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## Prosecutions For Attempts To Evade Income Tax: A Discordant View of a Procedural Hybrid\*

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Legal proscriptions have proliferated at a Parkinsonian rate during the twentieth century, along with the officials who enforce them.<sup>1</sup> Administrative agencies have assumed much of the prosecutor's prerogative of selecting targets for sanctions. Courts and juries, along with the prosecutor, have surrendered discretion to the agencies, as fact finding, law application, and law determination have all become part of the administrative process.<sup>2</sup>

Administrative expertise supposedly justifies this radical redistribution of power. Efficient use of enforcement resources, skillful selection of sanctions, and deft location of areas of noncompliance are all advantages claimed for deference to the administrator. To the ardent proponent of administrative discretion, judicial review seems a senseless interference with bureaucratic routine, or at best a superfluous ratification.

The Supreme Court has been the bellwether in this process of transferring competence from court to administrator where the sanction is a civil one.<sup>3</sup> Neither the Supreme Court nor Congress, however,

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[1.] See POUND, *CRIMINAL JUSTICE IN AMERICA* 23 (1930); ALLEN, *THE BORDERLAND OF CRIMINAL JUSTICE* 3 (1964).

[2.] See GELLHORN, *INDIVIDUAL FREEDOM AND GOVERNMENTAL RESTRAINTS* 3-23 (1956); McKay, *Sanctions in Motion, The Administrative Process*, 49 *IOWA L. REV.* 441 (1964).

[3.] See, e.g., *Shaughnessy v. United States ex rel. Mezci*, 345 U.S. 206 (1953); *O'Leary v. Brown-Maxon, Inc.*, 340 U.S. 504 (1951); *Ludecke v. Watkins*, 335 U.S. 160 (1948); *Gray v. Powell*, 314 U.S. 402 (1941).

has been willing explicitly to advance the same arguments in justification of a reallocation of authority where the sanction is "criminal." Indeed, recent trends in the criminal process have been in the opposite direction—making judge and jury more effective checks on the power of police and prosecutor. Yet the extent to which the Supreme Court has rejected the values of administrative deference in the criminal process can easily be exaggerated.<sup>4</sup> There are still substantial segments of the process which have barely been touched by the Court's epochal decisions.<sup>5</sup> In areas where there is no capital punishment, where the typical target has at least average intellectual and financial resources, and where the investigative officials are narrowly specialized and obviously expert—where, in short, the only major difference from the typical agency decision to invoke a sanction is that the sanction is criminal, the Court has seemed singularly unconcerned about preserving the trial as a potent vehicle of administrative control. The clearest example of this is the tax evasion prosecution.<sup>6</sup>

Trends in tax prosecution have for at least two decades been continuously running against the main currents in criminal procedure. By subtle doctrinal manipulation, the courts confer more and more dis-

[4.] At least until very recently, some 80 to 90 percent of cases in which the criminal process was invoked ended in guilty or *nolo* pleas. See 1964 DIRECTOR OF THE ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS ANN. REP. 256. In the typical criminal case, therefore, there is no judicial determination of guilt in any real sense; these decisions are made by police and prosecutors. This condition is due to the willingness of courts to permit interrogation of suspects incommunicado, the reluctance or inability of courts to provide competent defense counsel, the alacrity with which all but a few judges reward guilty pleas with comparatively light sentences (see Note, 112 U. PA. L. REV. 865 (1964); Comment, 66 YALE L.J. 204 (1956)), and to subtle shifts in the procedures of the trial itself which make it more difficult for the accused to avoid conviction (see Goldstein, *The State and The Accused: Balance of Advantage in Criminal Procedure*, 69 YALE L.J. 1149 (1960)). Some of these conditions are rapidly being changed. For an unusually perceptive analysis of current trends, see Packer, *Two Models of the Criminal Process*, 113 U. PA. L. REV. 1 (1964).

[5.] Several of the Supreme Court's epochal decisions in the criminal process have involved defendant's under death sentences, e.g., *Griffin v. California*, 380 U.S. 609 (1965). New standards have also frequently been set in cases involving particular criminal sanctions whose efficacy and justness are most dubious, e.g., *Massiah v. United States*, 377 U.S. 201 (1964) (narcotics), *Malloy v. Hogan*, 378 U.S. 1 (1964) (gambling), *Jones v. United States*, 357 U.S. 493 (1958) (illegal liquor transactions). In virtually all other cases in which the police have been curbed, the accused has been inordinately poor and ignorant, e.g., *Miranda v. Arizona*, 384 U.S. 436 (1966), *Escobedo v. Illinois*, 378 U.S. 478 (1964), *Gideon v. Wainwright*, 372 U.S. 335 (1963), *Douglas v. California*, 372 U.S. 353 (1963). Of course the Supreme Court speaks in these cases in terms of broad principles seemingly applicable to all areas of the criminal process, but what seems so often isn't.

[6.] Other less pervasive examples are antitrust and securities regulation. See Comment, *Discovery In Criminal Antitrust Cases*, 64 COLUM. L. REV. 735 (1964); Bork, *A General Appraisal*, 1963 N.Y.S.B.A. ANTITRUST LAW SYMPOSIUM 111 (1963); Spiegel, *The Antitrust Civil Process Act: The Attorney-General's Pre-action Key to Company Files*, 10 VILL. L. REV. 413 (1965); Ruck & Youngquist, *Commingle Civil and Criminal Proceedings: A Peek at Constitutional Limitations and a Poke at the SEC*, 34 GEO. WASH. L. REV. 527 (1966).

cretion on invoking officials and reduce the roles of judge and jury. The judge's role is limited by his abdication of responsibility to define the offense and to determine the sufficiency of evidence. The jury's function is restricted by a procedural panoply which prevents a full and fair test of the Government's proofs.

The main support for a different course of doctrinal development in tax prosecutions than in criminal procedure generally is the fact that civil and criminal sanctions apply to the same conduct and are invoked by the same officials. Tax agents act in a dual capacity, making their investigations ambiguous and creating powerful pressures for self-incrimination. Courts frequently confer procedural advantages upon the Government, and deny them to the accused, by labelling the problem as one of "civil" or "criminal" procedure, as the context requires. A tax prosecution is a procedural hybrid.

### I. The Definition of the Offense

Vagueness of definition, a standard source of administrative discretion,<sup>7</sup> is a significant feature of criminal tax sanctions.<sup>8</sup> Section 7201 of the Internal Revenue Code authorizes infliction of five years in prison, a \$10,000 fine and costs of prosecution upon "any person who willfully attempts in any manner to evade or defeat any tax . . . or the payment thereof."<sup>9</sup> Courts agree that there can be no conviction under this statute unless the defendant failed to pay all the income tax that was due.<sup>10</sup> It is not enough that the taxpayer made false entries in his return and thought he was cheating; his efforts must actually have produced a deficiency. Many courts go further and require that the deficiency be "substantial,"<sup>11</sup> though underpayment of a few hundred dollars has been held sufficient.<sup>12</sup>

[7.] See generally, Kadish, *Legal Norm and Discretion in the Police and Sentencing Process*, 75 HARV. L. REV. 904 (1962); Remington and Rosenblum, *The Criminal Law and the Legislative Process*, 1960 U. ILL. L. FOR. 481 (1960).

[8.] Vagueness may also enhance the deterrent effect of a sanction in that uncertainty may scare away many who otherwise would press close to the line of legality. *But see* Goldstein, *Conspiracy to Defraud the United States*, 68 YALE L.J. 405, 443-447 (1959).

[9.] Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall . . . be guilty of a felony and, upon conviction thereof, shall be fined not more than \$10,000, or imprisoned not more than five years, or both, together with costs of prosecution.  
INT. REV. CODE OF 1954, § 7201 [herein after cited as I.R.C.].

[10.] *Sansone v. United States*, 380 U.S. 343, 351 (1965); *Lawn v. United States*, 355 U.S. 339, 361 (1958); *Willingham v. United States*, 289 F.2d 283, 285 (5th Cir.), *cert. denied*, 368 U.S. 828 (1961); *BALTER, TAX FRAUD AND EVASION* § 11.4-5 (3d ed. 1963).

[11.] See, e.g., *Canaday v. United States*, 354 F.2d 849, 851 (8th Cir. 1966); *United States v. Nunan*, 236 F.2d 576, 585 (2d Cir. 1956), *cert. denied*, 353 U.S. 912 (1957).

[12.] *Janko v. United States*, 281 F.2d 156 (8th Cir. 1960), *rev'd on other grounds*, 366 U.S. 716 (1961).

Besides having underpaid his taxes, the defendant must have engaged in some affirmative act, the "likely effect of which would be to mislead or conceal."<sup>13</sup> The usual affirmative act of attempted tax evasion is the filing of a false income tax return.<sup>14</sup> A taxpayer may be convicted of attempting to evade payment of taxes even though he filed no return, however, or even if he filed a correct return but failed to pay his full tax, if there is evidence of some act of deception such as a false statement to revenue agents,<sup>15</sup> willful falsification or destruction of books and records, or any other act of concealment or subterfuge.<sup>16</sup>

The affirmative act is an offense if accompanied by "willfulness." This means, first, that at the time of the act the taxpayer knew he had a tax deficiency. His knowledge of the tax law and of the contents of his return are therefore elements of willfulness.<sup>17</sup> Second, the affirmative act must have been motivated, at least in part, by a desire to defeat the Government in its efforts to collect the tax deficiency.<sup>18</sup> Third, the state of mind accompanying the act must have included a "bad purpose" or "evil motive."<sup>19</sup>

With an Internal Revenue Code of more than half a million words strung together in sentences and clauses of unsurpassed complexity, supported by policies often both vague and contradictory, it is not unusual for a taxpayer to have an honest doubt about the treatment of a particular item—whether it is ordinary income or capital gain, exempt or taxable, subject to special credits and allowances, deductible in full or in part, a business expense or a personal one. Thus whether or not the taxpayer was aware of the falsity of his return is often, potentially at least, an issue of consequence, apart from the question of whether there was a deficiency. The proper tax treatment will sometimes be sufficiently uncertain to justify letting the jury determine not only what the defendant thought was the tax law governing a particular

[13.] *Spies v. United States*, 317 U.S. 492, 499 (1943).

[14.] *Achilli v. United States*, 353 U.S. 373, 377 (1957); *United States v. Raub*, 177 F.2d 312 (7th Cir. 1949).

[15.] *United States v. Beacon Brass Co.*, 344 U.S. 43 (1952).

[16.] *Cohen v. United States*, 297 F.2d 760 (9th Cir.), *cert. denied*, 369 U.S. 865 (1962); *United States v. Mollet*, 290 F.2d 273 (2d Cir. 1961); *United States v. Schipani*, 362 F.2d 825, 831 (2d Cir. 1966), *cert. denied*, 35 U.S.L. WEEK 3166 (U.S. Nov. 8, 1966).

[17.] See, *James v. United States*, 366 U.S. 213 (1961) (opinion of Warren, C.J.); *Wardlaw v. United States*, 203 F.2d 884 (5th Cir. 1953); *United States v. Martell*, 199 F.2d 670 (3d Cir. 1952), *cert. denied*, 345 U.S. 917 (1953); *Lurding v. United States*, 179 F.2d 419 (6th Cir. 1950); *Haigler v. United States*, 172 F.2d 986 (10th Cir. 1949).

[18.] *Spies v. United States*, *supra* note 13.

[19.] *Spies v. United States*, *supra* note 13 ("evil motive and want of justification"); *Armstrong v. United States*, 327 F.2d 189, 196 (9th Cir. 1964) ("bad faith and evil motive"); *Ballantyne v. United States*, 293 F.2d 112, 116 (5th Cir.), *cert. denied*, 369 U.S. 802 (1962) ("bad and evil purpose").

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item, but what it really was. For example, if an increase in wealth is claimed to have been an exempt gift, the question of taxability is "basically one of fact" to be decided by the jury drawing upon its "experience with the wellsprings of human conduct."<sup>20</sup> Herein lies a quagmire.

Whether the taxpayer is aware at the time he files the return of the proper tax treatment of an item will always be a matter of degree. He may be virtually certain that his handling of an item in the return is legally false, may appraise the probabilities of falsity at about 50-50, or may think there is little likelihood that an omitted item is income or a deducted item is non-deductible. The courts have not even suggested what degree of awareness constitutes "willfulness."

The question is further clouded by uncertainty as to what the taxpayer must have been rather sure of in order for him to have known his return was false. He is charged with making a prediction of his own obligations and failing to comply with the obligations as he perceived them. The prediction is apparently of hypothetical attitudes of decision-makers: what they would decide about the item if they knew about it. But who are the relevant decision-makers? Is a taxpayer's return willfully false if he omits as income an item which he believes the local agents would regard as taxable, but which he thinks a court would hold non-taxable? Or which he believes would be held a question for a jury? The courts have furnished no answers.<sup>21</sup>

The taxpayer's knowledge of the facts treated in his return is also often a matter of degree. He may have remained ignorant of the contents of the return or of his books and records in order to avoid learning the truth, or because he was indifferent to the possibilities of error, or simply because he placed faith in his accountant.<sup>22</sup>

[20.] *Comm'r v. Duberstein*, 363 U.S. 278 (1960) (a civil case). For a criminal case to the same effect, see *United States v. Burdick*, 214 F.2d 768 (3d Cir. 1954), *cert. denied*, 350 U.S. 831 (1955). See also, *Cohen v. United States*, *supra* note 16 (jury permitted to find that putative loans to taxpayer were income because taxpayer had no intent to repay); *United States v. Johnson*, 319 U.S. 503 (1942) (jury permitted to find that defendant was, contrary to his pretensions, the real owner of a gambling enterprise, hence the real owner of its profits); *Clawson v. United States*, 198 F.2d 792 (9th Cir. 1952), *cert. denied*, 345 U.S. 914 (1953) (jury permitted to determine that money from sale of corporate property retained by taxpayer was a constructive dividend); *Davis v. United States*, 226 F.2d 331 (6th Cir. 1955), *cert. denied*, 350 U.S. 965 (1956) (same).

[21.] Court opinions and jury instructions seem virtually oblivious to these problems, referring vaguely to the taxpayer's "actual knowledge of the existence of the obligation to pay his tax. . . ." *United States v. Shavin*, 320 F.2d 308, 313 (7th Cir.), *cert. denied*, 375 U.S. 944 (1963), or "a tax imposed by the income tax laws." *Lee v. United States*, 238 F.2d 341, 345 n.16 (9th Cir. 1956). See generally the instructions approved in various cases set out in *La Buy, Manual on Jury Instructions in Federal Criminal Cases*, 36 F.R.D. 457, 555 (1965). The Supreme Court recently added to confusion in *James v. United States*, *supra* note 17. See *Nordstrom v. United States*, 360 F.2d 734 (8th Cir. 1966).

[22.] *Cf. Imeson v. Comm'r*, 14 T.C. 1151 (1950).

Finally, even if the taxpayer knowingly filed a false return, he may not always have done so with a "bad purpose or evil motive." One who intentionally understates his obligations by a relatively small amount is not guilty of a felony, for the understatement must be "substantial." The meaning of "substantial," however, is far from clear.<sup>23</sup>

Millions of taxpayers are arguably guilty of attempting to evade tax, and most of them are arguably innocent too. Yet the courts contribute little in deciding guilt or innocence or in assisting the jury in doing so. As the law stands, almost anyone with income above the subsistence level is a potential criminal defendant.

### The Role of the Hunch in Disposing of Issues

A tax evasion case may involve the following issues: (1) Was there a tax deficiency? (2) Was it substantial? (3) Did the taxpayer know that his return included the deduction or excluded the income which produced the deficiency? (4) Did he know that the item in question was not taxable in the manner in which it was treated in his return? (5) Did he, if he filed a return which he knew to be false, do so with an "evil motive and bad purpose?" Or, did he, if he filed a correct return or filed no return at all, engage in "an affirmative act the likely effect of which was to mislead or conceal" income or assets from the IRS and thereby to avoid payment of his taxes? The jury has the predominant role in giving concrete meaning to these concepts and, in order legitimately to convict, must resolve all of the issues against the defendant.

It will usually be impossible for the taxpayer at trial to present a plausible defense on each of the above issues. For several reasons, he will have to select one or two and virtually to concede the others. A stance on one issue may logically preclude a defense on another—defending in the alternative may be lawful yet tactically ruinous. Often a narrowed focus can gather persuasive power from the concession of other points. Moreover, a broad defensive posture may appear, because of its breadth, to be suspect *in toto*. Finally, a defense which disputes every element of the prosecution's case risks confusing the trier of fact

[23.] See Lipton and Petrie, *The Substantial Understatement Requirement in Criminal Tax Fraud Cases*, N.Y.U. 19th INST. ON FED. TAX 1175 (1961). There are, moreover, instances in which a clearly substantial deficiency may have resulted from intentional misstatement on the return, yet where, at least arguably, the requisite "evilness and bad purpose" do not exist. *E.g.*, where a taxpayer mistakenly believes that it is a crime to file a return showing tax due without enclosing full payment, and, unable to pay his full tax and desiring to avoid committing a crime, understates his income with the intention of filing an amended return and paying up when he gets the money. For other possible instances, see Crowley, *Bargaining Position or Fraud in Claiming Deductions*, N.Y.U. 19th INST. ON FED. TAX 1159 (1961).

with the result that the cogency of the Government's case on some issues may inadvertently transfuse weaker points. Thus while a defendant may theoretically put the Government to its proof on every issue, he will virtually always make a serious tactical blunder if he in fact strenuously contests every point.

The less defendant knows about the Government's case, the more he must rely on hunches in deciding which issues to press, and the larger the risk that he will tacitly concede the truth of the frailest fragment of the Government's case. The less the defense knows about the Government's proof and strategies, therefore, and the later in the process that the knowledge is acquired, the greater the risk of convicting the innocent.

### II. The Prosecution's Burden of Proof

By defining burdens of proof and allocating duties to produce evidence, the courts can greatly affect the risks of error attributable to pre-trial ignorance of the evidence and strategies of the opposition. If the defendant appears unduly hampered by ignorance, the burden on the Government to make a *prima facie* case can be increased so that the cogency of its proof may virtually eliminate risks to defendant resulting from erroneous strategic or investigatory decisions.

If, on the other hand, the Government is thought to be inordinately disadvantaged in pre-trial preparations, the prosecution's burdens can be relaxed. It may be excused from presenting evidence on certain issues until defendant comes forward. Thus, the Government may be required only to adduce evidence of a deficiency, with the question of willfulness tacitly treated as a matter of defense. This adjustment can be rationalized to conform to the principle that the prosecution bears the burden on every element of the offense simply by saying that evidence of a deficiency is, in effect, evidence on every issue; it alone supports an inference of willfulness. A court may go further and hold that even evidence of an explanation for the deficiency, such as mistake of law or ignorance of the contents of the return, does not keep the case from getting to the jury—it merely presents a question of credibility.

The Government's traditional obligation to prove every element of the offense "beyond a reasonable doubt" is one of the most nebulous and pliant responsibilities in the trial process. It means what the courts make it mean. Some seem to think it has virtually nothing to do with the judge's role in controlling the jury, or with what the Government must prove to support a conviction when judicially reviewed, but is

merely a precatory admonition to the jury.<sup>24</sup> Others construe it as a significant limitation on the power of a jury to convict.<sup>25</sup> But the latter meaning seems seldom to be given to the concept in tax fraud prosecutions.<sup>26</sup> The prevailing practice of most courts seems to reflect the belief that the prosecution is unduly disadvantaged in trial preparation, that there is little need for the judge to evaluate the evidence independently, and that the jury may safely be trusted to sift the innocent from the guilty with tolerable accuracy. Thus the government is able to get its case to the jury with a minimum of evidence and the jury is given broad discretion to convict or acquit.

## Methods of Proof

### A. *Specific Items Proof*

A large part of the prosecution's proof in virtually every tax evasion case is circumstantial. Sometimes the deficiency can be proved by direct evidence, but the other elements of the offense will almost always be inferred indirectly. Thus, if the Government can show by direct evidence that the return was false, the facts that the defendant filed the return, knew that it was false, and intended to evade his tax obligations will all normally be inferred from the nature of the understatement (its size and character may be such that it would probably not have been overlooked),<sup>27</sup> defendant's experience in tax and business affairs (implying that he knew the proper tax treatment of the item in question),<sup>28</sup>

[24.] See, e.g., *United States v. Valenti*, 134 F.2d 362, 364 (2d Cir.), *cert. denied*, 319 U.S. 761 (1943) ("The requirement of proof beyond a reasonable doubt is a direction to the jury, not a rule of evidence, . . . it cannot be accorded a quantitative value other than as a cautionary admonition"); *United States v. Feinberg*, 140 F.2d 592, 594 (2d Cir.), *cert. denied*, 322 U.S. 726 (1944) ("given evidence from which a reasonable person might conclude that the charge in the indictment was proved, the court will look no further. . . ."); *United States v. Castro*, 228 F.2d 807, 808 (2d Cir.), *cert. denied*, 351 U.S. 940 (1956) (" . . . the only difference between a civil action and a criminal prosecution is in the instruction that must be given to the jury. . . ."); see generally Goldstein, *supra* note 4, at 1159.

[25.] *Isbell v. United States*, 227 Fed. 788, 792 (8th Cir. 1915): "Unless there is substantial evidence of facts which exclude every other hypothesis but that of guilt it is the duty of the trial judge to instruct the jury to return a verdict for the accused." See cases collected in Note, *Sufficiency of Circumstantial Evidence in a Criminal Case*, 55 COLUM. L. REV. 549 (1955).

[26.] See *Holland v. United States*, 348 U.S. 121, 140 (1954) ("If the jury is convinced beyond a reasonable doubt, we can require no more."); *United States v. Costello* 221 F.2d 668, 671 (2d Cir. 1955) *aff'd*, 350 U.S. 359 (1956) (" . . . as in all criminal prosecutions, the prosecution makes out a sufficient case to go to the jury, if the evidence would have been enough in a civil action . . .").

[27.] See, e.g., *Conford v. United States*, 336 F.2d 285 (10th Cir. 1964); *Sherwin v. United States*, 320 F.2d 137 (9th Cir. 1963).

