 (9th Cir. 1996). In raising the defense of present inability to comply, the respondent bears the burden of production, including the burden to show that he or she has, in good faith, made all reasonable efforts to comply with the summons. A mere showing of "some effort" to comply is not sufficient. *Hayes*, 722 F.2d at 725.

A contempt proceeding does not open the door to reconsideration of the legal or factual basis of the order alleged to have been disobeyed. *Maggio v. Zeitz*, 333 U.S. 56, 59 (1948). The only proper question at the contempt stage is whether the contemner has the present ability to obey the court's enforcement order. Because the enforcement order is final and appealable, it is binding on the contemner, and all issues that were raised or could have been raised in the enforcement hearing are *res judicata* and may not be raised anew in the contempt hearing. *See Rylander*, 460 U.S. at 757; *United States v. Brown*, 918 F.2d 82, 83 (9th Cir. 1990).

Merely obtaining an adjudication of contempt, however, is not enough. A civil contempt order is not "final" unless (1) a finding of contempt is issued and (2) an appropriate sanction is imposed. *See Steinert v. United States*, 571 F.2d 1105, 1107 (9th Cir. 1978); *Motorola, Inc. v. Computer Displays, Int'l*, 739 F.2d

1149, 1154 (7th Cir. 1984). As noted above, sanctions available in civil contempt situations include coercive fines, compensatory fines, and incarceration. If a taxpayer has destroyed information between the time he or she was served with the summons and the time the enforcement order was entered, then the Government can ask to be compensated for the actual damage caused by the contemner's conduct, including costs and attorneys fees. *United States v. Asay*, 614 F.2d 655 (9th Cir. 1980).

Some individuals will be persuaded to comply with a summons because of the imposition of monetary sanctions. The Government, however, often seeks to enforce summonses against individuals who have already amassed large unpaid tax liabilities or who are unwilling to acknowledge any order of a district court. If this is the case, the Government should carefully evaluate the circumstances and determine whether it is appropriate to ask the court to incarcerate the contemner. In reality, courts are reluctant to order incarceration unless and until the court is satisfied that nothing else will work. However, there are instances where courts have incarcerated individuals who refuse to comply with properly issued IRS summonses. *See, e.g., United States v. Carroll*, 567 F.2d 955 (10th Cir. 1977).

Since civil contempt is supposed to effect compliance with enforcement orders and not be punitive, any period of incarceration for contempt should be terminated at the point that the court becomes convinced there is no reasonable possibility that continued incarceration will induce compliance. Some judges will hold periodic hearings with the contemner to evaluate whether incarceration still has the possibility of being coercive. Other judges leave it to the contemner to indicate that he or she is willing to purge the contempt. In the Tax Division's experience, courts will not hold someone in custody on civil contempt for longer than 18 months. There have, however, been instances where individuals have remained incarcerated for a full 18 months, rather than comply with an IRS summons. Since summons enforcement responsibility is shared by USAOs and the Tax Division, contempt sanctions, including incarceration, may be sought in cases initially handled by the Tax Division. In contempt cases, it may be necessary for AUSAs and Tax Division attorneys to work together because these proceedings often require multiple hearings on relatively short notice.

Making an Appealable Record on Fifth Amendment Claims

One area of continuing concern in the post-enforcement context involves the taxpayer's blanket invocation of the Fifth Amendment privilege. As discussed in greater detail at pages 70 to 77 of the *Primer*, a party (usually the taxpayer) who desires to invoke his or her Fifth Amendment privilege in defense to enforcement of a summons *must* do so at the enforcement proceeding on a question-by-question and document-by-document basis. *United States v. Bell*, 448 F. 2d 40, 42 (9th Cir. 1971); *United States v. Davis*, 636 F.2d 1028, 1038-39 (5th Cir.), *cert. denied*, 454 U.S. 862 (1981). All too often, district courts simply overrule blanket assertions of privilege and enter orders enforcing summonses without any meaningful attempt to make the necessary question-by-question, document-by-document inquiry. When confronted with this issue, the courts of appeal usually remand the case to the district court for a particularized inquiry (through an *in camera* inspection, if necessary) of the claim of privilege. *See, e.g., United States v. Grable*, 98 F.3d 251 (6th Cir. 1996), *cert. denied*, 117 S. Ct. 691 (1997); *United States v. Argomaniz*, 925 F.2d 1349 (11th Cir. 1991).

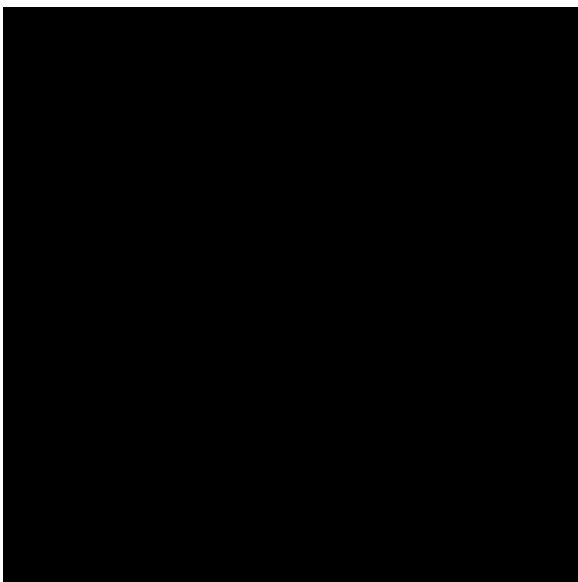
Furthermore, if the question-by-question, document-by-document inquiry was not made at the enforcement hearing, the courts of appeal generally mandate that such an inquiry be made as part of the contempt proceeding. *See, e.g., Grable*, 98 F.3d at 257; *Drollinger*, 80 F.3d at 392; *United States v. Allee*, 888 F.2d 208, 213 (1st Cir. 1989). To avoid the kind of protracted litigation encountered in these cases, Government attorneys handling IRS summons enforcement cases should ensure that Fifth Amendment defenses are properly addressed at the enforcement hearing.

Conclusion

This article only provides a brief overview of some special problems encountered in summons

enforcement litigation. As previously mentioned, the *Primer on IRS Summons Enforcement* contains a much more detailed legal discussion of basic summons enforcement issues. If you are unable to resolve any questions by referring to the *Primer*, please do not hesitate to contact one of us for further assistance. ❖

Office of Legal Education and Central Intelligence Agency Host Federal Attorneys



Robert M. McNamara, Jr.

On January 15, 1998, the Office of Legal Education and the Central Intelligence Agency's (CIA) Office of General Counsel hosted a conference for approximately 100 National Security Coordinators from USAOs nationwide. Attorneys from the Department of Justice's (DOJ) Criminal Division also attended. The conference addressed procedural problems and legal issues that arise in the course of criminal investigations and prosecutions involving classified information.

Keynote Speakers Winston P. Wiley, Associate Deputy Director for Intelligence/CIA, and Robert M. McNamara, Jr., General Counsel/CIA, discussed intelligence-related issues, information sharing with DOJ, and the need for communication between the intelligence and law enforcement communities. ❖