[28.] See, e.g., *Foley v. United States*, 290 F.2d 562 (8th Cir.), *cert. denied*, 368 U.S. 888 (1961); *Wallace v. United States*, 281 F.2d 656 (4th Cir. 1960) (lawyer—C.P.A.); see also *United States v. Alker*, 260 F.2d 135 (3d Cir. 1958), *cert. denied*, 359 U.S. 906



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his signature on the return and the fact that it was received in the mail by the IRS (suggesting that he knew the contents of the return and mailed it).<sup>29</sup> Ordinarily, therefore, when the Government can show by business records or direct testimony that a substantial portion of the defendant's gross income was omitted from the return, it has made a *prima facie* case. It is up to the defendant to adduce evidence of mistake, ignorance, or honest motives.<sup>30</sup>

Tax evasion is not usually proved by the defendant's own records alone, however. A tax evader will frequently fail to keep records which clearly show his evasion or will keep such records out of Government hands.<sup>31</sup> Thus, while the taxpayer's records will often be used, they will usually have to be supplemented with other evidence. When the defendant's records are inadequate, there are two basic methods of proving directly the falsity of the return. The first is by the testimony of an "inside witness"—defendant's bookkeeper, secretary, or former spouse<sup>32</sup>—who testifies that the defendant salted away some income before it was recorded in the books, or that he padded his deductions. The second method is to use witnesses who had transactions with the defendant which do not jibe with the transactions reported in the return. Thus, if a witness testifies that he paid the defendant a salary

(1959) (tax lawyer); *Fisher v. United States*, 212 F.2d 441 (10th Cir. 1954) (defendant's claim of ignorance and oversight rebutted by introducing a booklet he had written entitled, "Mind Your Own Business," which dealt in part with keeping accurate records).

[29.] It is not always necessary, however, that defendant have signed the return. That he knew its contents and caused it to be mailed may be inferred rather easily. See *Canton v. United States*, 226 F.2d 313 (8th Cir. 1955), *cert. denied*, 350 U.S. 965 (1956).

[30.] See, e.g., *Black v. United States*, 353 F.2d 885 (D.C. Cir. 1965), *rev'd on other grounds*, 87 Sup. Ct. 190 (1966); *United States v. Shavin*, *supra* note 21; *United States v. Goldberg*, 330 F.2d 30 (3d Cir.), *cert. denied*, 377 U.S. 953 (1964). It is unnecessary for the Government to prove that *taxable* income was understated; the possibility that the defendant was entitled to deductions which he did not claim, which omitted deductions would virtually eliminate a deficiency, need not be precluded by the Government. The burden of proving unclaimed deductions is on defendant. See *Black v. United States*, *supra*; note 49 *infra*.

Tax prosecutions are, of course, not limited to instances where gross income was allegedly underreported. Criminal cases are frequently brought for claiming excessive or entirely phoney deductions. See, e.g., *United States v. Ragen*, 314 U.S. 513 (1942). In such an event, the Government must adduce evidence of the falsity of the deductions. Prosecutions are also occasionally based upon illegal dependency exemption claims, *Janko v. United States*, *supra* note 12, and on the reporting of ordinary income as capital gain, e.g., *United States v. Schwartz*, 325 F.2d 355 (3d Cir. 1963). By far the most numerous of specific item cases, however, are based upon the omission of gross income from the return.

[31.] There are, however, many cases in which the defendant's records have been the foundation of the Government's case. See, e.g., *Miller v. United States*, 354 F.2d 801 (8th Cir. 1966); *United States v. Goldberg*, *supra* note 30; *Moore v. United States*, 254 F.2d 213 (5th Cir. 1958), *cert. denied*, 357 U.S. 926 (1958).

[32.] See, e.g., for prosecutions relying on the testimony of former spouses, *Janko v. United States*, *supra* note 12; *Canaday v. United States*, 354 F.2d 849 (8th Cir. 1966); *Barsky v. United States*, 339 F.2d 180 (9th Cir. 1964).

or a bribe, and his tax return includes only "capital gains" and "business income," there is evidence of unreported income.<sup>33</sup> Likewise, a claimed deduction can be shown false by the testimony of the person to whom it was supposedly paid.<sup>34</sup> This method is hampered by the typically vague entries in a tax return. Specific sources of income, or recipients of deducted expenses, are seldom detailed in the return itself. Usually, there are merely general headings like "business income" or "travel and entertainment expense." In such cases, testimony by an individual that he paid the defendant a sum of money, or that he was not paid any money by the taxpayer, will prove little unless buttressed by records or admissions of the defendant which detail the vague entries in the return.<sup>35</sup> If the defendant's records are not available, a deficiency might be proved by gathering together enough such persons to collectively account for more than the income reported. But this would often require the location and production of dozens, sometimes hundreds, of witnesses.<sup>36</sup> Rarely have only a few individuals been the source of more income than can be encompassed under some broad category in the taxpayer's return. Careful evaders, therefore, can often make detection and proof of guilt very difficult if they cheat in secret and make entries in the return which are nebulous enough to cover almost any items provable by the prosecution.<sup>37</sup>

### B. *Circumstantial Proof of Deficiencies*

Since testimonial proof of the falsity of specific items in the return is often cumbersome and costly, if not impossible, the Government had to develop techniques of proving every element of the case circumstantially. These techniques were first used against racketeers in the 30's.<sup>38</sup>

[33.] See, e.g., *Conford v. United States*, *supra* note 27, (stock sales proved through defendant's broker were not reflected on return); *Black v. United States*, 309 F.2d 331 (8th Cir. 1962), *cert. denied*, 372 U.S. 934 (1963) (unreported dividends from mutual fund).

[34.] See *Zacher v. United States*, 227 F.2d 219 (8th Cir. 1955), *cert. denied*, 350 U.S. 993 (1956) (deductions for church contributions proved false by the testimony of priests and officials of the churches that no such contributions were received).

[35.] *Dillon v. United States*, 218 F.2d 97 (8th Cir.), *petition for cert. dismissed*, 350 U.S. 906 (1955), where gross receipts were shown to have been omitted from the return by proving that they were not recorded in the defendant's books, whereas the returns reflected the income that was recorded in the books, thus supporting the inference that the receipts were not included in the return; see also *United States v. Hornstein*, 176 F.2d 217 (7th Cir. 1949).

[36.] In *Foley v. United States*, *supra* note 28, the prosecution reconstructed the income of an attorney by calling as witnesses 113 former clients who had paid him fees for legal services. See also, *Brown v. United States*, 224 F.2d 845 (6th Cir.), *cert. denied*, 350 U.S. 912 (1955); *United States v. Shavin*, *supra* note 21.

[37.] See *United States v. Nunan*, *supra* note 11 (former Commissioner of Internal Revenue reported several thousand dollars in "other income.")

[38.] See *United States v. Wexler*, 79 F.2d 526 (2d Cir. 1935), *cert. denied*, 297 U.S. 703

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With judicial benediction, they produced convictions at a very high rate.<sup>39</sup> Since then, the Government has come to rely on indirect evidence to prove the deficiency in the typical tax prosecution. As the Supreme Court noted in 1954, indirect methods "have evolved from the final volley to the first shot in the Government's battle for revenue."<sup>40</sup>

The methods employed usually fall into one of three major patterns, each of which has its standardized procedures, thoroughly tested and approved in the courts. Each method permits the proof of unreported income with relatively few important witnesses.<sup>41</sup> And the key witnesses do not need coaxing, nor is there any danger that they will appear in court with impoverished memories, because they are usually internal revenue agents.<sup>42</sup> Each method can also be used without reliance on the defendant's books and records. The essence of each technique is to reconstruct certain changes in the indicia of a taxpayer's economic condition which imply that he had more taxable income than he reported. Since all that is required for the crime is a willfully false return which results in a substantial deficiency, it is unnecessary to prove whether the deficiency resulted from improper deductions or understatements of gross income.<sup>43</sup>

### 1. *The Net Worth Method*

The most frequently employed technique of reconstructing taxable income indirectly is the "net worth method." Its basic premise is that most increases in net worth are attributable to taxable income and, as the Supreme Court put it, "when this is not true the taxpayer is in a position to explain the discrepancy."<sup>44</sup> The Government offers evidence of the taxpayer's net worth at the end of the tax year in question, sub-

(1936); *Guzik v. United States*, 54 F.2d 618 (7th Cir. 1931), *cert. denied*, 285 U.S. 545 (1932); *Capone v. United States*, 51 F.2d 609 (7th Cir. 1931).

[39.] For a popular account of the Treasury's biggest victories during this period, see IREY, *THE TAX DODGERS: THE INSIDE OF THE T-MEN'S WAR WITH AMERICA'S POLITICAL AND UNDERWORLD HOODLUMS* (1948).

[40.] *Holland v. United States*, *supra* note 26, at 126:

[The net worth method's] horizons have been widened until now it is used in run-of-the-mine cases, regardless of the amount of the deficiency involved.

[41.] There are often numerous witnesses, but most of them merely provide routine authentication of business records.

[42.] Typically, an Internal Revenue agent will testify about the investigation, produce and explain charts which summarize the testimonial and documentary evidence the Government has introduced, and will testify about the nature and size of the indicated deficiencies, defendant's admissions, etc.

[43.] For a detailed analysis of indirect proof in tax cases, see Schmidt, *Reconstruction of Income*, 18 TAX L. REV. 23 (1962), 19 TAX L. REV. 277 (1964); Krasilovsky and Stein, *An Evaluation of Net Worth Prosecution of Federal Income Tax Evaders*, 7 OKLA. L. REV. 49 (1954).

[44.] *Holland v. United States*, *supra* note 26, at 126.

tracting from this figure his net worth at the beginning of the year, and adding to the difference (the increment in net worth) his non-deductible expenditures. The result is ostensibly the taxable income for the year. If this figure substantially exceeds the taxable income reported on the return, the jury is asked to infer that the return was willfully falsified by the defendant.<sup>45</sup>

Most net worth increases are probably attributable to taxable income. Accretions to net worth frequently are, however, the result of gifts, inheritances, life insurance proceeds and other non-taxable sources. Thus, there is a danger of error whenever a jury must speculate on the character of a particular increase.

But there is a more serious risk: that the evidence of a net worth increase is false or that the claimed increase indicated is a gross exaggeration. Since wealth may be owned in myriad forms and locations, few people other than the owner or members of his family are likely to know where all of it is kept. When the Government agents in a typical net-worth investigation canvass local banks, property records and stock brokers in a search for assets, they have not thereby excluded the real possibility that the taxpayer has assets elsewhere or under another name. Similarly, even the most resourceful agent may miscalculate net worth by overlooking the existence of liabilities.

Another risk is that non-deductible living expenses, which are added to the net worth increment to determine taxable income, may be exaggerated. The Government's evidence of expenditures is often a mere estimate supported by proof of specific expenditures on luxuries or large items such as homes, cars and fur coats.<sup>46</sup> And taxpayers seldom keep accurate records of their personal expenditures since they have little incentive to do so.

In sum, evidence of a net worth increase as a basis for inferring a deficiency requires all of the following inferences:

1. The items included in the computation of beginning net worth are correct, and do not exclude any assets owned by the accused on that date nor overstate his liabilities;
2. The estimate of taxpayer's non-deductible expenditures is not larger than the actual expenditures;

[45.] Whether there must be evidence of willfulness in addition to the deficiency is considered in detail at text accompanying notes 135-42 *infra*.

[46.] See *Burgin v. United States*, 297 F.2d 63 (6th Cir. 1961); *United States v. Coleman*, 272 F.2d 108 (2d Cir. 1959); *Smith v. United States*, 236 F.2d 260 (8th Cir.), *cert. denied*, 352 U.S. 909 (1956); *Dawley v. United States*, 186 F.2d 978 (4th Cir. 1951); *United States v. Caserta*, 199 F.2d 905 (3d Cir. 1952).

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3. The calculation of net worth at the end of the period does not exaggerate the taxpayer's assets and includes all of his debts;
4. The increase in net worth indicated by the computations was not the result of an exempt gift, an inheritance, life insurance proceeds, or other non-taxable accession to wealth.

If any one of these assumptions or inferences is wrong, the ultimate inference of unreported income is *pro tanto* also wrong.

### 2. *The Expenditures Method*

Evidence that a taxpayer spent considerably more money on non-deductible items during a given period than he reported as income indicates that he (1) lived in part off capital, or, (2) borrowed more money than he paid back during the period, or, (3) had non-taxable accessions to wealth, or (4) underreported his income. The first three possibilities, consistent with a correct return, probably occur in the aggregate at least as frequently as the fourth. Consequently, evidence that a taxpayer lived beyond his reported income will probably not alone support a conviction.<sup>47</sup> When the Government relies on the expenditures method, it apparently always lubricates it with something else—typically a beginning net worth too small to account for the expenditures, which excludes the possibility that the taxpayer lived off accumulated capital.<sup>48</sup> When employed in connection with evidence of beginning net worth, therefore, expenditures evidence is merely a variation of the net worth method. Proof of the ending net worth may be dispensed with because the expenditures during the period exceeded assets available at the beginning of the period plus reported income. If the beginning net worth and the expenditures evidence is correct, the taxpayer acquired wealth during the period which was not reported on his tax returns as income. He may have acquired it from loans, gifts, inheritances, tax exempt income or it may have come from taxable sources. The relative duties of the Government and the taxpayer to identify the sources, discussed hereafter, are the same as for the net worth method.

### 3. *The Bank Deposit Method*

The major premise employed in this method is that deposits to bank accounts are frequently gross income of the holder of the account, and when they are not, he can explain what they are. If a taxpayer reported

[47.] See *Dupree v. United States*, 218 F.2d 781 (5th Cir. 1955).

[48.] See, e.g., *Irving v. United States*, 241 F.2d 306 (7th Cir.), *cert. denied*, 353 U.S. 983 (1957); *Costello v. United States*, *supra* note 26; *Hooper v. United States*, 216 F.2d 684 (10th Cir. 1954).

\$10,000 taxable income, consisting of \$12,000 gross income less \$2,000 in deductions, the Government may offer evidence obtained from his bank that \$20,000 was deposited in his account during the year. The inference advanced is that defendant had \$20,000 of gross income, rather than the \$12,000 reported. To get from there to the ultimate inference that he understated his taxable income by \$10,000, the prosecution is aided by a presumption that the taxpayer claimed all the deductions to which he was entitled, even though he underreported his gross income.<sup>49</sup> Note, however, that at least the following contingencies must be excluded before reaching the ultimate conclusion: (1) the excess money which was deposited to defendant's account might have belonged to someone else; (2) the money could have been the proceeds of a loan, a gift, a sale of property, an inheritance, or exempt income such as life insurance proceeds, damages, or insurance payments for personal injuries; (3) the excess deposits might have been withdrawn previously from a bank account; (4) the money might have been acquired before the prosecution year and held for some time in cash before being deposited; (5) defendant might have understated his deductions as well as his gross receipts. If any of these possibilities is wrongly rejected, the inference that taxpayer underreported his taxable income by \$10,000 is false.

There are palpably so many exceptions to the assumption that bank

[49.] The Government satisfies its burden of proof when it shows that the taxpayer has received more income than was reported. It is then the taxpayer's burden to show, if he can, that, even though he received more income than he reported, he does not owe any additional tax. This rule is grounded on the realization that it would be virtually impossible for the Government to show the negative fact that a taxpayer had no unreported deductions or exclusions. In such a case, the Government, having shown unreported income, is aided by the presumption that the deductions and exclusions listed by a taxpayer in his return are all that exist. This presumption is based upon reasonable experience (taxpayers would not knowingly fail to report all valid deductions), and has the effect of shifting the burden of going forward with the evidence to the defendant, when the Government has shown unreported income. *United States v. Bender*, 218 F.2d 869, 871-72 (7th Cir.), cert. denied, 349 U.S. 920 (1955); accord, *Vardine v. United States*, 305 F.2d 60 (2d Cir. 1962). This is not a presumption which "disappears" when the defendant adduces evidence of unreported deductions. Even when he does so, the Government keeps its *prima facie* case. See *United States v. Stayback*, 212 F.2d 313 (3d Cir. 1954), cert. denied, 348 U.S. 911 (1955); *Zimmerman v. United States*, 108 F.2d 370 (7th Cir. 1939). A different rationale is supplied in *United States v. Hornstein*, *supra* note 35, where the court said that the deductions claimed by the taxpayer in his return constitute admissions as to the proper amount of allowable deductions and would thus support a conviction even where taxpayer testified that the deductions were greater than he claimed on his return.

Some criticisms should be noted. First, the rule may have less justification in a case built on indirect proof of gross receipts than where gross receipts are proved directly, because the Government's proof that income exceeded that reported is almost always weaker when proved indirectly. Secondly, the "reasonable experience" asserted in *Bender*, *supra*, is subject to exceptions. Thus, a taxpayer who is reimbursed for expenses of various kinds might very well regard this simply as non-income and would neither include it as gross receipts nor take his counterbalancing deductions. See *Black v. United States*, *supra* note 30.

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deposits constitute income that any inference to that effect, drawn from bank deposit evidence alone, is extremely weak.<sup>50</sup> It is strengthened somewhat if the evidence shows regular, periodic deposits rather than a few large sums, yet regularity of deposits is probably not a condition of using the method.<sup>51</sup>

When combined with evidence of a beginning net worth too small to account for the deposits, then bank deposit evidence is also merely a variation of the net worth method. The inference is that defendant had a flow of incoming cash which did not come from prior accumulations and which exceeded reported income. The bank deposit method, however, does not require the use of a beginning net worth.<sup>52</sup> Apparently, if the Government shows that defendant had a business which could produce substantial cash receipts and that he made deposits of such receipts in his accounts, it can make a *prima facie* case with bank deposit evidence alone, leaving it to the defendant to adduce proof that the deposits did not come from income, and leaving it to the jury to decide whether his proof is sufficient.<sup>53</sup>

### 4. *Mixed Methods*

The prosecution may prove its case with any of the foregoing three methods, or it may employ two or three simultaneously, or combine parts of one method with parts of another.<sup>54</sup> Moreover, the three indirect methods outlined above represent merely the three techniques commonly employed to construct a case. There is virtually no limit to the kinds of evidence which can be woven into a circumstantial web.<sup>55</sup>

[50.] See *Kirsch v. United States*, 174 F.2d 595 (8th Cir. 1949), one of the few reversals of a bank-deposit method conviction for insufficiency of evidence.

[51.] See *United States v. Doyle*, 234 F.2d 788 (7th Cir.), *cert. denied*, 352 U.S. 893 (1956).

[52.] *United States v. Doyle*, *supra* note 51; *Holbrook v. United States*, 216 F.2d 233 (5th Cir.) *cert. denied*, 349 U.S. 915 (1954); *Morrison v. United States*, 270 F.2d 1 (4th Cir. 1959), *cert. denied*, 361 U.S. 894 (1959); *Stinnett v. United States*, 173 F.2d 129 (4th Cir. 1949), *cert. denied*, 337 U.S. 957 (1949).

[53.] See *Graves v. United States*, 191 F.2d 579 (10th Cir. 1951); *Stinnett v. United States*, *supra* note 52; *Zimmerman v. United States*, *supra* note 49.

[54.] *United States v. Johnson*, *supra* note 20; *United States v. Calderon*, 348 U.S. 160 (1954). See generally, Schmidt, *Hybrid Methods of Reconstructing Income in Criminal Fraud Cases*, 47 A.B.A.J. 560 (1961). Frequently, of course, direct proof of specific items will be buttressed by indirect evidence; see, e.g., *United States v. Nunan*, *supra* note 11.

[55.] In *Brodella v. United States*, 184 F.2d 823 (6th Cir. 1950) and *Jelaza v. United States*, 179 F.2d 202 (4th Cir. 1950), the Government introduced, to buttress its other proof, evidence that reported profits of defendant's business were out of line with profits from other similar businesses. The Government has been especially resourceful in recent civil cases, e.g., *Estate of Mac Crowe*, 14 CCH Tax Ct. Mem. 238 (1955), *vacated and remanded*, 264 F.2d 621 (4th Cir. 1959) (income of abortionist reconstructed with evidence of average fee he charged, number of morphine tablets he purchased, and his practice of giving each patient one pill); *D & H Bagel Bakery, Inc.*, 14 CCH Tax Ct. Mem. 100 (1955) (income of Bagel Bakery reconstructed by applying an industry-wide estimate of the number of

## Defendant's Admissions—The Bedplate of the Typical Case

Revenue agents who suspect fraud usually attempt to build the basis for a net worth case by asking the taxpayer during the investigation for a net worth statement showing changes for each of several years, and including annual non-deductible expenditures. They often get what they ask for.<sup>56</sup> One reason is that the IRS will frequently not consider an offer of compromise without a net worth statement.<sup>57</sup> Thus, if the taxpayer wants to settle a deficiency without criminal prosecution, the price may include not only back taxes and penalties but a detailed net worth statement.<sup>58</sup> Yet negotiations for compromise, even acceptance of a compromise of civil liability, does not preclude a criminal prosecution nor make the statements obtained in such negotiations inadmissible.<sup>59</sup>

Frequently, of course, taxpayers will not be so cooperative as to provide a written net worth statement which reveals substantial disparities between net worth accretions and reported income. The IRS may attempt to get one orally, however, and often succeeds. In *Vloutis v. United States*,<sup>60</sup> for example, the IRS agents had defendant, "an elderly man who reads and writes with difficulty, if at all," come with his bookkeeper to the IRS office, where defendant was put under oath and asked 131 questions. Among the 131 was, "How much, Mr. Vloutis, was your net worth at December 31, 1941?" (This was more than four and one-half years later, August 16, 1946.) At first, defendant said, "I don't recall, I don't remember." Later, when the question was repeated, he said, "I must have had about \$40,000 or \$50,000 at the time." The statement was used to establish his beginning net worth.<sup>61</sup>

bagels produced from 100 pounds of flour to the quantity of flour purchased by the taxpayer, then multiplying the result by the average wholesale price of bagels).

[56.] See, e.g., *Scanlon v. United States*, 223 F.2d 382 (1st Cir. 1955); *Smith v. United States*, 348 U.S. 147 (1954); *United States v. Burdick*, 214 F.2d 768 (3d Cir. 1954), *cert. denied*, 350 U.S. 831 (1955); *United States v. Calderon*, *supra* note 54.

[57.] An offer of compromise based upon inability to pay normally must be accompanied by a detailed financial statement. *BALTER, TAX FRAUD AND EVASION* § 7.5-1 (3d ed. 1963).

[58.] The dynamics of the investigation and negotiation process are considered in detail at text accompanying notes 151-82 *infra*.

[59.] See *Shotwell Mfg. Co. v. United States*, 371 U.S. 341 (1963); *McCue v. United States*, 178 F. Supp. 426 (D.C. Conn. 1959), *aff'd*, 301 F.2d 452 (2d Cir.), *cert. denied*, 370 U.S. 939 (1962); *Smith v. United States*, *supra* note 56.

[60.] 219 F.2d 782 (5th Cir. 1955).

[61.] The case was reversed, however, for erroneous instructions and for permitting an IRS agent to give an unsupported opinion that there was no cash on hand. *Ibid.* For a similar statement which was the starting point in the Government's calculations, see *Bostwick v. United States*, 218 F.2d 790 (5th Cir. 1955). There defendant was asked, in 1951, "Could you tell us how much you had on hand at that time?" He replied, "No, I can't tell you about 1941, but I know what I had in 1939—that is, when I got married. I told my wife what I had. I had around \$50,000.00. I had that in cash money. When I got married, I had an apartment house and one other house, an automobile, and some



As the Supreme Court said about the hazards to the innocent in a case based upon statements of this sort, "When a revenue agent confronts the taxpayer with an apparent deficiency, the latter may be more concerned with a quick settlement than an honest search for the truth. Moreover, the prosecution may pick and choose from the taxpayer's statement, relying on the favorable portion and throwing aside that which does not bolster its position."<sup>62</sup> The statements are also of doubtful reliability because the taxpayer often does not know the facts. Few people can remember what their net worth was five or ten years before, except in the crudest sense.<sup>63</sup> Unreliability is compounded by the fact that the taxpayer is seldom more than vaguely aware of the utility of the statement to the prosecution and cannot know its precise purpose.<sup>64</sup> If, for example, a taxpayer were asked for a net worth statement for the beginning and end of 1960, he might reasonably assume that the agent was interested only in the difference between the two figures and that if particular assets were omitted at both ends, it would make no difference. Yet if the taxpayer is prosecuted for evading taxes for 1961, what he thought was an end-of-year figure will be used as a starting point for 1961, and the lower it is, the larger will be the indicated deficiency.

The unreflective verbal estimate presents a special difficulty. When a taxpayer blurts out a figure in response to a query as to his net worth on a particular date, there is a substantial risk of misconstruing his meaning. When he says his "net worth" was "\$40,000 or \$50,000," he may be thinking primarily of his assets and may forget about liabilities, producing a net worth estimate which is considerably exaggerated. If, instead of asking taxpayer for his "net worth," the agents ask more specific questions, such as "How much cash did you have on. . . ?", the figure given by the taxpayer may represent his recollection of the cash in his safe deposit box, or the cash he had in his safe deposit box plus

diamonds, and stock. This is besides my \$50,000.00 cash. I probably had some mortgages because I had some money loaned out." 218 F.2d at 793.

[62.] *Holland v. United States*, *supra* note 26.

[63.] See *Smith v. United States*, *supra* note 56, where defendant gave the Government a net worth statement which revealed substantial disparities between net worth increases and reported income, yet which, according to the Government's own computations, understated the *beginning* net worth by more than \$20,000.

[64.] See, *e.g.*, *Hooper v. United States*, *supra* note 48, where agents asked defendant if he kept any large sums of cash in his safe. Doubtless thinking that an affirmative answer would be harmful (it would not only be a suspicious circumstance but could increase an ending net worth figure), defendant, in the presence of his counsel, said no, and later repeated the statement in an affidavit. On the basis of the statements, the Government credited defendant with only \$400 cash on hand at the beginning of the prosecution period. At the trial, defendant testified that he kept up to \$12,000 in the safe. The jury, however, did not believe him.

his bank account or almost anything else.<sup>65</sup> "Cash," like most concepts, is a chameleon. If he is asked if he has any "outstanding loans," he may interpret this to mean debts he owes others, debts owed by others to him, or both. His response may not reveal his interpretation. Even if it does, the agent who testifies in court may leave out that part.

The Government's use of the taxpayer's statements to build up a net worth case, moreover, is not limited to statements obtained by the agents from the defendant. Any statement which the accused has ever made to anyone which relates to his financial condition is admissible against him. Balance sheets submitted as part of a loan application are frequently used,<sup>66</sup> as are statements to credit agencies<sup>67</sup> and insurance companies.<sup>68</sup> The Government has even used a statement defendant made to his parole board while he was in prison to the effect that he had no substantial assets;<sup>69</sup> in another case, a letter written by defendant to a veteran's hospital stating that he was unable to pay for medical treatment.<sup>70</sup>

The prosecution may rest upon statements made several years before the period for which the defendant is being prosecuted.<sup>71</sup> Time alone renders them unreliable. The cogency of a statement made to third parties may also be undercut by the obscurity of the taxpayer's motives when he made the statement; his propensity to distort items may not be properly gauged by the jury. It might be assumed, for example, that one has no interest in minimizing net worth when applying to a bank for a loan; that exaggeration of net assets is the only real risk involved in giving weight to the statement. But a millionaire applying for a \$10,000 bank loan has little reason to include his last pfennig on a

[65.] See *United States v. Calderon*, *supra* note 54.

[66.] *Friedberg v. United States*, 348 U.S. 142 (1954); *Blackwell v. United States*, 244 F.2d 423 (8th Cir.), *cert. denied*, 355 U.S. 838 (1957); *Bateman v. United States*, 212 F.2d 61 (9th Cir. 1954); *Mitchell v. United States*, 208 F.2d 854 (8th Cir. 1954), *vacated and remanded*, 348 U.S. 905 (1955), *reaffirmed*, 221 F.2d 554 (8th Cir.), *cert. denied*, 350 U.S. 832 (1955) (*held*, fact that statement to bank reflected market values rather than cost did not make it inadmissible); *United States v. Norris*, 205 F.2d 828 (2d Cir. 1953).

[67.] *Epstein v. United States*, 246 F.2d 563 (6th Cir.), *cert. denied*, 355 U.S. 868 (1957) (statement to Dun & Bradstreet).

[68.] *United States v. Burdick*, *supra* note 56.

[69.] *Smith v. United States*, *supra* note 46. See also *United States v. Schipani*, *supra* note 16 (statement to prison officials, thirteen years before indictment, used in net worth calculation).

[70.] *Hamman v. United States*, 340 F.2d 145 (9th Cir.), *cert. denied*, 380 U.S. 977 (1965).

[71.] *Hamman v. United States*, *supra* note 70 (six years); *Warring v. United States*, 222 F.2d 906 (4th Cir.), *cert. denied*, 350 U.S. 861 (1955) (prosecution for evading taxes for 1947, starting point was statement made in 1936 by taxpayer in connection with civil tax litigation with the Government); *Banks v. United States*, 223 F.2d 884 (8th Cir. 1955), *cert. denied*, 350 U.S. 986 (1956) (prosecution for evading taxes for 1945-47, starting point was statement made in 1937).

balance sheet and may even be motivated to minimize his assets, if a low net worth was necessary to qualify for the loan, or if he was contemplating a divorce and feared the statement would be used in the divorce proceedings by his wife. Yet, the Government is not required to introduce proof of the context in order to get the statement into evidence.<sup>72</sup>

The taxpayer's statements may also make the Government's expenditure or bank deposit case. The IRS can usually find out from stores, brokers, property records about large expenditures the taxpayer has made, but it may want to exclude the possibility that these expenditures were made from prior accumulated funds or assets acquired from non-taxable sources. The agents may therefore ask the taxpayer where he got the funds for particular expenditures, thus tying him to a story which can then hopefully be disproved.<sup>73</sup> Or they may ask if he had any assets on hand on a particular date or received any large gifts or inheritances.<sup>74</sup> In a bank deposit case, the agents can easily get the taxpayer's bank records but will want to get his explanation of the source of the deposits, and usually will get one.<sup>75</sup> Sometimes, explanations can be found in statements to third parties. Thus, in one case,<sup>76</sup> the taxpayer had testified in "a judicial proceeding in Holland" that he had obtained funds for the purchase of a house from his mother and two friends. The Government proceeded to prove that defendant's mother had not had the money to make such a gift and that the two friends had not supplied any money. The court held that the jury could infer from this evidence that the source of the money was taxable income which accrued during the prosecution period.

Finally, there is, in virtually every tax prosecution, the use of admissions implied by evasive or uncooperative conduct. While the IRS occasionally fails to get explicit admissions from the taxpayer, it is virtually never unable to buttress its evidence with the fact that the taxpayer when asked for his books and records, or a net worth statement, or some explanation, was evasive, uncooperative, or dilatory.<sup>77</sup> These kinds of

[72.] See cases cited in notes 66-71, *supra*.

[73.] See, e.g., *United States v. Holovachka*, 314 F.2d 345 (7th Cir.), *cert. denied*, 374 U.S. 809 (1963) (claim of cash hoard and loans); *United States v. Sclafani*, 265 F.2d 403 (2d Cir.), *cert. denied*, 360 U.S. 918 (1959) (claim of large gift from father-in-law); *Murray v. United States*, 297 F.2d 812 (2d Cir. 1958), *cert. denied*, 369 U.S. 828 (1962) (claim of loan from named person); *United States v. Nunan*, *supra* note 11 (claim of cash hoard).

[74.] *United States v. Doyle*, *supra* note 51.

[75.] See, e.g., *United States v. Ford*, 237 F.2d 57 (2d Cir. 1956), *vacated and remanded for mootness*, 355 U.S. 38 (1957).

[76.] *United States v. Adonis*, 221 F.2d 717 (3d Cir. 1955).

[77.] See, e.g., *United States v. Doyle*, *supra* note 51 (agents asked defendant six times for a net worth statement, offered to trade figures, defendant said he didn't know the facts well enough); *Beard v. United States*, 222 F.2d 84 (4th Cir.), *cert. denied*, 350 U.S. 846

admission have almost no probative value. There may be any of a hundred reasons why a taxpayer under investigation fails to cooperate or produce the desired explanations and many of these reasons may be consistent with innocence. Even if they may fairly be said to evidence consciousness of wrongdoing, however, they are unreliable because the taxpayer may be mistaken in his assumption that he has something to hide.<sup>78</sup>

### *Phantom Safeguards*

When it gave plenary consideration to net worth proof in tax prosecutions more than a decade ago,<sup>79</sup> the Supreme Court noted many perils to the accused presented by the methods but suggested safeguards which it thought would adequately protect the innocent. Noting that statements obtained from the taxpayer during an investigation of his tax returns may be unreliable, the Court held that such statements would not alone support conviction but must be corroborated.<sup>80</sup> The Court added that the beginning net worth must be established "with reasonable certainty,"<sup>81</sup> and that the Government must investigate "relevant leads furnished by the taxpayer" which are "reasonably susceptible of being checked," and would, "if true, establish the taxpayer's innocence."<sup>82</sup> Another "requisite to the use of the net worth method," the Court said, "is evidence supporting the inference that the defendant's net worth increases are attributable to currently taxable income."<sup>83</sup> A final requirement was proof of willfulness. Agreeing that willfulness "cannot be inferred from the mere understatement of income,"<sup>84</sup> the Court nonetheless held that willfulness was proved in the case at hand by "evidence of a consistent pattern of underreporting large amounts of

(1955) (defendant refused, on advice of counsel, to permit agents to examine his books); *Dillon v. United States*, *supra* note 35; (agent asked defendant about some checks and "the defendant declined to give any information other than that all of it was not income, which later the agent was not able to substantiate"); *United States v. Adonis*, *supra* note 76; (defendant "elected to stay away from the investigators who sought to interrogate him about his 1948 income.")

[78.] The premise that evasiveness or non-cooperation evidences consciousness of guilt is weakened in the tax context because such conduct frequently will mean no more than that the taxpayer apprehends that he may have a deficiency, which is quite different from consciousness of criminality. Yet the difference is one which may not readily leap to a juror's mind; moreover, the taxpayer's belief that he may have a deficiency can easily be in error. See text accompanying notes 19-20, *supra*.

[79.] *Holland v. United States*, *supra* note 26; *United States v. Calderon*, *supra* note 54; *Friedberg v. United States*, *supra* note 66; *Smith v. United States*, *supra* note 56.

[80.] *Smith v. United States*, *supra* note 56.

[81.] *Holland v. United States*, *supra* note 26, at 132.

[82.] *Id.* at 135-36.

[83.] *Id.* at 137.

[84.] *Id.* at 139.

income, and of the failure on petitioner's part to include all of their income in their books and records."<sup>85</sup>

In subsequent cases, defense lawyers have seized on each of these "requisites" as laying down rigid conditions which the Government's proof must meet before the case can go to a jury. The lower courts, however, have consistently either given the concepts little meaning or have left it to the jury to determine whether the requisites existed.

### 1. Corroboration of Admissions

In *Smith v. United States*,<sup>86</sup> the Supreme Court said that a defendant who had given IRS agents detailed net worth statements could not be convicted on these statements alone. Incriminating extrajudicial statements must be corroborated. The Court stated, however, that all that was necessary for corroboration of a taxpayer's admission was "substantial independent evidence that the offense has been committed" and that such "evidence does not have to prove the offense beyond a reasonable doubt, or even by a preponderance."<sup>87</sup> The Court also implied that statements of the taxpayer which are not made to agents while investigating defendant's tax returns do not need corroboration.<sup>88</sup> Lower courts have since ruled that statements made to a parole board by defendant while in prison do not require corroboration.<sup>89</sup> Likewise statements in a loan application.<sup>90</sup> Since the requirements are so slight,<sup>91</sup> however, the courts usually hedge by finding that corroboration exists.<sup>92</sup>

Another type of admission that may require no corroboration is the admission implied indirectly by an apparently self-serving or exculpatory statement, the self-serving aspect of which is disproved, disregarded, or accepted by the prosecution. Thus, where defendant claimed a large cash hoard in pre-trial statements and this was disproved, his claim was

[85.] *Id.* at 139.

[86.] Note 81 *supra*.

[87.] *Id.* at 156.

[88.] The Court's holding that corroboration is required was limited to the situation before it, where "the admission is made after the fact to an official charged with investigating the possibility of wrongdoing, and the statement embraces an element vital to the Government's case." *Id.* at 155.

[89.] *Smith v. United States*, *supra* note 46.

[90.] *Epstein v. United States*, *supra* note 67.

[91.] Tax returns prior to the prosecution period which show little reported income will probably suffice to corroborate a small beginning net worth statement, see *Banks v. United States*, *supra* note 71; *Smith v. United States*, *supra* note 46, as will evidence of financial deprivation or the borrowing of money during the pre-prosecution period, *United States v. Calderon*, *supra* note 54; *McFee v. United States*, 206 F.2d 872 (9th Cir. 1953), *reaffirmed*, 221 F.2d 807 (9th Cir. 1955), or a substantial increase during the prosecution period of visible assets, *Warring v. United States*, *supra* note 71; *United States v. Calderon*, *supra* note 54.

[92.] *Banks v. United States*, *supra* note 71; *Warring v. United States*, *supra* note 71.

apparently an implied admission that he had no other liquid assets—stocks, bonds, and the like—and excused the Government from disproving the possibility.<sup>93</sup> And where the defendant's claim of a large gift from his father-in-law was negated, his lie was apparently adequate to exclude all other possible non-taxable sources of the assets.<sup>94</sup> The corroboration problem is seldom even recognized in these cases. In *United States v. Adonis*,<sup>95</sup> the Third Circuit saw the problem but said it did not really exist. There, the defendant made several pre-trial statements claiming that he had obtained large sums from specific non-taxable sources. The court held that the jury could infer from these statements, if satisfied that they were false, that his lying "was an effort to conceal the fact and real sources of taxable gain in that year."<sup>96</sup> As for corroboration, the court said, "this is not a situation in which the Government relies upon an admission, which may require corroboration. The statement of the defendant is proved as a relevant fact. Independent evidence of its falsity is then introduced to show the significance of the statement."<sup>97</sup> The distinction the court makes is neither obvious nor persuasive. It is difficult to see why an exculpatory statement which the Government asserts is false in whole or in part is substantially more reliable to prove facts implied by it, as to which the Government claims the statement is true, than a statement which is non-exculpatory and which the Government asserts is all true.

A relevant Supreme Court case decided the same day the Court rendered the net worth decisions,<sup>98</sup> is *Opper v. United States*.<sup>99</sup> There, the defendant's pre-trial statement that he had delivered \$1,000 to a Government employee but that it was "strictly a loan," was relied upon by the Government to prove that he unlawfully had paid the money for services rendered by the Government employee. The Court held that the statement, though exculpatory, would not even suffice, without "substantial independent evidence," as proof that money was delivered.<sup>100</sup>

[93.] *United States v. Nunan*, *supra* note 11.

[94.] *United States v. Sclafani*, *supra* note 73. Since the defendant testified to the cash hoard at the trial, however, his testimony was arguably ample corroboration of his own pre-trial implied admission that he had no other substantial assets. And in so testifying, he probably waived any objection to the failure of the Government to prove the non-existence of other assets at the starting point. *Cf. United States v. Calderon*, *supra* note 54, at 164 n.1, 167.

[95.] Note 76 *supra*.

[96.] *Id.* at 719.

[97.] *Id.* at 719 n.1.

[98.] Note 79 *supra*.

[99.] 348 U.S. 84 (1954).

[100.] The Court rejected Wigmore's argument that corroboration is needed only of a

The same rule should apply in tax evasion cases. The decisions of lower courts since *Smith*, however, reveal a clear willingness to treat tax prosecutions as *sui generis* and to extend the duty of corroboration not an inch further than required by the Supreme Court. Thus the corroboration requirement is neither a significant hindrance to the prosecution nor an important safeguard to the accused.<sup>101</sup>

## 2. Reasonably Certain Evidence of Starting Point

The Supreme Court said in *Holland v. United States*, that "an essential condition in [net worth cases] is the establishment, with reasonable certainty, of an opening net worth, to serve as a starting point from which to calculate future increases in the taxpayer's assets."<sup>102</sup> The Court did not make clear, however, whether this was to be a condition imposed by the trial judge on a motion for acquittal or was merely to be a *caveat* to the jury. The lower courts seem to think it is the latter.

It is by no means essential that the Government start from a net worth statement given by the taxpayer to the agents or to third parties. The starting point is often established simply by asking the defendant if he had any large sums of cash on hand, securities, or other non-visible assets. If he says no, the Government can take him at his word and compute the starting point from his visible assets.<sup>103</sup> If, on the other hand, he claims a large cash hoard, accounts receivable, stocks, securities, or loans, the agents can ask where the assets or debtors are located. If he refuses to tell them, declines to permit inspection of the assets, or tells the agents of a location that is difficult for them to verify, the Government may apparently disregard these claims and credit him with

confession, *i.e.*, an "acknowledgment in express words . . . of the truth of the guilty fact charged or of some essential part of it" and that statements denying guilt are more reliable than confessions. WIGMORE, EVIDENCE § 821 (3d ed. 1940). The Court held instead that exculpatory statements "may not differ from other admissions of incriminating facts." 348 U.S. at 92. It is noteworthy that in the recent case of *Miranda v. Arizona*, *supra* note 5, Chief Justice Warren stated that the new requirements regarding the questioning of suspects applied to exculpatory statements as well as confessions, the Court again rejecting any distinction between the two.

[101.] Apparently the only conviction overturned on appeal for insufficient corroboration in more than a decade is *United States v. Massei*, 241 F.2d 895 (1st Cir. 1957), where a new trial was granted for failure to corroborate admissions as to the existence of a likely source of income. But the Supreme Court disapproved the decision on the ground that the Government was not bound to prove a likely source. 355 U.S. 595 (1958) (technical affirmation). Thus, the decision of the Circuit Court, being based on an erroneous belief as to the Government's burden of proof, has not been followed.

[102.] 348 U.S. 121, 132 (1954).

[103.] See, *e.g.*, *Smith v. United States*, *supra* note 46; *Hooper v. United States*, *supra* note 48. The same is apparently true if he refuses to answer on advice of counsel. *United States v. Mackey*, 345 F.2d 499 (7th Cir.), *cert. denied*, 382 U.S. 824 (1965).

little or no such assets.<sup>104</sup> The theory apparently is that the defendant's refusal to permit the agents to verify his claim, or to help them do so, has sufficient earmarks of fabrication to present a question for the jury and to permit the jury to infer not only that the taxpayer's claim of specific assets on hand was false, but that in fact there were no assets on hand other than visible ones.<sup>105</sup> The same theory seems to be applied to the claim that cannot easily be verified.<sup>106</sup>

Moreover, several cases hold that gaps in the starting point can often be filled simply by estimates<sup>107</sup> and that it is not necessarily fatal to the Government's case if such estimates are clearly erroneous. In *Beard v. United States*,<sup>108</sup> the agents credited defendant with no cash on hand, other than in bank accounts, despite the fact that he was known to deal with and to carry large sums of cash. The court noted that there was likewise no cash entered by the agents as on hand at the end of the year and "nothing to show that the amount of cash on hand was greater at one end of the year than the other." The burden was apparently put on the defendant not only to show error in the beginning net worth computation but to show that the error had an effect upon the calculated increase. To do this, he had to adduce evidence that his cash on hand at the end of the year was significantly smaller than at the beginning.<sup>109</sup>

The Government's task of establishing a beginning net worth is further eased by the willingness of courts not only to permit inclusion in the defendant's net worth of any assets, such as bank accounts, realty, automobiles, held in his name, without any evidence negating the possibility that he held them as agent or trustee for someone else, but to permit inclusion in full of any assets in which the defendant is named as joint owner, with little or no proof that none of the assets were actually contributed by the other joint owner.<sup>110</sup>

[104.] See, e.g., *Mighell v. United States*, 233 F.2d 731 (10th Cir.), cert. denied, 352 U.S. 832 (1956); *Hooper v. United States*, supra note 48; *United States v. Vardine*, supra note 49; *Murray v. United States*, 297 F.2d 812 (2d Cir.), cert. denied, 369 U.S. 828 (1962). This problem is closely related to the duty to investigate "leads" considered text accompanying notes 117-19 *infra*.

[105.] See *United States v. Adonis*, supra note 76.

[106.] See *United States v. Ford*, supra note 75; *United States v. Frank*, 151 F. Supp. 864 (W.D. Pa. 1956), *aff'd*, 245 F.2d 284 (3d Cir.), cert. denied, 355 U.S. 819 (1957); *Smith v. United States*, supra note 46.

[107.] See, e.g., *Talik v. United States*, 340 F.2d 138 (9th Cir. 1965); *United States v. Mackey*, supra note 103.

[108.] 222 F.2d 84 (4th Cir.), cert. denied, 350 U.S. 846 (1955).

[109.] *Id.* at 89; *accord*, *United States v. Mackey*, supra note 103; *Talik v. United States*, supra note 107.

[110.] See, e.g., *Talik v. United States*, supra note 107 (defendant's savings account with daughter, the balance of which increased from zero to over \$40,000 during a prosecution).



It seems plain that the "requirement" that the beginning net worth be "established with reasonable certainty" is little more than a boilerplate jury instruction.<sup>111</sup> As a separable safeguard and component of the Government's burden of establishing a *prima facie* case, it is, in many courts at least, a fiction.

### 3. *Government's Duty to Investigate*

Evidence of assets and liabilities which the agents found in their investigation has virtually no probative value apart from the quality of their search or the explanation given by the defendant. The Supreme Court in the *Holland*<sup>112</sup> case recognized that the cogency of net worth proof depends on the thoroughness of investigation. But the Court declined to prescribe minimal investigative procedures to support a net worth conviction.<sup>113</sup> Instead, it merely required the Government to track down relevant "leads" furnished by the taxpayer before trial which are "reasonably susceptible of being checked" and which, "if true, would establish the taxpayer's innocence."<sup>114</sup> The Court ventured that if such leads are furnished and the Government failed to check them out, "the trial judge may consider them as true and the Government's case insufficient to go to the jury."<sup>115</sup>

Whether the Supreme Court intended it or not, this passage has been construed as imposing virtually the *only* investigative duties upon the Government. If a taxpayer gives no leads, gives leads which cannot easily be checked, or which seem inherently unlikely, or which, however likely and easily checked, are not explanatory of substantially all the increase indicated by the Government's proofs, the courts since *Holland* seem to hold that no failure to investigate entitles the de-

year, was included in Government's calculations although there was no evidence of the source of more than \$15,000 of the deposits. Government held under no duty to prove the source; jury could infer it was income). If the defendant filed a joint return with his wife, the Government normally includes in its net worth calculations assets owned by either spouse. The duty to negate non-taxable sources of the wife's share is not, ordinarily, a heavy one. See *Talik v. United States*, *supra* (joint account of defendant and newly acquired wife held properly includible upon proof only that defendant actually made all deposits); *United States v. Ford*, *supra* note 75. For instances in which the Government was permitted to include assets held entirely in the names of others, see *United States v. Johnson*, 319 U.S. 503 (1943); *Bell v. United States*, 185 F.2d 302 (4th Cir. 1950), *cert. denied*, 340 U.S. 930 (1951); *United States v. Mackey*, *supra* note 103 (assets held in names of three closely held corporations).

[111.] See *La Buy*, *Manual on Jury Instructions in Federal Criminal Cases*, 36 F.R.D. 457, 574 (1965).

[112.] *Holland v. United States*, *supra* note 26.

[113.] *Id.* at 135.

[114.] *Id.* at 135-36.

[115.] *Id.* at 136.

defendant to an acquittal.<sup>116</sup> Thus, the IRS apparently is under no duty to ask questions of any of the taxpayer's relatives, his bookkeeper or anyone else, even though they are likely to have relevant information. Indeed, it is not clear that the agents must even ask the taxpayer any questions, although they virtually always do. The Government can apparently survive a motion for acquittal simply by adducing evidence that its agents checked local banks, brokers, and property records, and, including all assets entered in defendant's name and all liabilities there found, together with any assets in defendant's possession, a net worth increase substantially in excess of reported income is indicated.<sup>117</sup>

The Government's duties to investigate the existence of liabilities are no more rigorous. At the end of the prosecution period, the smaller the defendant's liabilities, the larger is the indicated increase and the stronger is the prosecution's case. The agents therefore have no incentive to investigate thoroughly for the existence of liabilities at the end of the period beyond that supplied by the risk that the defendant may assert, in his defense, the existence of omitted liabilities which the Government cannot rebut to the satisfaction of the court and the jury. And the agents do not have to worry about satisfying the court if they have checked out any easily verified claims that the defendant has made before trial. As with the beginning net worth computation, the defendant can apparently show gross error in the Government's calculations of net worth increases without destroying its case. Thus, where the defendant showed that the prosecution had omitted some \$38,000 in liabilities from its ending net worth calculation (the liabilities were for outstanding checks), the court held that this did not affect the Government's case because there was no proof offered *by the defendant* that these liabilities were not equally large at the beginning of the period.<sup>118</sup> Indeed, the court implied that from the defendant's failure to prove the

[116.] See, e.g., *Mighell v. United States*, *supra* note 104 (no duty to investigate claim of buried cash by questioning defendant's son although defendant asserted that son saw the money buried); *Hooper v. United States*, *supra* note 48 (no duty to investigate claimed loans to and repayments from alleged debtors who had died before investigation); *United States v. Ford*, *supra* note 75 (claimed gifts from brother and "Great Aunt Mary" too vague to require investigation); *United States v. Frank*, *supra* note 106 (no duty to investigate affidavits of defendant's co-tenant and bookkeeper that defendant kept large sums of cash in safe deposit box).

Even if leads were given and could have easily been checked, the failure of the Government to investigate them is not fatal unless the leads account for a substantial portion of the indicated net worth increase. See *Scanlon v. United States*, *supra* note 56.

Where defendant gives no leads at all, he apparently has no standing to complain about the quality or thoroughness of the investigation. See *Talik v. United States*, *supra* note 107; *United States v. Mackey*, *supra* note 103, at 506.

[117.] See *United States v. Talik*, *supra* note 107; *Beard v. United States*, *supra* note 108.

[118.] *Beard v. United States*, *supra* note 108.

amount of the liabilities at the beginning of the period, the inference was justified that liabilities were omitted at the beginning which were even larger than at the end.<sup>119</sup>

The defendant can, therefore, rarely hope to keep a case from the jury on the ground of inadequate investigation, even though the cogency of the evidence rests on the thoroughness of the investigation to the extent that it does not rest on admissions of the defendant. The adequacy of the investigation is virtually always for the jury to decide.

#### 4. *Proof of Likely Taxable Source of Net Worth Increase*

Assuming that the Government adduces acceptable evidence of a net worth increase (or expenditures, or bank deposits) in excess of reported income, should the jury be permitted to guess whether the increases are attributable to taxable or non-taxable sources? The Supreme Court seemed to say no in 1954, when, in the *Holland* case, it said that a "requisite to the use of the net worth method is evidence supporting the inference that the defendant's net worth increases are attributable to currently taxable income."<sup>120</sup> The Court found adequate evidence in *Holland* where it was shown that the taxpayers acquired a hotel and reported only one-fourth as much income as had been reported by the previous owners, even though the hotel's business was booming. Having offered especially cogent evidence that taxpayers had large unreported earnings,<sup>121</sup> it was not necessary, the Court held, to furnish evidence negating all possible non-taxable sources of the alleged net worth increases—gifts, loans, inheritances, etc. "The Government's proof," the Court said, "carried with it [these] negations."<sup>122</sup> The

[119.] The existence of these checks was not known to the agents until they were produced by attorneys for the defendant during trial; but if they had been previously known it would not have been proper to have taken them into consideration, unless the amount of outstanding checks at the end of the previous year had also been known . . . . The defendant's attorneys had access to his records and their failure to produce . . . [the outstanding checks at the beginning of the year] justifies the inference that their production would not have been to the defendant's interest.

*Id.* at 90.

[120.] *Holland v. United States*, *supra* note 26, at 137.

[121.] There was also apparently some evidence that the books were false, although the Court's opinion is not clear on this point. See note 137 *infra*.

[122.] *Holland v. United States*, *supra* note 26, at 138. It seems important to note, however, that the Court believed, correctly, that the evidence of unreported income was so strong that this in itself went far toward negating non-taxable sources. Indeed, since there was strong circumstantial evidence that the hotel had far more income than was reported, the case was not a typical net worth case. The net worth evidence merely corroborated other cogent evidence of a large deficiency. The context of the statement quoted above, therefore, does not justify the inference that the Government is never under a duty to investigate possible non-taxable sources for an apparent net worth increase unless given pre-trial leads. *But see* cases cited note 116 *supra*.

Court added that "where relevant leads are not forthcoming, the Government is not required to negate every possible source of non-taxable income, a matter peculiarly within the knowledge of the defendant."<sup>123</sup>

A number of post-*Holland* cases read the Supreme Court's opinion as making indispensable proof of a likely source of taxable income.<sup>124</sup> Yet all held that the requirement could be met with much less evidence than was adduced in *Holland*. It seems sufficient, for example, for the Government to prove that the defendant received some income from a source not reported on his returns,<sup>125</sup> or if it merely proves that a source disclosed in the return is of a kind generally capable of producing the unreported income shown by the net worth calculation.<sup>126</sup> Since "gambling is an occupation with indeterminate possibilities,"<sup>127</sup> the courts seem willing to find that the Government meets its burden merely by proving that defendant is a gambler.<sup>128</sup> The prosecution need not, as it did in *Holland*, produce evidence of the actual size and nature of the business operations. The requirement has become in many courts a duty merely to show that the defendant is engaged in a profit-directed activity of some kind.

*Holland* held that if there is ample proof of a taxable source, non-taxable sources must be negated only if the defendant supplies reasonable, relevant leads.<sup>129</sup> The courts seem to be applying the same minimal duty when there is no proof whatever of a likely source.<sup>130</sup> Thus, if the taxpayer gives one explanation, such as a large gift, for the apparent net worth increase, the Government meets its burden by disproving the

[123.] *Holland v. United States*, *supra* note 26.

[124.] See, e.g., *Olender v. United States*, 237 F.2d 859 (9th Cir. 1956), *cert. denied*, 352 U.S. 982 (1957); *United States v. Ford*, *supra* note 75.

[125.] See *McFee v. United States*, 206 F.2d 872 (9th Cir. 1953), *reaff'd*, 221 F.2d 807 (1955) (precise source need not be proved); *United States v. Adonis*, *supra* note 76; *United States v. Ford*, *supra* note 75.

[126.] See *Scanlon v. United States*, *supra* note 56 (bookie); *United States v. Nunan*, *supra* note 11.

[127.] *United States v. Costello*, *supra* note 26.

[128.] *Scanlon v. United States*, *supra* note 56; *Campononico v. United States*, 222 F.2d 310 (9th Cir.), *cert. denied*, 350 U.S. 831 (1955).

[129.] See note 122 *supra* and accompanying text.

[130.] Some support of this extension of *Holland* may be drawn from the Supreme Court's only foray into the field in more than a decade, *United States v. Massci*, 355 U.S. 595 (1958). The Court there in a one paragraph opinion said that although it had held in *Holland* that proof of a likely source is "sufficient" to convict in net worth case, "this was not intended to imply that proof of a likely source was necessary in every case. On the contrary, should all possible sources of non-taxable income be negated, there would be no necessity for proof of a likely source." Obviously, the negation of all non-taxable sources is itself proof of a taxable source, albeit an unidentified one. However, it is virtually impossible to exclude, by solid proof, all possible non-taxable sources, e.g., gifts, loans, inheritance, other non-taxable acquisitions. The opinion is academic, therefore, unless it is read as dispensing with hard evidence of either a taxable source or the non-existence of an exempt source.

gift.<sup>131</sup> The defendant's explanation itself disproves all other possible non-taxable sources. The same is apparently true where the explanation is not reasonably verifiable. If defendant merely refers vaguely to a specific source, such as a "loan," without particulars, the Government is apparently relieved of the duty to prove a likely taxable source or to disprove possible non-taxable sources.<sup>132</sup> It can rest on the hope that the jury will disbelieve defendant's explanation and conclude that in lying he was covering up the existence of a taxable source. Likewise, if the defendant merely denies there was a net worth increase, his denial apparently carries with it an admission that if, contrary to his assertions, there was a net worth increase, it was attributable to taxable income.<sup>133</sup>

And what of the defendant who provides no leads, gives no explanations? The law is not clear as to him, because he is almost non-existent, but the cases imply that the Government satisfies its burden if its agents testify that they found no non-taxable sources.<sup>134</sup>

Thus what was once thought to be an important burden imposed upon the Government has been subtly shifted to the defendant. Either he gives pre-trial discovery by tendering an explanation or he relieves the Government of the duty to prove the source of the net worth increase and authorizes the jury to conclude, without evidence, that it was taxable income.

##### 5. *Consistent Underreporting of Large Amounts of Income*

The Supreme Court in the *Holland* case agreed with the defendant that willfulness cannot be "inferred from the mere understatement of income."<sup>135</sup> The Court held, however, that "a consistent pattern of understating large amounts of income, and the failure on petitioners' part to include all of their income in their books and records" justified an inference of willfulness.<sup>136</sup> In every net worth case the defendant's books will not reveal all the income shown by the net worth evidence, for if they did there would be no need to rely on circumstantial proof. The discrepancy between the books and the net worth evidence, there-

[131.] See *Thomas v. Comm'r*, 261 F.2d 643 (1st Cir. 1958) (civil net worth case with elaborate analysis of *Massei*, *supra* note 130); *United States v. Schafani*, *supra* note 73.

[132.] *United States v. Ford*, *supra* note 75; see also *Smith v. United States*, *supra* note 46 (defendant claimed apparent net worth bulge came from an "old iron pot" and "an old mail bag.")

[133.] See *Gatling v. Comm'r*, 236 F.2d 139 (4th Cir. 1961); *Hamman v. United States*, *supra* note 70.

[134.] *Gatling v. Comm'r*, *supra* note 133; *United States v. Ford*, *supra* note 75.

[135.] *Holland v. United States*, *supra* note 26.

[136.] *Ibid.*

fore, adds nothing to the net worth evidence.<sup>137</sup> How, then, does "a consistent pattern of underreporting large amounts of income" differ in cogency from evidence of a "mere understatement of income?" It differs in many respects.

The larger the indicated omission, both absolutely and relative to the income actually reported, the less likely that the taxpayer was ignorant of the unreported income. If he reported only \$10,000 of income but his net worth increased (from taxable sources) by \$50,000, the inference may be strong that he was aware that his income exceeded that which he reported. The inference becomes almost overwhelming when the same thing happens three or four years in a row.

Largeness and repetition of the understatements also greatly reduce the consequentiality of error in the net worth calculations. If net worth evidence shows that a taxpayer who reported about \$10,000 income for each of four years actually had steady net worth increases of about \$50,000 in each of those years, it is unlikely that virtually all of the indicated increase is attributable to the inevitable errors in net worth evidence. As the size and repetition of the indicated deficiency diminish, however, the risk that most of it is erroneous greatly magnifies.<sup>138</sup>

If, therefore, the Government were required to show a "consistent pattern of large underreportings," as a condition of getting a net worth case to the jury, many of the dangers noted would be greatly minimized. The *Holland* case, however, has not been interpreted as creating any such obligation. There are numerous cases in which the jury was

[137.] It is unclear from the *Holland* opinion whether the Court in the passage quoted above, "failure on petitioner's part to include all their income in their books and records," was referring to the fact that independent evidence apparently showed that defendant's records were inaccurate, *id.* at 137, or merely reflected the truism that proof of unreported income by the net worth method, or any other method, also proves that taxpayer's books to the contrary are false. There is language in the opinion which may support the latter reading: "when there are no books and records, willfulness may be inferred from that fact coupled with proof of an understatement of income," *id.*, at 128; "the very failure of the books to disclose a proved deficiency might indicate deliberate falsification," *ibid.*; "the Government did not detect any specific false entries [in defendant's books]" *id.* at 132.

The writers on tax fraud are, in general, reluctant to concede that *Holland* authorizes a criminal conviction in a "pure" net worth case, *i.e.*, where there is no evidence, in addition to net worth increases larger than reported income, of falsification of books, suspicious destruction of records, lies to revenue agents, etc. See Avakian, *Net Worth Method in Proving Tax Evasion*, 41 A.B.A.J. 563 (1955); Balter, *A Ten Year Review of Fraud Prosecutions*, N.Y.U. 19TH INST. ON FED. TAX. 1125, 1130 (1961). The cases, however, offer little support for the notion that there must be direct evidence of a "badge of fraud," in addition to net worth proof, as a condition to conviction. Moreover, it is difficult to find any such evidence in many cases, *e.g.*, *Barsky v. United States*, *supra* note 32; *Warring v. United States*, *supra* note 71; *United States v. Altruda*, 224 F.2d 935 (2d Cir. 1955).

[138.] Proof of net worth increases in excess of income over a period of several years also tends to exclude the possibility of non-taxable sources for the apparent increase. Regular receipt of large gifts, inheritances or other non-taxable accessions to wealth over a period of years is unusual.

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permitted to convict although the omissions indicated by circumstantial evidence were not "large" as that term was employed in *Holland*.<sup>139</sup> Convictions have been affirmed where the understatements were no more than a few thousand dollars.<sup>140</sup> Moreover, many taxpayers have been convicted without evidence of a consistent pattern of underreporting; where, so far as it appears, the deficiency occurred in only one<sup>141</sup> or two years.<sup>142</sup>

### Summary, and Some Considerations

The Government has at least six different ways of proving a tax evasion case: (1) with the taxpayer's own books, records, and admissions, (2) through an inside eyewitness to taxpayer's false entries or secretion of income, (3) with outsiders, whose records or testimony permit reconstruction of transactions with the defendant; with evidence of (4) net worth increases, (5) expenditures, or (6) bank deposits exceeding reported taxable income. Each of these methods is relatively independent of the others in that the records and witnesses employed to build the Government's case will often differ depending upon the method selected. Whether the prosecution uses direct or indirect proof, its case usually shows no more than substantial unreported receipts during the

[139.] In *Holland*, the defendants, over a span of three years during which they reported income of \$31,265.92, had an apparent net worth increase of \$113,185.32. The evidence thus indicated that they had reported less than 30 per cent of their income. *Holland v. United States*, *supra* note 26.

[140.] In *United States v. Ford*, *supra* note 75, the Government's evidence showed total underreportings over the prosecution period, 1947-1951, of about \$27,000. Underreported income for 1950, however, was only about \$1,100, producing a tax deficiency of no more than \$200 or \$300; and the Government's evidence as to 1951 indicated an *overstatement* of income by defendant of about \$180. Nonetheless, the trial judge sent all five counts (one for each year) to the jury. Not surprisingly, the jury acquitted for 1951. Convictions for 1948-1950 were affirmed (the jury hung on the 1947 count). It should be noted, however, that the Government had also adduced evidence of underreporting for 1942-1946. Thus, while the omissions proved hardly seem large there was at least a "consistent pattern of . . . underreporting." *But see United States v. Frank*, *supra* note 106 (underreporting in single year of less than \$20,000; apparently no evidence of prior underreportings); *Chinn v. United States*, 228 F.2d 151 (4th Cir. 1955) (unreported income for 1947 of \$9,000 proved by net worth method; specific items proof of underreportings for 1948-50, totaling only about \$6,000, proved by direct evidence); *Coleman v. United States*, *supra* note 46 (two years' underreporting totaled about \$14,000); *Altruda v. United States*, *supra* note 137; (excluding amounts which Government conceded were erroneously but not fraudulently omitted, Government's evidence showed underreportings of about \$13,000 in 1946, \$3,000 in 1947 and an overdeclaration for 1948 of about \$4,000. Also, there was virtually no net worth increase. Evidence of income consisted of expenditures); *Canaday v. United States*, *supra* note 32 (understatements in each of five years varied from about \$4,600 to \$6,100).

Small omissions in specific items cases are, of course, more frequent. See, e.g., *Foley v. United States*, *supra* note 28 (about \$1,000 in each of two years); *Brown v. United States*, 224 F.2d 845 (6th Cir.), *cert. denied*, 350 U.S. 912 (1955) (about \$4,000 in 1946, \$5,000 in 1947); *Dillon v. United States*, *supra* note 35 (less than \$6,000 in each of two years).

[141.] *United States v. Adonis*, *supra* note 76; *United States v. Frank*, *supra* note 106.

[142.] *Scanlon v. United States*, *supra* note 56; *Coleman v. United States*, *supra* note 46; *United States v. Shavin*, *supra* note 21; *United States v. Vardine*, *supra* note 49.

tax years in question. The burden of coming forward with evidence of offsetting deductions which were also not reported, of mistake of law or fact, or of ameliorating circumstances negating willfulness is usually on the defendant.

When the Government employs circumstantial methods to prove the deficiency, the burden of producing evidence that the Government's calculations excluded assets, loans or non-taxable sources is heavily upon the defendant. And rarely, if ever, is defendant's contrary evidence sufficient to require the Government to go forward with more evidence or suffer a judgment of acquittal.

The Government's case will stand even though its evidence of a deficiency may not be very cogent. An investigation of local bank, property, and other records, without the help of defendant or members of his family does not yield strong proof of the existence of a large deficiency, much less of willful evasion. By no stretch of argument can such evidence constitute proof of guilt beyond a reasonable doubt. If considered apart from the response of the defendant, it is often as consistent with innocence as with guilt. Millions of innocent taxpayers would appear guilty if the changes in their locally recorded and visible assets were alone considered as proof of guilt.

By permitting such proof to suffice as a *prima facie* case, courts have given juries vast discretion to convict on meager evidence and have greatly diminished the value of the taxpayer's privilege against self-incrimination, both at the trial and in pre-trial investigations. (The usual effect of a taxpayer's pre-trial claim of privilege will be to assure his prosecution, to relieve the Government of the duty to negate possible explanations, and, perhaps, to create admissible evidence of willfulness.) When a jury is authorized to convict on such thin evidence, the principles of the Fifth Amendment are undermined. The courts, however, do not seem to think so. The conventional judicial attitude is to treat burden of proof and the self-incrimination privilege as wholly unrelated. Typical is *Yee Hem v. United States*,<sup>143</sup> where defendant, convicted of concealing opium knowing it to have been imported illegally, contended that a statute which made mere possession of opium *prima facie* evidence of guilt compelled him to be a witness against himself because it forced him to take the stand and explain. Said the Court, "The statute compels nothing. . . . It leaves the accused entirely free to testify or not as he chooses. If the accused happens to

[143.] 268 U.S. 178 (1925).



be the only repository of the facts necessary to negate the presumption . . . that is a misfortune which the statute . . . does not create but which is inherent in the case."<sup>144</sup> The same view prevails in net worth cases.<sup>145</sup> Yet the burden of proof is inextricably related to the Fifth Amendment privilege. With a light burden, the Government can merely cast suspicion on the defendant and force him to testify in his own defense. By this means, the Fifth Amendment is circumvented, the prosecution no longer being "compelled to establish guilt by evidence independently and freely secured."<sup>146</sup> Lessening the Government's burden because the defendant, if he is innocent, can explain, is an attempt to "solemnize the silence of the accused into evidence against him"<sup>147</sup> which, according to the Supreme Court, the Fifth Amendment forbids.<sup>148</sup> Surely if legislation attempted to establish a mere official accusation of crime as sufficient to require the defendant to prove himself innocent or take his chances with the jury, the courts would strike it down, and on Fifth Amendment grounds.<sup>149</sup> Yet the difference between net worth proof and mere accusation is one of degree only, and not a very large one.<sup>150</sup>

One thing is clear: the Government's easy burden gives it great

[144.] 268 U.S. at 185.

[145.] See *Holland v. United States*, *supra* note 26, where the Court tossed off the problem by saying, "Nor does this rule shift the burden of proof. The Government must still prove every element of the offense beyond a reasonable doubt. . . . Once the Government has established its case, the defendant remains quiet at his peril." *Id.* at 138-39. The trouble is that under current standards, the Government can make a *prima facie* case without producing evidence which, under any tenable meaning of the term, constitutes proof beyond a reasonable doubt. The approach in *Holland* implies that, so long as the jury is instructed on reasonable doubt, virtually anything may be done with the Government's burden of production.

[146.] *Malloy v. Hogan*, 378 U.S. 1, 8 (1964).

[147.] *Griffin v. California*, 380 U.S. 609, 614 (1965).

[148.] *Id.* at 615.

[149.] Occasionally, the Courts will strike down a statutory presumption in a criminal case on the ground of no "rational connection." The doctrinal support is found, however, not in the Self-Incrimination Clause, but in the requirements of Due Process. See, e.g., *United States v. Romano*, 382 U.S. 136 (1965).

[150.] This analysis leads to the conclusion that all burden of proof questions in criminal cases are self-incrimination questions. Acceptance of this view would require the explicit balancing of the policies of the privilege against considerations of efficiency, a process which is both difficult and unpopular. Ironically, the Justice of the Supreme Court who comes closest to concluding that burden of proof and self-incrimination are interdependent is the principal foe of "balancing," Mr. Justice Black. See his dissent in *United States v. Gainey*, 380 U.S. 63, 87 (1965).

The problem cannot be set to rest merely by noting the difference between the burden of producing evidence (going forward) and the burden of persuasion. As Professor McNaughton has pointed out, the two burdens aren't very different. The quantum and cogency of evidence which the Government must adduce to make a *prima facie* case depends upon the burden of persuasion which the court actually imposes upon the prosecution. See McNaughton, *Burden of Production of Evidence: A Function of Burden of Persuasion*, 68 HARV. L. REV. 1382 (1955).

tactical advantages. The lighter the Government's burden, the larger the range of alternative modes of proof, and the greater its opportunity to approach the trial with a defendant who must guess about which issues to press, what records to search for, which witnesses to call.

### III. The Investigative Process

The taxpayer's Fifth Amendment rights are nullified in yet another way: the Government is permitted to treat its investigation as a civil matter until its files are full, and to keep the taxpayer unaware of the transmutation of the case from civil to criminal.

The IRS audits three to four million tax returns per year,<sup>151</sup> and from this mass selects approximately 1000 taxpayers whom it recommends to the Justice Department for criminal prosecution.<sup>152</sup> The initial audit is ordinarily performed by a regular Internal Revenue Agent who may write to the taxpayer and request that he come in and explain questioned items or permit the agent to come to his home or office. (Sometimes, however, the agent appears without advance notice.)<sup>153</sup> At this point the audit is usually regarded as a routine civil audit and fraud is not suspected. After the revenue agent makes a preliminary investigation, however, he may scent fraud and call in a special agent from the Intelligence Division, whose job is to investigate criminal fraud suspects.<sup>154</sup> Sometimes, of course, fraud will be anticipated at the outset and a special agent assigned immediately. Even then, a revenue agent may be used in tandem with the special agent to develop the civil aspects of the case and also to continue working with the taxpayer in an attempt to get information before he learns that he is a criminal suspect.<sup>155</sup>

At any stage of the investigative process prior to the assignment of a special agent, the revenue agent has virtually unreviewable discretion to close the criminal aspects of the case by suggesting a simple deficiency and thus eliminating almost all possibility that the taxpayer will

[151.] During 1965, 3,268,000 income tax returns were audited, 584,000 in field audits and the remainder in office audits, 1965 COMM'R INT. REV. ANN. REP. 23.

[152.] Of 8786 preliminary fraud investigations in 1965, the IRS recommended prosecution in 1216. *Id.* at 29. There were 1032 prosecution recommendations in 1964. *Ibid.*

[153.] See *Austin v. United States*, 297 F.2d 356 (4th Cir. 1961); *Spomar v. United States*, 339 F.2d 941 (7th Cir. 1964), *cert. denied*, 380 U.S. 975 (1965).

[154.] SCHMIDT, LEGAL AND ACCOUNTING HANDBOOK OF FEDERAL TAX FRAUD 186 (1963).

[155.] *Id.* at 187; KOSTELANETZ & BENDER, CRIMINAL ASPECTS OF TAX FRAUD CASES 41 (A.L.I. 1957); *Hearings Before the Subcommittee on Administrative Practice and Procedure of the Senate Comm. on the Judiciary*, 89th Cong., 1st Sess., part 3, at 1224.

## Income Tax Prosecutions

be prosecuted for evading during the years covered by the audit. Once a special agent is in the case, he also has abundant power over the continuance of the case into further phases of the criminal process.<sup>155</sup> Less than  $\frac{3}{10}$  of 1% of all returns audited are carried beyond the routine audit and civil deficiency stage,<sup>157</sup> and even after a special agent is assigned, the chances are about 7 in 8 that prosecution will not be recommended.<sup>158</sup>

During the early phases of an investigation, its character as a civil or criminal case will be ambiguous. The revenue agent calling upon a taxpayer to examine his books is not analogous to the policeman who raps on the door. Since more than 99% of audits which reveal deficiencies are never treated as criminal cases,<sup>159</sup> the probability is high in virtually any case that the main purpose of the audit is, and its ultimate conclusion will be, non-criminal. Moreover, the existence of the criminal sanction, the dread with which most taxpayers regard involvement in criminal proceedings, the vagueness of the crime, and the enormous discretion of the investigator, make noncooperation by an audited taxpayer in most cases an inordinately foolish decision. The civil aspects of an audit also point toward cooperation. The return of almost any taxpayer contains items upon which an obdurate agent can assert a deficiency which is both difficult and costly for the taxpayer to resist. Non-cooperation may be very expensive.<sup>160</sup>

An audit, therefore, usually occurs in an atmosphere which invites the taxpayer to negotiate and compromise. He will usually produce records, give statements, make explanations, tender excuses—often only vaguely aware of their relevance to an ultimate tax prosecution. If prosecution results, however, his statements will be extremely helpful to the Government in narrowing the issues in the case and easing its burden of proof.

[155.] Apparently, if the special agent decides against prosecution and his chief in the local Intelligence Office concurs, that is normally the end of the matter. See SCHMIDT, *op. cit. supra* note 154, at 470. It is not even clear, moreover, that the agent's superior routinely reviews "no prosecution" decisions. See BALTER, *TAX FRAUD AND EVASION* § 3.3-3 (3d ed. 1963).

[157.] Of 3,268,000 returns audited in 1965, only 8,786 (.27%) were investigated for fraud. See data in notes 151-52 *supra*.

[158.] See note 152 *supra*.

[159.] More than 99% of audits which reveal deficiencies are never treated as criminal cases; for if at least half of all audits result in deficiencies, then there were at least 1,700,000 deficiencies revealed by audits in 1965. See note 151 *supra*. Yet less than 9,000 (.5%) were fraud audits and only 1216 (.07%) produced recommendations for prosecution. See note 152 *supra*.

[160.] Another powerful inducement to cooperation is the well-founded fear that non-cooperation may result in the making of inquiries to the taxpayer's associates, clients, customers, etc., which are harmful, if not ruinous, to one's reputation. See *Hearings Before*

There are doubtless many taxpayers who are not fully aware of the risks of non-cooperation and of the long odds against an ordinary audit being a criminal investigation or leading to criminal prosecution. Nonetheless, even these people are seldom uncooperative. Unless they are racketeers or for some other reason know that the Government is trying to build a criminal case against them, they are frequently unable to conceive of themselves seriously as criminals, no matter how blatant their derelictions.<sup>161</sup> Consequently, they act like ordinary taxpayers, who cooperate, negotiate, and sometimes prevaricate. They do not run to a lawyer when the agents appear. Many people in this context, moreover, feel challenged by the agents and see the confrontation as an opportunity to exercise their special skills and untapped courage. They "take on" the agents and attempt to lead them off the track. Frequently, such attempts are precisely what a suspicious agent wants to hear—just what he needs to make a case.<sup>162</sup>

Even if the agent suspects fraud early in the investigation, the courts hold that he need not inform the taxpayer of his suspicions before interrogating him and asking to examine his books. Most courts hold that even after a special agent is assigned to the case, although his job is to investigate criminal cases, no warnings to the taxpayer are necessary.<sup>163</sup> Some have even held that a special agent may falsely tell the taxpayer that he is making a "routine audit."<sup>164</sup> Virtually all hold that a special agent who merely identifies himself as a "special agent" or "from Intelligence" has given the taxpayer all the warning he deserves,<sup>165</sup> despite the probability that not one taxpayer in twenty knows that this means a criminal investigation. The courts uniformly have held, moreover, that the taxpayer's mere ignorance of the nature

*the Subcommittee on Administrative Practice and Procedure of the Senate Comm. on the Judiciary, supra* note 155, at 1179-83.

[161.] In most instances, when the special agent calls, either (a) the taxpayer's guard is way down, or (b) the taxpayer is guarded and sophisticated, but with illusions of superiority and omnipotence, or (c) the taxpayer has fear in his guts and appeasement on his lips . . . . And thus begins the honeymoon, the period in which records are generously handed over ("May I take this journal with me for a day or two?" "Of course, anything you wish"); statements are generously made, and the loss of virginal constitutional rights is consummated on a table in the taxpayer's office.

Wald, *What to Do When the Special Agent Calls*, in *SELECTED PAPERS FROM THE FIRST ANNUAL TAX INSTITUTE 8* (Arizona State University 1960). See also BALTER, *TAX FRAUD AND EVASION* § 6.2; SCHMIDT, *op. cit. supra* note 154, at 262.

[162.] See text accompanying notes 77, 103-05.

[163.] *Vloutis v. United States*, 219 F.2d 782 (5th Cir. 1955); *Turner v. United States*, 222 F.2d 926 (4th Cir.), *cert. denied*, 350 U.S. 831 (1955).

[164.] *United States v. Frank*, *supra* note 106; *Palmisano v. United States*, 226 F. Supp. 562 (N.D.N.Y. 1963); *cf. United States v. Sclafani*, *supra* note 73.

[165.] *United States v. Sclafani*, *supra* note 73; *Kohatsu v. United States*, 351 F.2d 898 (9th Cir. 1965), *cert. denied*, 384 U.S. 1011 (1966).

of the investigation and of his legal rights to resist is insufficient ground for suppression of evidence “voluntarily” given.<sup>166</sup>

The Supreme Court’s recent decision in *Miranda v. Arizona*,<sup>167</sup> that a person subjected to “custodial interrogation” is entitled to be fully warned of his rights to have counsel present and to remain silent, may ultimately lead to reform of tax investigations. The holding, however, does not apply to a tax audit because the taxpayer is not in custody. While he probably has a right to consult counsel<sup>168</sup>—which right is seldom denied in practice—the taxpayer under audit is not yet entitled to the full panoply of pre-interrogation warnings accorded the criminal suspect who is under arrest. Neither *Miranda* nor its predecessor, *Escobedo*,<sup>169</sup> speak to the duty to warn one who is not under arrest. The holding of *Miranda* is clearly limited to one whose freedom of movement has been curtailed,<sup>170</sup> and the reasons for requiring warnings are more often present in a custodial context than in a less oppressive atmosphere. Yet unless constitutional rights are to turn on a formality—whether the suspect is told he is under arrest before or after the interrogation—the existence of actual custody often will be unclear. The courts will have to resort in such cases to an evaluation of the particular coercive conditions. Eventually, arrest will probably cease to be a *sine qua non* to a duty to warn.

The Court’s earlier opinion in *Escobedo* hinted at the propriety of a contextual test and also suggested relevant criteria in addition to coercive circumstances, *e.g.*, interrogation in an unfamiliar place, the absence of friends or family, the number of interrogators, etc. The Court there emphasized, in holding that the suspect was entitled to consult counsel during interrogation, that the interrogators were not engaged in “a general investigation of ‘an unsolved crime’” but that their “purpose [was] to ‘get him’ to confess his guilt. . . .”<sup>171</sup> The investigation had “begun to focus on a particular suspect,” the “process [had shifted] from investigatory to accusatory . . . and its purpose [was] to

[166.] See, *e.g.*, *Spomar v. United States*, *supra* note 153.

[167.] 384 U.S. 436 (1966).

[168.] See 5 U.S.C. § 1005(a) (1964). *But see* *Smith v. United States*, 250 F. Supp. 803 (D.N.J. 1966).

[169.] *Escobedo v. Illinois*, 378 U.S. 478 (1964).

[170.] See 384 U.S. at 467 (protects persons “whose freedom of action is curtailed”; duty to warn “a person in custody”); *id.* at 471 (individual “held for interrogation” must be warned), *id.* at 477 (“the principles announced today deal with the protection which must be given . . . when the individual is first subjected to police interrogation while in custody or otherwise deprived of his freedom of action in any way”).

[171.] 378 U.S. at 485.

elicit a confession.”<sup>172</sup> This suggests that in a non-custodial interrogation, the duty to warn may depend on the purpose of the inquiries, which in turn may be ascertained by gauging the degree of the interrogator’s suspicion. If the questions are put by one who “knows” the suspect is guilty and who, consequently, is engaged in building a case rather than investigating a possible crime, then his subject may deserve the *Miranda* warnings, even though not under arrest.<sup>173</sup>

Yet even if *Miranda* is thus extended, it would have to be stretched to cover the typical tax audit. As earlier noted, the nature of the early confrontations between the taxpayer and the IRS agent will almost always be ambiguous. Though the fact that the agent is conducting an audit implies some apprehension that the taxpayer’s return may be incorrect, this is not the same as suspicion that the deficiency was intentional. And even a hazy hunch that a deficiency was intentional is not equivalent to an expectation that further inquiry will reveal facts warranting criminal prosecution. Probably only a fraction of taxpayers who appear clearly to have made intentional understatements are regarded seriously as candidates for criminal prosecution.<sup>174</sup> Therefore, if an investigation becomes “accusatory” only at the point where the agent has made a preliminary decision to recommend prosecution and is seeking evidence to sustain the prosecution, most tax investigations will be virtually completed and the Government’s evidence gathered before the duty to warn occurs.

It is possible that an investigation might be held “accusatory” whenever the agent expects to find a violation of the law, *i.e.*, a deficiency; and this may occur in almost every audit at the initial confrontation. Taxpayers might, therefore, be held entitled to routine warnings of their rights. But what effect would this have on the Government’s ability to gather evidence from the many taxpayers who already know they have an abstract and often costly<sup>175</sup> right to consult counsel and to claim the privilege against self-incrimination? A routine warning given at the outset of every audit could well become little more than

[172.] *Id.* at 493.

[173.] A supporting rationale might be that, viewing the matter as of the time of the interrogation, the greater the likelihood that statements obtained will in fact be offered in a criminal prosecution, the less likely that the defendant would be willing to waive his privilege and, consequently, the greater the need for assuring that he knows of his rights. Rather clearly, it would seem, the question should be viewed from the perspective of the interrogator, for it is he upon whom the duty to warn is to be placed. Hence, it is his purpose, his intentions, his belief in guilt that determines his duty, just as it is the facts as they appear to him that determine his duty to refrain from arresting a suspect.

[174.] See data in note 159 *supra*.

[175.] See text accompanying notes 158-62 *supra*.

a formality, regarded as such by agent and taxpayer alike, and therefore would have little impact upon taxpayer cooperation. If, on the other hand, such warnings significantly inhibited taxpayer-disclosure, this would seldom be the result of information imparted by them, but would flow primarily from the atmosphere of adversariness and hostility, and the usually groundless fear produced by the warnings. Routine warnings would cripple normal tax administration if hundreds of thousands of auditees ceased cooperating.<sup>176</sup> This could be too high a price for the problematical protection of fewer than one thousand criminal defendants per year. Thus, it seems fairly safe to predict that routine warnings to all auditees will either fail to forestall cooperation in most instances, or they will not be required.

It would seem reasonable, nonetheless, to require warnings as a condition of using the taxpayer's disclosures in a criminal prosecution. This rule would merely compel the IRS to elect, before obtaining disclosures from a taxpayer, whether to warn him and preserve a right to prosecute him criminally at the cost of possible non-cooperation, or to proceed without a warning and be practically foreclosed from criminal prosecution regardless of what the investigation turned up. Selective use of warnings would itself enhance their meaningfulness, since the warned taxpayer would know that he was a criminal suspect.<sup>177</sup>

Much more meaningful, and more likely to protect a criminal defendant from self-incrimination, would be a duty of the IRS to advise the taxpayer of not only his rights, but the nature of the investigation—what the Government knows or suspects, the precise purpose of the evidence it seeks and so forth. In short, a showing at the outset by the Government of both its cards and its plans to play them. Yet, establishing criteria for the content of such a disclosure, and determining case-by-case if adequate warnings were given, would be enormously difficult.

[176.] See the discussion of this problem in Redlich, *Searches, Seizures and Self-Incrimination in Tax Cases*, 10 TAX. L. REV. 191, 210 (1955).

[177.] The suggestion that warnings should, in effect, be optional with the IRS, depending upon whether it wants to preserve a right to use the evidence in a criminal prosecution, would have the merit of simplicity, since it would be unnecessary, in determining whether evidence was lawfully obtained, to attempt to fix the point when the investigation had shifted to the "accusatory" stage. Other policy considerations are set forth in note 201 *infra*, in connection with a related proposal. There would, however, still be difficulty in determining the proper content of the requisite warning. A *Miranda*-type warning, with minor modifications, might suffice except that it might be misleading, for it would imply that there are no adverse consequences to the exercise of a taxpayer's rights and this is seldom, if ever, the case. Not only will refusal to cooperate arouse the suspicion and perhaps the ire of the agent, the cases suggest that it will be admissible evidence against the defendant. Thus, fashioning the content of the warning requires resolution of the questions regarding admissibility of evidence of non-cooperation. See note 180 *infra*.

And it still would not prevent self-incrimination by the many defendants who at the inception of the investigation are assumed by all concerned to be ordinary civil audit candidates unless the IRS were also required to reveal the progress of its investigation each time an agent dealt with the taxpayer or his attorney. Such a duty goes miles beyond *Miranda*.<sup>178</sup>

Some auditees, of course, are represented by counsel even before a criminal investigation is suspected. Yet even if counsel is the rare one who is well informed about both his client's tax affairs and the general aim of the agent's inquiries, cooperation will often be the result.<sup>179</sup> Few of the pressures for disclosure, built into the system, disappear when counsel enters the case. Furthermore, counsel may be aware of additional reasons for cooperation. He may realize that complete non-cooperation prevents the defendant from providing leads tending to explain an apparent net worth bulge, easing the Government's burden of proof. He may also know that evidence of non-cooperation will be admissible at the trial on the issue of "willfulness" even, so some cases dubiously suggest, if the recalcitrance consisted of a claim of the Fifth Amendment.<sup>180</sup> He can be certain, on the other hand, that evidence

[178.] For an able argument that *Miranda* creates a duty to warn in tax investigations, see Hewitt, *The Constitutional Rights of the Taxpayer in a Fraud Investigation*, 44 TAXES 660 (October 1966). The courts, however, have not as yet viewed either *Escobedo* or *Miranda* as affecting tax investigations. *Kohatsu v. United States*, *supra* note 165 (*Escobedo*); *United States v. Carlson*, 18 AFTR 2d 5659 (E.D.N.Y. 1966) (*Miranda*); *United States v. Fiore*, 18 AFTR 2d 5870 (W.D. Pa. 1966) (*Miranda*).

[179.] Cases are legion in which taxpayers were convicted with evidence supplied in the presence of, or after consultation with, counsel. See, e.g., *Percifield v. United States*, 241 F.2d 225 (9th Cir. 1957) (defendant executed affidavit dictated by his lawyer in the lawyer's office admitting to large understatements of income); *Hooper v. United States*, *supra* note 48.

[180.] The main case to this effect is *Beard v. United States*, *supra* note 108, where the court upheld an instruction authorizing the jury to consider defendant's failure to produce his records as evidence of willfulness and said that, while the defendant had a right to refuse to surrender the books, such right "is not impaired" by the adverse inferences from his exercise of the right. *Accord*, *Smith v. United States*, *supra* note 46. Such cases are shaky, however, because they rest upon the assumption that there is no privilege to withhold tax records because such records are within the scope of *Shapiro v. United States*, 335 U.S. 1 (1948), a question which is still open. (See note 196 *infra*.) Assuming, however, that the "required records" doctrine is inapplicable, or that non-cooperation consists of something other than refusal to produce "required records," the fact that the taxpayer invoked the privilege at the investigative stage should normally be inadmissible under *Grunewald v. United States*, 353 U.S. 391 (1957). It would seem to follow that "non-cooperation," if in reliance upon a Fifth Amendment claim, would also be inadmissible. One could further contend that, even without an explicit claim of the Fifth Amendment, non-cooperation is an exercise of the privilege and cannot be used as evidence. This is the clear import of *Miranda v. Arizona*, *supra* note 167, at least as to one in custody. See, e.g., 384 U.S. at 468 n.37: ". . . it is impermissible to penalize an individual for exercising his Fifth Amendment privilege when he is under police custodial interrogation. The prosecution may not, therefore, use at trial the fact that he stood mute or claimed his privilege in the face of accusation . . ." There is no apparent reason why this rule should not apply to one who remains silent or refuses to



of cooperation will be admissible in his client's own behalf and may be the difference between conviction and acquittal.<sup>181</sup> Finally, counsel may be aware of the immense formal discovery power of the IRS which can make many efforts at non-cooperation end in futility. In virtually no other part of the criminal process do both law and sound strategy lean so heavily in favor of self-incrimination.<sup>182</sup>

Thus, it seems like that the modest proposal suggested—requiring warnings as a condition of using disclosures in a criminal prosecution—would not seriously interfere with normal tax enforcement activities and would seldom prevent substantial disclosure by one who was warned, even if he acted on the warning and consulted counsel. His disclosures, however, would be more intelligent and more reliable.

### *The Administrative Summons*

If his informal investigative efforts are not enough to make his case, the agent has formal discovery devices not available to the policeman. Their availability is also attributable to the ambiguous, hence, non-criminal character of the agent's investigation. Again, the self-incrimination privilege is little comfort to the potential accused.

All revenue agents and special agents are authorized by statute to summon "any person" they "deem proper" to "produce any books, papers, records, or other data" which "may be relevant" in "determining the liability of any person for any internal revenue tax," and also

cooperate with an internal revenue agent, even though not in custody. There are cases, however, which hold that the Fifth Amendment privilege must be expressly asserted so that the validity of the claim can be ruled upon, e.g., *United States ex rel. Vajtauer v. Comm'r*, 273 U.S. 103 (1927). The latter doctrine seems irreconcilable with *Miranda* and indefensible in the context of an administrative investigation. If an agent has doubts about the taxpayer's right to remain silent, he is free to issue a summons, institute enforcement proceedings, and compel the taxpayer to cooperate or claim the privilege before a court. Why should the taxpayer, or anyone else who is questioned by one having no authority to adjudicate the validity of a claim of privilege, be required as the price of exercising the privilege, to mouth a particular verbal formula?

[181.] Pre-trial cooperation may also weigh heavily in favor of a lighter sentence if the defendant is convicted. See *Pilot Institute on Sentencing*, 26 F.R.D. 231, 269 (remarks of Judge Boldt); *id.* at 287 (remarks of Judge Delehant). For a full exposition of the complexities of the lawyer's decision regarding cooperation, and for illustrations of the contrariety of expert views on the subject, see BALTER, *TAX FRAUD AND EVASION* §§ 6.1-6.4 (3d ed. 1963); SCHMIDT, *op. cit. supra* note 154, at 256-63; Lipton, *The Taxpayer under Fraud Investigation: Suggestions for Effective Representation*, 47 A.B.A.J. 265 (1961).

[182.] An additional factor which frequently induces attorneys to counsel cooperation, even after it is clear that a fraud investigation is under way, is the hope that cooperation in paying up delinquent taxes is really all the agents are after. Not long ago the IRS advertised its willingness to forego prosecution of tax evaders who confessed and paid up before the agents were hard on their haunches. See BALTER, *TAX FRAUD AND EVASION* §§ 4.1-4.11 (3d ed. 1963). Since a reorganization of the Internal Revenue Service in 1952, which was accompanied by a withdrawal of the "voluntary disclosure" policy, however, taxpayers cannot buy immunity by cooperation. Yet there

to take the testimony of such person under oath.<sup>183</sup> If the summoned person fails or refuses to comply, the agent may obtain an order from the district court requiring compliance under threat of contempt.<sup>184</sup> Willful neglect of such a summons is also a crime.<sup>185</sup> Requirements of specificity and materiality of the summons are slight and are easily met,<sup>186</sup> and there is no limit on how far back in time a summons for records may reach.<sup>187</sup> No allegation or proof of probable cause or even suspicion is required to justify a summons or an enforcement order.<sup>188</sup>

The Government, therefore, has the power to compel the taxpayer to produce any documentary evidence which "may be relevant" to his deficiencies, together with a deposition procedure that is even more useful than a deposition under a Federal Rules of Civil Procedure, because the defendant and his counsel have no right to give explanatory testimony unless requested to do so by the IRS, nor must the Government first apprise defendant of the precise purpose of the inquiry.

The administrative summons is theoretically a "civil" discovery device and not a "criminal" one.<sup>189</sup> Yet the courts hold that a summons issued any time before indictment is enforceable even if the agent admits that one of his objectives in issuing the summons was to get evidence for a criminal prosecution.<sup>190</sup>

is still reason to believe that an informal "voluntary disclosure" policy of sorts is still in effect. See, e.g., the statement of Commissioner Caplin in 1962:

The coming of ADP makes this just about the best time for a delinquent taxpayer to put his house in order . . . . As to those who have committed tax frauds . . . the question may arise whether a taxpayer's voluntary disclosure of his willful violations will afford immunity against criminal prosecution. I want to reaffirm our existing policy in this regard. Even true voluntary disclosure of a willful violation will not of itself guarantee prosecution immunity. *At the same time, the Service will carefully consider and weigh this, along with all other facts and circumstances, in deciding whether or not to recommend prosecution. Voluntary disclosure would of course have to be made before any investigation had been initiated.*

16 J. TAXATION 104 (1962). (Emphasis added.) Thus, while it has been said that offers of settlement while the IRS or the Justice Department are considering prosecution is "useless . . . unwise and dangerous," BALTER, TAX FRAUD AND EVASION § 7.2 (3d ed. 1963), there are still many optimists who hope, by making a generous settlement and admitting past misdeeds, to forestall criminal prosecution.

[183.] I.R.C. §§ 7602, 7608.

[184.] I.R.C. § 7604.

[185.] I.R.C. § 7210.

[186.] See generally, Burroughs, *The Use of the Administrative Summons in Federal Tax Investigations*, 9 VILL. L. REV. 371 (1964).

[187.] *United States v. Powell*, 379 U.S. 48 (1964).

[188.] *Ibid.*

[189.] *United States v. O'Connor*, 118 F. Supp. 248 (D. Mass. 1953).

[190.] Where the summons is issued after indictment and the agent can suggest no purpose of it but to assist in the criminal prosecution, enforcement has been refused. *United States v. O'Connor*, *supra* note 189; *Application of Myers*, 202 F. Supp. 212 (E.D. Pa. 1962) (summons to third party). But if the summons is issued before indictment, it is enforceable even if the agent admits that one of his purposes is to get evidence for a criminal prosecution, *Boren v. Tucker*, 239 F.2d 767 (9th Cir. 1956); *McGarry v. Riley*, 363 F.2d 421 (1st Cir. 1966), and even if enforcement is sought after indictment. In the

*Privilege as a Defense to a Summons*

If a taxpayer chooses, he may invoke the privilege against self-incrimination to resist a summons to give his oral testimony under oath. After indictment, he may on such grounds probably refuse even to be sworn.<sup>191</sup> Before indictment, he can only refuse to answer specific incriminating questions.<sup>192</sup> The protection afforded by the Fifth Amendment against a summons to produce books, records and other documents is another matter. Several courts have held that the required records doctrine (enunciated by the Supreme Court in a case involving price records required by OPA regulations<sup>193</sup>) applies to tax records.<sup>194</sup> Under that doctrine, records are not within the protection of the Fifth Amendment if they are "required by law to be kept in order that there may be suitable information of transactions which are the appropriate subjects of governmental regulation and the enforcement of restrictions validly established."<sup>195</sup> The Supreme Court has not yet decided whether the doctrine applies to tax records, however, and the Justice Department seldom relies upon it in litigation.<sup>196</sup> It is usually possible to get the taxpayer's books without it.

Few taxpayers will resist a summons and require the agent to go to court for an enforcement order. For, if a court order is required, the taxpayer may be burdened with producing more records, at greater cost, than if he belatedly cooperates with the agent. Moreover, the Fifth Amendment is usually the only shield which the taxpayer has,<sup>197</sup> and

matter of Magnus, Mabee & Reynard, Inc., 311 F.2d 12 (2d Cir. 1962), *cert. denied*, 373 U.S. 902 (1963).

[191.] *Cf.* United States v. Lawn, 115 F. Supp. 674 (S.D.N.Y. 1953).

[192.] See Landy v. United States, 283 F.2d 303 (5th Cir. 1960), *cert. denied*, 365 U.S. 845 (1961).

[193.] Shapiro v. United States, *supra* note 180.

[194.] Falsone v. United States, 205 F.2d 734 (5th Cir.), *cert. denied*, 346 U.S. 864 (1953); United States v. Willis, 145 F. Supp. 365 (M.D. Ga. 1955); Beard v. United States, *supra* note 108; *cf.* United States v. Clancy, 276 F.2d 617 (7th Cir. 1960); *rev'd on other grounds*, 365 U.S. 312 (1961) (wagering tax records not protected by privilege).

[195.] Shapiro v. United States, *supra* note 180, at 33, quoting from Davis v. United States, 328 U.S. 582, 589-90 (1946).

[196.] Compare the scholarly views on the propriety of extending *Shapiro* to tax records: Redlich, *supra* note 176, at 192; Meltzer, *Required Records, The McCarran Act, and the Privilege Against Self-Incrimination*, 18 U. CHI. L. REV. 687, 715 (1951). The *Shapiro* case itself has not been approved recently by the Supreme Court, and its recent decision in *Albertson v. Subversive Activities Control Bd.*, 382 U.S. 70 (1965) (holding Communist registration provisions unconstitutional), although distinguishable, seems inconsistent with *Shapiro's* broad dicta.

[197.] Although there have been cases equating an administrative summons with a "search and seizure" within the meaning of the Fourth Amendment, see Redlich, *supra* note 176, at 202, no court requires "probable cause," in the usual meaning of those words, as a condition of enforcing a summons or subpoena. The Supreme Court virtually read the administrative subpoena or summons out of the Fourth Amendment in *Oklahoma Press Pub. Co. v. Walling*, 327 U.S. 186 (1946). Nor is "fishing expedition" likely

many taxpayers are not willing to bear the onus of its exercise. If, however, the taxpayer asserts the Fifth Amendment, and if the court which is asked to enforce the summons does not apply the required records doctrine, production can be resisted—but only as to records which are the claimant's personal property.<sup>198</sup> Thus, several courts have held that the working papers of a taxpayer's public accountant, even if in the rightful possession of the taxpayer, are not the taxpayer's property and cannot be withheld.<sup>199</sup> Furthermore, since the self-incrimination privilege does not apply to corporations, the taxpayer may be forced to produce corporate records under his control, even if he is the sole owner of the stock of the corporation, and regardless of the extent to which the records incriminate him personally.<sup>200</sup>

As in the case of admissions and tangible evidence obtained from the defendant informally before warning him of his rights and the possible consequences of cooperation, such evidence obtained by a summons should arguably be inadmissible in a criminal trial. The courts are correct in holding that the mere possibility of a criminal prosecution should not deprive the agents of the right to resort to an administrative summons; and it would not seem feasible to hold that a summons becomes illegal whenever the agent's purpose is sufficiently focussed upon criminal prosecution to meet some abstract standard. Yet, it is hard to see why the dual role of the agent and the uncertainty of his aims in using the summons should justify a court in disregarding the fact that the defendant's statements and records were obtained involuntarily by a device designed for civil investigations. An exclusionary

to be a defense to a summons, even one seeking all "books, papers, documents and records relating in any way to the income tax liability for the years . . ." See *In re International Corp. Co.*, 5 F. Supp. 608 (S.D.N.Y. 1934). See generally, *Burroughs*, *supra* note 186, at 382; *United States v. Powell*, *supra* note 187.

[198.] "The papers and effects which the privilege protects must be the private property of the person claiming the privilege, or at least in his possession in a purely personal capacity." *United States v. White*, 322 U.S. 694, 699 (1944). See also MODEL CODE OF EVIDENCE rule 206 (1942), denying the privilege if someone other than the claimant has "a superior right to possession of the thing ordered to be produced."

[199.] *Deck v. United States*, 339 F.2d 739 (D.C. Cir. 1964); *In re Fahey*, 192 F. Supp. 492 (W.D. Ky.), *aff'd*, 300 F.2d 383 (6th Cir. 1961); *United States v. Boccuto*, 175 F. Supp. 886 (D.N.J. 1959), *appeal dismissed*, 274 F.2d 860 (3d Cir. 1959) (accountant disclaimed any interest in the working papers; *held*, they were still his); *Contra*, Application of House, 144 F. Supp. 95 (N.D. Cal. 1956) (where accountant disclaimed any interest in the papers); *United States v. Cohen*, 250 F. Supp. 472 (D. Nev. 1965). See generally, Annot. 90 A.L.R.2d 784 (1963); *Fahey, Testimonial Privilege of Accountants in Federal Tax Fraud Investigations*, 17 TAX L. REV. 491 (1962).

[200.] *Wild v. Brewer*, 329 F.2d 924 (9th Cir. 1964). The same doctrine applies to records of other entities such as labor unions, *United States v. White*, 322 U.S. 694 (1944), and large partnerships, *United States v. Silverstein*, 314 F.2d 789 (2d Cir. 1963). See generally, Note, *The Constitutional Rights of Associations to Assert the Privilege Against Self-Incrimination*, 112 U. PA. L. REV. 394 (1964).

rule, applicable only in a criminal prosecution, would preserve the summons' utility as a civil discovery device and at the same time assure that the Government could not use the summons to evade its duty to prove guilt by "evidence independently and freely secured."<sup>201</sup> It would therefore be up to the agent to determine whether the likelihood of prosecution was so great as to justify his not using the summons.

A case for reform is not clearly established, however, by showing that the Government is distinctly and anomalously advantaged in its burden of proof, its informal investigations, and its administrative summons powers. There may be equally unique compensatory disadvantages in other phases of the process, or extraordinary advantages held by the tax fraud defendant. If the total balance does not unduly favor the prosecution, there may be reason to retain present doctrines. The justifications for affording the Government these advantages would seem to be one or more of the following:

- (1) the prosecution is uniquely hindered in its investigation of a criminal tax case because the offense is ordinarily committed in secret, without eyewitnesses, and without tangible traces of the crime;
- (2) the innocent defendant in a criminal tax case has uncommonly easy access to persuasive proof of innocence; hence, his inability to satisfactorily explain is entitled to great weight in deciding guilt;

[201.] *Malloy v. Hogan*, 378 U.S. 1, 8 (1964). It is, of course, doctrinally unconventional to hold that evidence which can lawfully be compelled over Fifth Amendment claims can nonetheless be excluded at trial on Fifth Amendment grounds, but the administrative summons is not a conventional criminal discovery tool. And the notion is not without precedent. When the Supreme Court abolished the "dual-sovereignty" doctrine which permitted a state to compel a witness to incriminate himself regarding a federal crime, it nonetheless held that the States may continue to compel answers with a grant of State immunity, but that the evidence so obtained cannot be used in a federal prosecution. *Murphy v. New York Waterfront Comm'n*, 378 U.S. 52 (1964). The suggestion above seems consistent with that approach.

It will be noted that the reforms suggested (both as to the use of the summons and the duty to warn) may result occasionally in virtually immunizing from prosecution a person who is clearly guilty, despite the absence of culpability on the part of the examining agent. Not expecting to find evidence of fraud, he examines books without prior warnings, or issues a summons and obtains the books. Then he finds fraud. Under the proposed reforms, he would probably be forced to forego criminal prosecution and to rely on civil fraud sanctions. But this is a consequence of any of the rules which exclude evidence obtained by illegal searches or wiretaps or in violation of the duties under *Miranda*. Moreover, the price of preserving Fifth Amendment rights in a tax investigation is arguably much lower than in more conventional cases. A blunder by a tax investigator which permits a guilty man to escape punishment does not let loose on society a person who threatens anyone's well-being. The function of the criminal tax sanctions is almost entirely that of general deterrence; a particular violator needs no rehabilitation beyond that supplied by civil penalties and his avoidance of criminal sanctions merely places him in a vast reservoir of evaders who are not prosecuted either because they are not investigated or because they were not sufficiently good "examples" to justify the use of the criminal sanction.

- (3) the jury in a tax evasion case is singularly well-equipped to evaluate evidence of tax evasion and to sift out the innocent;
- (4) there is something peculiar about the administrative selection process which makes it especially likely that prosecutions will be commenced only against the guilty; hence, trial safeguards are relatively superfluous.

Let us examine each of these propositions.

1. *Does the Government have less access to proof of tax evasion than it does to evidence of other crimes?*

That the Government has a more toilsome task amassing evidence of guilt in tax evasion cases than in some offenses, such as robbery or murder, where there are often eyewitnesses and physical traces of the crime, is doubtless true. But if tax evasion is compared with other non-violent offenses such as embezzlement, theft, price-fixing, various conspiracies, and many of the so-called "victimless crimes," the comparative disadvantages of the Government are not obvious. In many of these offenses, all the persons who possess probative evidence are frequently *in pari delicto*. They are highly motivated to keep quiet. Often, however, tax evasion is conducted with the knowledge of other persons who are not seriously implicated or who, more importantly, do not conceive of themselves as parties to crime, *e.g.*, secretaries, clerks, bookkeepers.

Aside from eyewitnesses, the Government can receive help from outsiders who have dealt with the taxpayer in legitimate commercial transactions. Customers, employers, employees, clients of the taxpayer seldom have any strong reason to obscure their dealings with the taxpayer. Thus, even if the prosecution were required to prove the deficiency by direct evidence, there would often be ample proof available. And when it is permitted in addition to employ the various methods of circumstantial proof there are probably few crimes on which evidence of guilt is so plentiful. Gathering it may be costly, but it exists and its accumulation only takes time.

Moreover, the traditional devices available to the Government to obtain disclosure from the accused and from third parties are at least as effective as those available for any other criminal charge.

### Traditional Discovery Devices Available Against the Defendant

#### A. *Search and Seizure*

Although revenue agents seldom resort to a search for books, presumably because other means of discovery are so easily employed and because a search would tip off the suspect, a search warrant is available to the agent who can muster probable cause to believe the taxpayer

has committed a crime.<sup>202</sup> The taxpayer's records may be subject to seizure as "instrumentalities of the crime" of tax evasion, or, perhaps, the crime of failing to keep adequate books and records.<sup>203</sup> And if a valid search warrant is obtained, the agent may seize the taxpayer's books and avoid the fetters of the Fifth Amendment, since he has not compelled the taxpayer to produce any evidence, but has required him merely to step aside while the agent helps himself.<sup>204</sup>

Even if the summons were not available, therefore, the only way the taxpayer could clearly avoid disclosing some records to an imaginative and persistent agent would be to hide or destroy them. Yet such conduct is a "badge of fraud," will itself constitute an attempt to evade taxation and thus support an additional count in the indictment, will be damaging evidence of willfulness on all counts,<sup>205</sup> and may prevent the use of the records or copies in the taxpayer's defense.<sup>206</sup> It is a risky remedy which will be resorted to only by a taxpayer clearly conscious of guilt, and convinced that the Government will prosecute if it sees his books.

### B. *The Grand Jury*

By the time the defendant's case is ripe for an indictment, the Government will usually have extracted all the evidence it needs from

[202.] See *Zachary v. United States*, 275 F.2d 793 (6th Cir. 1960); *Levin v. United States*, 5 F.2d 598, 601 (9th Cir. 1925). The Supreme Court seems willing, moreover, to apply a special standard of "probable cause" in a tax evasion case, less stringent than that which it applies in other criminal cases, because, it is said,

Establishment of grounds for belief that the offense of tax evasion has been committed often requires a reconstruction from many individually unrevealing facts which are not subject to concise statement in a complaint. Furthermore, unlike narcotics informants, for example, whose credibility may often be suspect, the sources in [a] tax evasion case are much less likely to produce false or untrustworthy information. Thus, whereas some supporting information concerning the credibility of informants in narcotics cases or other common garden varieties of crime may be required, such information is not so necessary [in tax fraud cases].

*Jaben v. United States*, 381 U.S. 214, 224 (1965) (where the Court held that a complaint under oath of a special agent stated "probable cause" when it recited the fact that he had investigated defendant's return by interviewing "third parties with whom said taxpayer did business" and had consulted "public and private records," and had concluded that taxpayer committed tax evasion by understating his income for 1936 by about \$22,000).

[203.] *Alioto v. United States*, 216 F. Supp. 49 (E.D. Wis. 1963). The court added, moreover, that if books and records were willfully withheld in disobedience of a summons, the records "would take on the nature of contraband subject to search and seizure as the fruit of a crime." *Id.* at 50.

[204.] Evidence of tax evasion is sometimes turned up in the course of searches for, at least ostensibly, evidence of other crimes. See, e.g., *Miller v. United States*, 354 F.2d 801 (8th Cir.), cert. denied, — U.S. — (1966) (arrest by state officers in home on warrant for abortion; search of home produced records used to convict for federal income tax evasion).

[205.] See text accompanying note 16 *supra*.

[206.] See *United States v. O'Connor*, 273 F.2d 358 (2d Cir. 1959).

him. But if there are still some loose ends, he can be subpoenaed to testify before a grand jury. It has been held not a violation of the *de facto* defendant's constitutional rights to subpoena him to testify before a grand jury investigating his criminal activities, even though he is denied the assistance of counsel during the interrogation and is not warned of his rights by the prosecutor.<sup>207</sup> Nor need the prosecutor inform him that it is he who is under investigation.<sup>208</sup> Seeking to avoid legal tests of these questions, however, prosecutors often "suggest" to the suspect that he request the "privilege" of appearing before the grand jury or, if the suggestion is not taken,<sup>209</sup> require him to testify before a grand jury which is not considering his case. The latter prosecutorial technique rests on the theory that since the grand jury before whom the suspect testifies is not a part of the screening machinery in his case, he is not forced by the subpoena to be a witness in his own case. Thus, his rights are like those of other grand jury witnesses—to refuse to answer only specific questions on self-incrimination grounds and to do so without the help of counsel.<sup>210</sup>

It seems doubtful that this procedure can survive long after *Escobedo* and *Miranda*, provided there is evidence that the taxpayer at the time of the hearing was a "suspect."<sup>211</sup> Yet, even if interrogation of a "suspect" before a grand jury without the presence of counsel is ultimately outlawed, the freedom of the prosecution to employ the grand jury in this manner will largely depend upon the ability of the defendant to prove he was a suspect at the time of the hearing. Since the information is peculiarly within the knowledge of the IRS or the prosecutor, defendant's success will depend upon their candor in revealing their purposes in bringing him before the grand jury.

[207.] *United States v. Klein*, 247 F.2d 908 (2d Cir. 1957); *United States v. Scully*, 225 F.2d 113 (2d Cir. 1955); *United States v. Manno*, 118 F. Supp. 511 (N.D. Ill. 1954); *Himmelfarb v. United States*, 175 F.2d 924 (9th Cir. 1949). If the witness has become a *de jure* accused by reason of already having been arrested, indicted, or named in an information, he can probably quash the subpoena and refuse to appear; and if he appears, he is entitled to some warnings. See *United States v. Lawn*, *supra* note 191; *but see United States v. Scully*, *supra*, at 115, suggesting that the distinction in this context between the rights of *de jure* and *de facto* defendants "may be artificial and unsound." See generally, Goldstein, *The State and the Accused: Balance of Advantage in Criminal Procedure*, 69 YALE L.J. 1149, 1190 (1960).

[208.] See Goldstein, *supra* note 207, at 1190.

[209.] Since prosecutors can almost always get an indictment from a grand jury upon request, declining an invitation of the prosecutor to appear "voluntarily" entails a risk that failure to appear may result in indictment.

[210.] See *United States v. Keenan*, 267 F.2d 118 (7th Cir. 1959); *Isaacs v. United States*, 256 F.2d 654 (8th Cir. 1958).

[211.] See text accompanying notes 171-75 *supra*.



C. *The Subpoena Duces Tecum*

Rule 17(c) of the Federal Rules of Criminal Procedure authorizes a subpoena for the production of tangible evidence "before the court at a time prior to trial" and provides that the court may upon production "permit the . . . documents or objects or portions thereof to be inspected by the parties or their attorneys."<sup>212</sup> Although it has been said in *dictum* that this rule does not authorize a pre-trial subpoena of documents from the defendant himself, and that if it did so it would violate the Fifth Amendment,<sup>213</sup> the few courts which have actually decided the question hold otherwise.<sup>214</sup> Apparently, the defendant whose records are subpoenaed under Rule 17(c) must produce them or claim the Fifth Amendment even though he is already under indictment. If so, he may not be able to resist the subpoena if the documents, though in his possession, belong to someone else<sup>215</sup> or are considered by the court to fall within the required records doctrine.<sup>216</sup>

Government's Discovery from Third Parties

The IRS has little difficulty in getting pertinent information from third parties with which to erect or support its case against a taxpayer. It gets much data from required information returns<sup>217</sup> and also from third party income tax returns and supporting records.<sup>218</sup> Banks, employers, customers, and others who have had dealings with the taxpayer are usually willing to cooperate.<sup>219</sup> There is rarely any reason for the agent to issue a summons and seldom any legal ground to resist if one is issued.<sup>220</sup> And there is always the spectre in the background of a costly audit of the third person's own tax returns. Sometimes, of course,

[212.] FED. R. CRIM. P. 17(c).

[213.] *United States v. Carter*, 15 F.R.D. 367 (D.D.C. 1954).

[214.] *United States v. Woodner*, 28 F.R.D. 22 (S.D.N.Y. 1961) (characterizing the subpoena as "not a discovery proceeding, but merely a procedure to facilitate the trial of the case"); *United States v. Gross*, 24 F.R.D. 138 (S.D.N.Y. 1959); *United States v. Eli Lilly Co.*, 24 F.R.D. 235 (D.N.J. 1959) (corporation's records, since not protected by the self-incrimination privilege, are producible.) See Annot., 96 A.L.R.2d 1224 (1964).

[215.] See notes 193-200 *supra* and accompanying text.

[216.] See notes 193-96 *supra* and accompanying text.

[217.] More than 340 million information reports were filed with the IRS during 1965. 1965 COMM'R INT. REV. ANN. REP. 8.

[218.] An audit of taxpayer X will frequently produce evidence of the fraud of Y, a customer, client, or employee of X, who may have to incriminate Y to clear himself. An audit of X's return may also be a guise for gathering evidence against Y without alerting Y or X, who may be a friend, of the fact that Y is under suspicion.

[219.] See text accompanying note 75 *supra*.

[220.] Occasionally, however, a bank or other institution may refuse to produce records without a summons, then resist the summons at the behest of a valued customer. See *e.g.*, *United States v. Foster*, 309 F.2d 8 (4th Cir. 1962). But seldom is resistance ultimately successful.

there may be reason to surmise that the third party, *e.g.*, a lawyer or accountant, may have participated in an offense with the suspect taxpayer. Enthusiastic, unqualified cooperation may be the only way to dispel such notions.<sup>221</sup>

Third parties, moreover, may be compelled to produce not only their own records but any documents in their possession or under their control.<sup>222</sup> Thus if a taxpayer turns his records over to an accountant or an attorney for assistance in preparing his defense, they are vulnerable to a summons. The accountant or attorney can assert neither his client's Fifth Amendment rights—the rights are personal<sup>223</sup>—nor his own—since he does not own the records.<sup>224</sup> Even though it exists by statute in several states, no accountant-client privilege is recognized in federal court.<sup>225</sup> And the attorney-client privilege is unavailable to the attorney because that privilege does not apply to pre-existing documents.<sup>226</sup> The third party summons is therefore a potent device with

[221.] See, *e.g.*, *United States v. Goldberg*, *supra* note 30 (defendant's former controller and administrative assistant joined with defendant, permitted to plead *nolo*, then testified for the prosecution); *Black v. United States*, 353 F.2d 885 (D.C. Cir.), *rev'd on other grounds*, 87 Sup. Ct. 190 (1966) (defendant's attorney and his accountant testified against him, destroyed his claim of reliance on them and, incidentally, absolved themselves of suspicion of aiding and abetting. The attorney testified that a special agent of the IRS threatened him with criminal prosecution if he did not cooperate. *Id.* at 896 (dissenting opinion)); *Lord v. Kelley*, 223 F. Supp. 684 (D. Mass. 1963), *appeal dismissed*, 334 F.2d 742 (1st Cir. 1964), *cert. denied*, 379 U.S. 961 (1965) (special agent obtained defendant's records from accountant by saying that if he didn't cooperate the accountant would "be in trouble"); *Lawn v. United States*, 355 U.S. 339 (two taxpayers, their accountant, and their lawyer jointly tried); *United States v. Cox*, 348 F.2d 294 (6th Cir. 1965) (defendant's accountant executed affidavit at behest of defendant which apparently absolved defendant. The accountant then had several sessions with a special agent during which he was "duly warned of his constitutional rights." Ultimately he repudiated the affidavit and testified for the prosecution). See also testimony before the Long Committee concerning tactics employed against taxpayer representatives, *Hearings Before the Subcommittee on Administrative Practice and Procedure of the Senate Comm. on the Judiciary*, *supra* note 155, at 1375, 1388, 1405, 1407-08, 1436.

When threats do not work, rewards often will. The Internal Revenue paid \$565,254 in informers' rewards in 1964. 1964 COMM'R INT. REV. ANN. REP. 25 (1964).

[222.] I.R.C. § 7602(2).

[223.] *United States v. Willis*, 145 F. Supp. 365, 368 (M.D. Ga. 1955); *United States v. Goldfarb*, 328 F.2d 280, 282 (6th Cir.), *cert. denied*, 377 U.S. 976 (1964); *Bouschor v. United States*, 316 F.2d 451 (8th Cir. 1963). *Contra*, as to the attorney's standing to assert his client's Fifth Amendment rights, *United States v. Judson*, 322 F.2d 460 (9th Cir. 1963).

[224.] See notes 198-200 *supra*. Seldom, however, does the attorney or client actually assert his own privilege against incrimination, for obvious reasons.

[225.] *United States v. Bowman*, 236 F. Supp. 548 (M.D. Pa. 1964); *Falsone v. United States*, *supra* note 194. *But see Baird v. Koerner*, 279 F.2d 623 (9th Cir. 1960). See generally, Comment, 31 U. CHI. L. REV. 395 (1964).

[226.] *Bouschor v. United States*, *supra* note 223; *United States v. Judson*, *supra* note 223; 8 WIGMORE, EVIDENCE § 2307 (3d ed. 1940). *But see* Note, 74 YALE L.J. 539, 546 (1965), which is cogently critical of the mechanical application of the pre-existing document exception.

which to circumvent the taxpayer's exercise of his Fifth Amendment rights.<sup>227</sup>

The Government's legitimate power to produce evidence from third parties is greater than that in most other criminal cases.<sup>228</sup> In conventional criminal investigations, the grand jury, which affords the prosecution "a full fledged deposition procedure without the embarrassing presence of defendant or his counsel,"<sup>229</sup> is the Government's principal formal discovery device. In tax evasion cases, however, the Government has the same thing in the summons power, which may be exercised long before indictment, before either the taxpayer or the person summoned has an inkling of the nature of the investigation.

To the extent, therefore, that the Government's traditional burden of proof is relaxed and the defendant's rights eroded in criminal tax cases on the premise that the Government's access to evidence is uniquely limited, the rulings rest on shaky legs. The Government is well-equipped to get evidence against the great majority of tax evaders. The widely held belief to the contrary arose over the past generation because the most publicized cases have been the Government's hard ones: those involving racketeers, gamblers, corrupt politicians, persons who know from the start of an audit that the IRS is trying to build a criminal case against them, and who have the power and the ruthlessness to make witnesses disappear or forget. But most tax fraud defendants are not racketeers,<sup>230</sup> and virtually all taxpayers are potential tax fraud defendants. Moreover, there are other laws specially designed for racketeers, gangsters, gamblers and hoodlums, many of which did not exist twenty years ago.<sup>231</sup> If those laws are inadequate or the Government's difficulties of proof are too great, the place to rectify

[227.] See text at notes 197-98 *supra*.

[228.] No meaningful comparisons can be made with the Government's effective power to gather evidence by unlawful, as well as lawful means, *e.g.*, by wire-tapping, electronic eavesdropping, theft and fraud. There is no reason to think, however, that the actual freedom of the Government to gather evidence unlawfully is any less extensive in tax cases than in others. See Long, *We Must Stop Tax Snooping*, Sat. Eve. Post, Nov. 20, 1965, p. 10; *Hearings Before the Subcommittee on Administrative Practice and Procedure of the Senate Comm. on the Judiciary*, *supra* note 155.

[229.] Goldstein, *supra* note 207, at 1191.

[230.] See *Pilot Institute on Sentencing*, 26 F.R.D. 231, 263 (remarks of Judge Boldt); *id.* at 275 (remarks of Judge Weber). In fiscal 1965, "racketeer" cases represented "about 11% of the Tax Division's criminal tax workload." 1965 ATT'Y GEN. ANN. REP. 311.

[231.] *E.g.*, 18 U.S.C. §§ 201, 1503 (1964) (bribery, intimidation of officials, witnesses); § 1074 (flight to avoid prosecution or giving testimony); § 9084 (transmission of wagering information); § 1262 (illegal transportation of liquor); § 1301 (transportation of lottery tickets); § 1403 (use of communication facilities in narcotics traffic); § 1951 (extortionate interference with commerce); § 1952 (interstate travel or use of mail in aid of "any unlawful activity"); § 1953 (interstate transportation of gambling paraphernalia).

the shortcomings is elsewhere.<sup>232</sup> A process designed to trap an Al Capone<sup>233</sup> or a "Greasy-thumb" Guzik<sup>234</sup> may be an even better trap for an innocent taxpayer.

2. *Does the tax evasion defendant have peculiar access to evidence which justifies placing heavy probative weight on his inability to explain?*

Every taxpayer is required by statute to "keep such records . . . as the [Treasury] may from time to time prescribe."<sup>235</sup> The Treasury Regulations require that these records be such "as are sufficient to establish . . . [any] matters required to be shown . . . in any return."<sup>236</sup> Compliance is encouraged by a statute which makes willful failure to keep required records a crime,<sup>237</sup> although apparently no one has ever been prosecuted for keeping inadequate records, and it would be a rare case in which willfulness could be proved.<sup>238</sup> The main incentive to keep accurate records is that the burden of proof in civil tax controversies is usually on the taxpayer.<sup>239</sup> Records are also essential in the operations of many small businesses and all large ones. It might seem, therefore, that innocent defendants have records which will permit them easily to rebut charges of tax evasion. There are three major flaws in the premise, however, as a justification for placing a heavy burden of explanation on the defendant.

First, it has limited application to one, such as a wage earner or salaried employee, who has little business need for records and who may well prefer to assume the risks of having a few tax deductions disallowed than to shoulder the trouble and expense of keeping elaborate records. Many taxpayers thus elect not to insure themselves against erroneous assessments by keeping detailed records.

Second, books of account may at one time have existed yet have been lost or destroyed before the tax prosecution was commenced. The statute of limitations on civil assessments of tax deficiencies is ordinarily three years.<sup>240</sup> Taxpayers may therefore destroy records after four or

[232.] See Avakian, *Criminal Procedure and Penalties in Tax Cases—The New Policy of the Bureau*, 1953 U.S.C. TAX INST. 549 (1953).

[233.] *United States v. Capone*, 93 F.2d 840 (7th Cir.), cert. denied, 303 U.S. 651 (1937).

[234.] *Guzik v. United States*, *supra* note 38.

[235.] I.R.C. § 6001.

[236.] Treas. Reg. § 1.6001-1(a).

[237.] I.R.C. § 7203.

[238.] *Cf. United States v. Murdock*, 290 U.S. 389 (1933).

[239.] See SCHMIDT, *op. cit. supra* note 154, at 584 (1963). There are exceptions, of course, and one of them is where the proposed deficiency includes civil fraud penalties. I.R.C. § 7454(a).

[240.] I.R.C. § 6501.

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five years, reasonably assuming they are no longer needed, either for tax or business purposes. The tax years which the records cover are closed in the absence of fraud.<sup>241</sup> Fear of prosecution for tax evasion or of a civil fraud assessment is a trivial factor in the decision of an honest but not overly-prudent man to retain or dispose of records. Yet the statute of limitations on criminal tax evasion is six years,<sup>242</sup> and, through various doctrinal devices, it can be extended.<sup>243</sup> Prosecutions are sometimes initiated eight or ten years after the tax year in question.<sup>244</sup>

Third, even if apparently accurate records do exist, they are not necessarily defenses to a net worth, expenditure, or bank deposit case. If circumstantial evidence indicates that income was underreported, it also implies that taxpayer's records to the contrary are false, and a jury is free to infer that they are.<sup>245</sup> Only records relating to net worth, expenditure, or bank deposits squarely meet the Government's circumstantial evidence, and these records are rarely maintained, much less preserved.

Since records often will not exonerate the innocent net-worth defendant, reliance must be placed on his memory. He is expected to recall items the Government has omitted from its computations, or that, for example, he withdrew money from the bank and redeposited it, or purchased a boat ten years ago with cash on hand from income of a prior year. Attributing such powers of recollection to an ordinary taxpayer seems dubious, especially if he is called upon to search his memory for the first time at the trial. If the Government's theories and the details of its computations were made available to defendant well before trial, and before the agents called upon him to explain, the assumption would at least be arguable, but the Government is not compelled to submit such details to defendant under present procedures. The defendant can be asked, even before he has counsel, for an explana-

[241.] If the taxpayer's return was "false or fraudulent with intent to evade tax," or if he filed no return, the tax may be assessed "at any time." I.R.C. § 6501(c). There is also an exception extending the limitations period to six years if gross income was understated by more than 25 per cent. I.R.C. § 6501(e). The latter provision is seldom invoked, however, and the former, though often employed, is not a major consideration to taxpayers who regard themselves as honest.

[242.] I.R.C. § 6531.

[243.] See *Capone v. United States*, 51 F.2d 609 (7th Cir. 1931); *United States v. Beacon Brass Co.*, 344 U.S. 43 (1952); *United States v. Sclafani*, 126 F. Supp. 654 (E.D.N.Y. 1954); *Jaben v. United States*, *supra* note 202; *Cohen v. United States*, *supra* note 16; Comment, *The Statute of Limitations for Tax Evasion: The Possibilities of Circumvention by Administrative Procedures*, 55 Nw. L. REV. 97 (1960); Comment, *Conspiracy, Concealment, and the Statute of Limitations*, 70 YALE L.J. 1311 (1961).

[244.] See, e.g., *Cohen v. United States*, *supra* note 16.

[245.] See note 137 *supra* and accompanying text.

tion of the vaguest of assertions, and his response will be used to disprove any different explanation he offers at the trial.

The taxpayer's records and his memory, moreover, may be little help in destroying the testimony of a witness who falsely claims he paid defendant a cash bribe five years ago or that of an IRS agent who erroneously testifies that taxpayer made certain incriminating statements. In tax evasion cases, as in others, the best defense will often be an attack on the prosecutor's witnesses. Yet if a tax evasion defendant has a sharper set of instruments for assailing the credibility of Government witnesses than do other criminal defendants, the nature of the tools has not been suggested.

The assumption that a tax fraud defendant has peculiar access to evidence is further weakened by the fundamental differences between tax evasion and other criminal cases in the breadth of the inquiry. In the typical criminal case the charge is that a particular form of illegal conduct occurred in a named location within a specified, relatively brief period of time. The nature of the charge permits the defendant to taper his tactics and to concentrate his defensive energies. It limits the nature and sources of evidence that the Government can adduce and gives defendant general notice of these limits. In the tax evasion case, however, the typical accusation is that sometime during a period of three or four years the defendant received some income which he did not report on his tax returns. Evidence in support of the accusation may cover ten or twenty years.<sup>246</sup> The search for evidence of innocence must cover the whole period too.

If, therefore, there is merit in the notion that the tax defendant has peculiar access to evidence, it must lie in differences in the formal and informal discovery mechanisms available to him.

## Disclosure Available to Defendant

### 1. *Informally*

#### *At the Investigation Stage*

In a routine audit, the revenue agent who asks to see the taxpayer's records will usually specify the particular items on the return which he

[246.] As earlier noted, when the Government relies upon a statement made by the taxpayer to third parties as a starting point from which to calculate net worth increases, the statement may antedate the prosecution period by several years, thus putting into issue the defendant's net worth changes over a decade or more. See note 71 *supra* and accompanying text.

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questions. If it is these items which ultimately generate the criminal prosecution, the taxpayer in his negotiations with the agent will have gotten a general notion of the nature of the suspicion. In his efforts to clear up questions, the agent will often reveal his theories and, sometimes, the essence of his evidence which conflicts with the taxpayer's claims.

Yet as soon as fraud is suspected—whether before the initial confrontation or later—the inquiries made by the agent will be an unreliable source of disclosure to the taxpayer. An agent may ask to see the books to verify deductions when his main concern is with understated gross income. He may indicate concern about the tax return for 1962, when he is primarily interested in 1959, and may justify examining the records for 1959 because of the illumination they ostensibly may provide on the 1962 matter. Moreover, if the agent was originally concerned about deductions for 1962, but notices in his perusal of taxpayer's books apparent irregularities involving different items or different years, he may continue his probe without revealing his new purposes.

As the agent's suspicion mounts, he becomes a policeman and is motivated to get the maximum disclosure from the taxpayer while disclosing a minimum of the nature and focus of his quest. This permits the agent to extract more evidence because the taxpayer does not detect danger and may give damaging perfunctory explanations without clearly realizing what he is being asked to explain or the risks affixed to error.<sup>247</sup> If the agent can lull or mislead the taxpayer about the character and strength of his suspicions,<sup>248</sup> the taxpayer will also be less likely to warn his friends, family, and associates before the agent gets statements from them, or at least will be unlikely to give them warnings which will make their interrogation fruitless.

The confrontations between agent and taxpayer cannot help but produce some disclosure of the Government's case to the taxpayer, but its quality and reliability are not great. Even if the matters about which the agent initially inquired were apparently unsatisfactorily explained, and even if it is thus apparent to the taxpayer that these items may ultimately be involved in the prosecution, there is no assurance that other items or other years may not also be included. Once the special agent

[247.] See the instructions to revenue agents reproduced in *United States v. Frank*, 245 F.2d 284 (3d Cir. 1957): "Be cautious and alert and cultivate the confidence of the taxpayer without tipping your hand as he may cooperate to some degree with you, but if he finds out you are on his trail as an 'R' sleuth, he may clam up, and from then on your job will be much more tedious and a lot of harder work is ahead of you."

[248.] See text accompanying notes 154-58.

decides he has a tax fraud target in hand he will ordinarily look for all the evidence of evasion in all the years that are open. The Government's case may be altered considerably between the audit and trial stages and the audit may not even suggest the nature of the changes.

A frequently fruitful source of disclosure to the taxpayer is third parties—friends, family, agents, banks and other businesses, who after being questioned by the IRS, promptly report the conversations to the taxpayer. Clever agents can throw the taxpayer off the track, however, by asking these people for information which the agents do not really want and by misleading them about the agents' real concerns, much as they can mislead the taxpayer. The easiest way, of course, is simply to audit the third person's returns.

Because third parties will frequently report to the taxpayer, people who are neutral or actively hostile to him—former employees or business associates, social or business rivals, envious neighbors, ex-wives—are preferred sources of information to the Government. Not only will these people be more willing to talk and to testify against the taxpayer, they may be open to overtures or admonitions against talking to the taxpayer or his attorney. The Government can capitalize on their hostility toward the taxpayer and can employ more effectively the inducements of patriotism and public service, financial rewards, and a benign attitude toward the third party's own tax returns.<sup>249</sup> If such persons exist, the Government is therefore highly motivated to build its case upon them. When it does so, third parties may provide little or no useful information to the defendant.

The taxpayer will nonetheless often know a good deal more than the typical criminal defendant about the Government's case before the criminal process is actually invoked. Yet this is largely because much of the Government's investigation in routine criminal cases occurs after arrest, whereas tax fraud investigations typically are almost completed before criminal charges are made. The difference is a matter more of the time when disclosure occurs, than of its quantity or quality. Moreover, much of what the taxpayer learns will be misleading and the pieces of information filtering back to him will often be considerably less important to his defense than that which he might get from his friends if he were charged with a different crime, because of the variety and the complexity of the methods and sources of proof available to the Government and the breadth of time periods which the investigation and the prosecution can cover.

[249.] See note 221 *supra*.



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### *At the Administrative Level*

After the special agent completes his fraud investigation, he submits a report to his supervisor who, if he approves a recommendation for prosecution, submits it to the Chief of the local Intelligence Division, who reviews the case and decides whether to propose prosecution to the Assistant Regional Commissioner in charge of Intelligence.<sup>250</sup> If the Assistant Regional Commissioner agrees, the file is sent to the Office of Regional Counsel, where it is reviewed again, then sent to the Tax Division of the Department of Justice, where another decision is made before the file is transmitted to the U.S. Attorney for presentation to the grand jury. At these various levels of the IRS, and in the Justice Department as well, the taxpayer and his counsel are ordinarily given the opportunity to appear for conferences and to produce evidence and argument to induce the officials to decide against prosecution.<sup>251</sup> In the course of these conferences, the taxpayer may get some concrete information about the Government's case. Yet he usually gives much more than he receives.<sup>252</sup> It is IRS and Department of Justice policy to give the taxpayer or his attorney virtually no details of the case at the IRS level, and even when the case reaches the Justice Department, the defense will usually get no more than the amounts of the deficiencies and the years for which evasion is to be charged.<sup>253</sup> Defense counsel seldom sees any evidence or hears any theories.

### *From the Prosecuting Attorney*

When defense counsel learns that the file has been sent to the United States Attorney for formal criminal action, he can usually get a conference with the prosecuting attorney. Sometimes he will get some details about the Government's case—its theories, a description of and, rarely, a look at some of its evidence and the names of some of the prospective

[250.] For a detailed account of the review process, see *BALTER, TAX FRAUD AND EVASION* § 3.3-3 (3d ed. 1963).

[251.] Success, however, is modest, at least at the higher levels. The Regional Counsel's Office and the Justice Department together declined prosecution in only 170 cases in 1964, a period in which the Intelligence Division recommended 1,032 prosecutions. Thus, recommendations by the Intelligence Division were accepted in about 84% of the cases. See 1964 *COMM'R INT. REV. ANN. REP.* 23.

[252.] It appears that, in the past, taxpayers have apparently given away information unknowingly: conferences with their attorneys in conference rooms provided in IRS offices have sometimes been bugged. See *Hearings Before the Subcommittee on Administrative Practice and Procedure of the Senate Comm. on the Judiciary*, *supra* note 155, at 1130, 1139-41, 1165-67, 1223, 1227-30, 1354, 1357-61, 1373-74, 1429, 1510.

[253.] This statement is based upon discussions with Mr. Richard Roberts, Second Assistant to the Assistant Attorney General, Tax Division, Department of Justice, and Mr. Louis Bender, New York practitioner and co-author of *KOSTELANETZ & BENDER, CRIMINAL ASPECTS OF TAX FRAUD CASES* (A.L.I. 1957).

Government witnesses. Sometimes he will get nothing. What the Government attorney will be willing to disclose is a product of several factors. One is his attitude about the propriety and fairness of disclosure to the defense. Opinions on this subject are widely divergent, but most federal prosecutors probably feel that defendant deserves no more discovery than he can get by motion.<sup>254</sup> Another variable is the relationship between the prosecutor and counsel. If the prosecutor knows and trusts defense counsel, he is more likely to divulge information. If there is a pattern of reciprocal cooperation, the prosecutor may trade disclosure for concessions of various kinds in the same or in a different case in which counsel is engaged. Other factors include the prosecutor's evaluation of the character of the defendant and of the plasticity of prospective witnesses. Another is the prosecutor's estimation of the strength of his case. His desire to get a guilty plea will often induce him to reveal at least the skeleton of a strong case in the hope that the defense will surrender.<sup>255</sup>

Generalizations about prosecutorial disclosure are difficult, since available data are scanty. It seems safe to assert, however, that the names of prospective witnesses are more often kept secret than divulged, that the prosecutor seldom permits defense counsel to examine and copy documentary evidence unless it is clear that disclosure will be compelled by court order, that the weaker the Government's case the less disclosure is likely to be made, and that prosecutorial disclosure is no more generous in a tax fraud case than in other criminal cases.<sup>256</sup> Only in the rare case in which the prosecutor has serious doubts about defendant's guilt is he likely to divulge evidence which reveals weaknesses in his

[254.] Apparently the only published poll of prosecutor's attitudes toward discovery in criminal cases appears in *Discovery in Federal Criminal Cases*, 33 F.R.D. 47, 113-20 (1963). The sample, however, consisted of only fourteen assistant United States attorneys in the District of Columbia. Nine of the fourteen thought defendants were "not generally handicapped by lack of discovery." *Id.* at 118. Only three thought "judicial pre-trial discovery rulings too restrictive against defendants." *Id.* at 119. See also Louisell, *Criminal Discovery: Dilemma Real or Apparent?*, 49 CALIF. L. REV. 56, 58 n.6 (1961):

... one like the author whose experience in criminal cases has been at the defendant's side of the table—may be pardoned a skeptical inquiry whether [voluntary disclosure by prosecutors] is not done most typically in cases where it is believed that sharing the information will induce a plea of guilty. Probably many prosecutors will in any case not yield more than they must.

[255.] Of fourteen assistant United States Attorneys polled, 79% said that the "likelihood of a guilty plea" was a factor in their decision to grant or withhold informal discovery. Of seventeen defense attorneys practicing in the District of Columbia, 94% believed this was a factor in the prosecutor's decision. *Discovery in Federal Criminal Cases*, *supra* note 254, at 116.

[256.] The United States Attorney for the District of Connecticut recently made news by announcing that henceforth he would exchange all his evidence before trial with counsel for the defense, *except* in "cases involving complicated financial transactions." Jon O. Newman quoted in *Time*, Sept. 30, 1966, p. 62.

case or suggests possible gaps in the government's proofs. Thus, even when the prosecutor purports to summarize his evidence for defense counsel, he will have sifted and pruned it to wear its best face.

## 2. *Formal Devices to Compel Disclosure*

Tax prosecutions present two possible means of obtaining disclosure from the prosecution which are not available in other criminal cases: resisting an IRS summons and commencing a civil suit. Both devices result from the fact that civil and criminal sanctions cover the same conduct, are investigated and invoked in large part by the same persons, and may be enforced simultaneously or alternatively.<sup>257</sup> In the case of the summons, however, disclosure is denied because of considerations of efficiency having to do with the enforcement of civil sanctions, and in the civil refund suit disclosure is refused because notions of pre-trial secrecy applicable to criminal sanctions are regarded as paramount. Thus, whether civil or criminal criteria control depends upon which choice serves the purposes of the IRS.

### A. *Resisting a Summons*

Some cases used to permit the taxpayer to get a glimmer of the Government's theory before indictment by permitting him to resist an IRS summons for records more than three years old unless the Government supported its request for the summons by factual allegations of fraud.<sup>258</sup> The theory was that since the statute of limitations on tax deficiencies is normally three years in the absence of fraud,<sup>259</sup> a summons for records more than three years old was not reasonably related to tax collection unless there was probable cause to believe that civil fraud had been committed. The Supreme Court, however, rejected the argument in *United States v. Powell*,<sup>260</sup> holding that a summons for years closed by the normal statute of limitations for civil assessments need be supported neither by proof nor allegation of fraud. Said the Court, "we reject any such interpretation because it might seriously hamper the Commissioner in carrying out investigations he thinks war-

[257.] A penalty of 50% of the deficiency may be recovered from any taxpayer at any time if "any part" of the deficiency was "due to fraud." I.R.C. § 6653(b). A conviction for tax evasion normally is followed by an assertion of civil fraud penalties, though civil fraud penalties are frequently assessed against taxpayers who are not criminally prosecuted. Acquittal on a charge of tax evasion does not bar civil penalties. *Helvering v. Mitchell*, 303 U.S. 391 (1938).

[258.] *E.g.*, *O'Connor v. O'Connell*, 253 F.2d 365 (1st Cir. 1958).

[259.] See note 241 *supra*.

[260.] 379 U.S. 48 (1964).

ranted . . . ."<sup>261</sup> Instead, said the Court, "inquiry must not be limited by forecasts of the probable result of the investigation."<sup>262</sup>

A footnote in the opinion of the Supreme Court in the *Powell* case, however, has raised hopes of defense counsel along another line. The Court said that if the summoned person refuses to comply and forces the agent to seek a court order, "the Federal Rules of Civil Procedure apply. . . . The proceedings are instituted by filing a complaint, followed by answer and hearing."<sup>263</sup> Theretofore, the usual procedure was considerably less formal.<sup>264</sup> The Court's footnote leads some to hope that by resisting a summons the taxpayer can force the IRS to file a "civil action," bringing all the Federal Rules of Civil Procedure into play, including those authorizing interrogatories, depositions and inspection of documents. Even so, however, it would not follow that an action by the IRS to enforce a summons justifies the use of discovery devices to uncover the Government's evidence of fraud. Such probes would probably fail the test that they must be "relevant to the subject matter of the pending action,"<sup>265</sup> a limitation on the scope of all discovery devices under the civil rules.<sup>266</sup>

### B. *Civil Refund Suit*

Another possible technique for obtaining discovery is for the taxpayer to institute a civil refund action in the district court, alleging that he overpaid his taxes. The liberal civil discovery devices would then be available and could be helpful in uncovering the Government's criminal case—or so it was hoped. In *Campbell v. Eastland*,<sup>267</sup> however, the Fifth Circuit reversed a district judge who granted discovery in a civil refund case because a criminal prosecution was pending against the taxpayer, although the refund request had been filed before any fraud investigation<sup>268</sup> and more than two years before the Justice Department

[261.] *Id.* at 53-54.

[262.] *Id.* at 57, quoting from *Oklahoma Press Pub. Co. v. Walling*, 327 U.S. 186, 216 (1946), and quoting also the statement in *United States v. Morton Salt Co.*, 338 U.S. 632, 642-43 (1950), that the agency "can investigate merely on suspicion that the law is being violated, or even because it wants assurance that it is not."

[263.] 379 U.S. at 58 n.18.

[264.] See Bender, *The Implications of Reisman v. Caplin in Fraud Cases*, N.Y.U. 23d INST. ON FED. TAX 1293, 1311 (1965).

[265.] FED. R. CIV. P. 26(b).

[266.] Since the Court held in *Powell* that the agent need have neither evidence nor suspicion of fraud to justify a summons, *United States v. Powell*, *supra* note 260, his evidence and his suspicions would seem clearly irrelevant to any issue in the enforcement proceeding. *But see* *Kennedy v. Rubin*, 254 F. Supp 190, 193 (N.D. Ill. 1966) (permitting limited deposition of the special agent who sought an enforcement order).

[267.] 307 F.2d 478 (5th Cir. 1962), *cert. denied*, 371 U.S. 955 (1963).

[268.] Actually, the refund request apparently precipitated a routine audit about a year later, which became a fraud investigation two weeks after that. See *id.* at 480.

authorized submission of the case to a grand jury, and even though the civil action was assumed to have been filed in good faith and not merely as an effort to get criminal discovery, and notwithstanding the fact that defendant had not been indicted when the discovery order was made. After stating that in civil tax cases, "we start with the feeling that fundamental fairness to both sides—the Government starts with a great advantage in investigative resources—requires recognition of the taxpayer's right to pre-trial discovery of the reports of the Internal Revenue Agent who examined the taxpayer's books,"<sup>269</sup> the court proceeded to hold that the "public interest in a criminal prosecution" outweighed the "private interests in civil litigation" and therefore required a determination of priority in favor of the pending criminal case and the pre-trial secrecy which went with it.<sup>270</sup>

Thus, only in the rare instance in which the Government actually assesses a civil deficiency is the defendant entitled to civil discovery while a criminal case pends,<sup>271</sup> and probably even then the court in the civil case will yield to a Government request to postpone the civil trial, and discovery, until the criminal case is over.<sup>272</sup>

### C. Traditional Devices

The taxpayer, like other criminal defendants, must rely chiefly on traditional discovery devices: motions to suppress evidence, to obtain a bill of particulars, and to inspect evidentiary documents. The general inadequacy of these devices has been explored by others<sup>273</sup> and will not be repeated here. It is often assumed, however, that these devices are considerably more useful to tax fraud defendants than to others,

[269.] *Id.* at 485.

[270.] *Id.* at 487.

[271.] See *Frazier v. Phinney*, 24 F.R.D. 406 (S.D. Tex. 1959). The Government's policy is against assessing civil penalties or deficiencies while criminal prosecution is being considered. SCHMIDT, *op. cit. supra* note 154, at 19. The only apparent reason is to prevent the taxpayer from maneuvering the civil case into the Tax Court or the District Court and flushing out the Government's criminal case. Since there is no statute of limitations for civil deficiencies due to fraud, see note 241 *supra*, the Government risks little by delaying assessment.

[272.] Even if the Government assesses a deficiency, it can normally get the Tax Court or the District Court to delay the civil proceedings, and discovery if any, until the criminal trial is over. See SCHMIDT, *op. cit. supra* note 154, at 20; *United States v. Bridges* 86 F. Supp. 931 (N.D. Cal. 1949) (naturalization proceeding). For exceptional cases in which the courts granted discovery despite pendency of criminal proceedings, see *Comm'r v. Licavoli*, 252 F.2d 268 (6th Cir. 1958); *United States v. Brodson*, 155 F. Supp. 407 (E.D. Wis. 1957).

[273.] See Louisell, *Criminal Discovery: Dilemma Real or Apparent?* 49 CALIF. L. REV. 56 (1961); Goldstein, *The State and the Accused: Balance of Advantage in Criminal Procedure*, 69 YALE L.J. 1149 (1960); *Developments in the Law—Discovery*, 74 HARV. L. REV. 940, 1051-64 (1961); *Discovery in Federal Criminal Cases*, 33 F.R.D. 47 (1963).

probably because of the documentary nature of much of the Government's proof. Moreover, since the Rules of Criminal Procedure were recently revised in response to the case for more liberal disclosure to the defendant, it is necessary to take a brief look at what is available.

It should be noted at the outset that perhaps the most important discovery device in the criminal process, the preliminary hearing, is not available to one accused of tax evasion. The preliminary hearing, it has been held, is available only to an accused who is in custody and has not been indicted.<sup>274</sup> In tax cases, the Government virtually always postpones arresting the suspect until the grand jury has returned an indictment, thus precluding any right of the accused to a preliminary hearing.<sup>275</sup>

### *Motions To Suppress*

Motions or petitions to suppress evidence may be brought before or after indictment.<sup>276</sup> Since there is no duty to warn the taxpayer during an investigation of his tax returns, nothing short of misrepresentation or theft on the part of the agent in obtaining the taxpayer's books or statements will constitute an illegal seizure and grounds to have the evidence suppressed. Nonetheless, a resourceful taxpayer might move to suppress evidence in the hope of smoking out the Government's case with discovery orders and depositions ostensibly needed to prepare for the suppression hearing. Since the proceeding if brought before indictment is a "civil action," the Rules of Civil Procedure are applicable. Yet courts often dispose of these motions without even granting a hearing, much less discovery, relying upon the failure of opposing affidavits to raise material issues or upon "lack of equity."<sup>277</sup> And even if a judge grants a hearing, he will seldom make any significant discovery orders because the materials sought—usually the reports of the investigating revenue agents—will be unrelated to the narrow issue of illegal seizure.<sup>278</sup> It would, of course, be otherwise if the nature of the agent's

[274.] *Crump v. Anderson*, 352 F.2d 649 (D.C. Cir. 1965).

[275.] See *Jaben v. United States*, *supra* note 202, at 220.

[276.] *Palmisano v. United States*, 64-2 U.S. Tax. Cas. 93413 (N.D.N.Y. 1963) (no indictment); *Lord v. Kelly*, *supra* note 221. After indictment, the proceeding is brought under FED. R. CRIM. P. 41(e).

[277.] See *Grant v. United States*, 282 F.2d 165 (2d Cir. 1960) (saying that hearings should not be held unless the petition alleges facts which, if true, would warrant relief); *Centracchio v. Garrity*, 198 F.2d 382 (1st Cir.), *cert. denied*, 344 U.S. 866 (1952) (implying that the district judge has substantial freedom to deny a hearing for lack of equity); *Parrish v. United States*, 256 F. Supp. 793 (D. Mont. 1966) (hearing is discretionary).

[278.] See *United States v. Foley*, 283 F.2d 582 (2d Cir. 1960).

suspicious and his purposes at the time of the audit were held to create a duty to warn when the agent had focussed on the taxpayer as an "accused."<sup>279</sup> Then, the agent's reports and other memoranda would be relevant in determining his duties to warn and, consequently, the legality of his obtaining the evidence.<sup>280</sup> Thus, the freedom of the agent to employ guise not only permits him to get more disclosure from the taxpayer,<sup>281</sup> it indirectly enables him to stave off attempts by the taxpayer to get discovery from him through formal processes.<sup>282</sup>

### *Bill of Particulars*

The typical indictment in a tax prosecution reveals virtually nothing.<sup>283</sup> Hence, the defendant's main hope in getting some of the details

[279.] See text at notes 162-66, *supra*.

[280.] The notes and reports might still be privileged from pre-trial production, however, under the Jencks Act, 18 U.S.C. § 3500(a) (1964) (emphasis added), which provides: *In any criminal prosecution* brought by the United States, no statement or report in the possession of the United States which was made by a Government witness or prospective Government witness (other than the defendant) to an agent of the Government shall be the subject of subpoena, discovery, or inspection until said witness has testified on direct examination *in the trial of the case*.

An agent's notes or reports would not seem to be a "statement" of defendant's unless made contemporaneously with the defendant's oral statements and constituting a substantially verbatim account. See 18 U.S.C. §§ 3500(e)(1), (2) (1964). The notes would therefore be "statements" of the agent only and probably immune from pre-trial discovery. See note 303 *infra*. There are, however, at least three possible escapes from Jencks Act immunity, if a court is inclined to grant discovery. The court can interpret "in any criminal prosecution" literally, and hold that the Jencks immunity does not attach before indictment. *But cf.* *Campbell v. Eastland*, *supra* note 267, at 486. Alternatively, the court can construe "in the trial of the case" not to refer merely to the trial on the merits, but to any hearing or trial on subsidiary issues, such as, e.g., a petition or motion to suppress evidence. Thus, the agents' reports would be producible after their direct testimony at the hearing. Third, the court could hold that even if the documents are privileged, this does not permit the Government to defeat the taxpayer's motion to suppress; the Government may be put to a choice: waive the privilege or be enjoined from using the allegedly tainted evidence. *Cf.* *Timken Roller Bearing Co. v. United States*, 66-1 U.S. Tax Cas. 85185 (N.D. Ohio 1964); *United States v. Andolschek*, 142 F.2d 503, 506 (2d Cir. 1944); *McCORMICK*, EVIDENCE 305 (1954).

[281.] See text accompanying notes 163-66 *supra*.

[282.] See, however, *United States v. Gower*, 65-2 U.S. Tax. Cas. 97039 (M.D. Pa. 1965), which granted pre-hearing discovery to taxpayer to assist him in preparing to support his motion to suppress, of *inter alia*, agents' manual of instructions, and "all information, reports and administrative files pertaining to [the] investigation." The Jencks Act issue was apparently not raised, but a general claim of Government privilege was raised and rejected. The court in *Gower*, contrary to all authority, assumed that once the investigation shifts "from a routine civil investigatory stage to the accusatory stage where a criminal prosecution against defendant [is] contemplated," the defendant is entitled to be "properly and adequately advised of his constitutional rights."

[283.] All that is customarily set forth in the indictment are the years in which the taxpayer allegedly committed attempts to avoid tax, the affirmative acts of evasion, the allegation that the attempts were made "willfully and knowingly" and the amount of the deficiency in tax for each of the years covered by the indictment. See *BALTER*, *TAX FRAUD AND EVASION* § 12.3 (3d ed. 1963). Moreover, the Government is not even bound by these allegations: it need not prove that the deficiency even approximated that alleged. *Gentlemen v. United States*, 191 F.2d 993 (9th Cir. 1951), *cert. denied*, 342 U.S. 909 (1952). See also *Himmelfarb v. United States*, *supra* note 207, at 934, 936.

of the case against him will be in the motion for bill of particulars.<sup>284</sup> The bill of particulars is supposed to provide the defendant, when the indictment does not, sufficient notice to enable him to prepare his defense and to prevent surprise at the trial.<sup>285</sup> But the amount of information considered necessary for adequate preparation varies enormously among trial courts and, however stingy, the lower court's allotment is virtually never ground for reversal.<sup>286</sup>

Allowing for the variations among trial courts, some generalizations can still be made about what tax fraud defendants may usually discover through a bill. The Government's theory of proof will usually be divulged, *i.e.*, whether the net worth method, specific items, bank deposits or some combination of methods will be used.<sup>287</sup> If it is the net worth method, the defendant will want to know the opening and closing net worth figures for each year, the assets and liabilities included in the calculations, the starting point in the Government's proofs, the sources of the unreported income, the expenditures the Government will attempt to prove, and all other intermediate calculations. No court will apparently give him all of this information. Most probably require the Government only to reveal its intention to use the net worth method.<sup>288</sup> Some grant the opening and closing figures;<sup>289</sup> and a few, a substantial part of the analysis.<sup>290</sup> In a specific items case, the defendant will want to know what the items are and will usually get such information.<sup>291</sup> He cannot expect to get much more, though some courts will let him have the names, dates, amounts and nature of the payments.<sup>292</sup> In a bank

[284.] FED. R. CRIM. P. 7(f).

[285.] *United States v. Finegan*, 189 F. Supp. 728 (N.D. Ohio 1960).

[286.] The matter is "addressed to the sound discretion of the [trial] court." *Wong Tai v. United States*, 273 U.S. 77, 82 (1927). No conviction has apparently been reversed for failure to grant a motion for particulars in a tax evasion case in more than 30 years. Ziegler, *Detailed Particulars Are Necessary in Fraud Prosecutions*, 16 J. TAXATION 294 (1962).

[287.] *United States v. Doyle*, *supra* note 51; *United States v. Sermon*, 218 F. Supp. 871 (W.D. Mo. 1963); *United States v. Kleinman*, 19 F.R.D. 423, 426 (E.D.N.Y. 1956).

[288.] *Blackwell v. United States*, *supra* note 66, at 426; *United States v. Finegan*, *supra* note 285; *United States v. Hudson*, 176 F. Supp. 327 (M.D. Ga. 1959).

[289.] *United States v. Geller*, 163 F. Supp. 502 (S.D.N.Y. 1958) (including amount and payees of expenditures); *United States v. Brown*, 179 F. Supp. 893 (E.D.N.Y. 1959) (same); see also *United States v. Eissner*, 206 F. Supp. 103 (N.D.N.Y. 1962).

[290.] *United States v. Hoornbeek*, 164 F. Supp. 657 (S.D.N.Y. 1954) (beginning and ending net worth figures for each year; item, date, amount, and payee of each expenditure to be proved; claimed gross income and deductions for each year).

[291.] *United States v. Geller*, *supra* note 289; *United States v. Lipshitz*, 150 F. Supp. 321 (E.D.N.Y. 1957).

[292.] *United States v. Profaci*, 124 F. Supp. 141, 144 (E.D.N.Y. 1954) (defendant in specific items case entitled to names and dates, if items not large in number; otherwise a list of general classes or sources); *United States v. Kelly*, 10 F.R.D. 191 (W.D. Mo. 1950) (nature, source, and amount of gross income and deductions).



## Income Tax Prosecutions

deposit case, some courts will require no more than revelation of the theory on the ground that the bank deposit evidence is available to defendant.<sup>293</sup>

Few, if any, courts will require the Government to disclose in a bill of particulars the names of witnesses it intends to call or to describe the nature of the documentary evidence it intends to offer.<sup>294</sup> The bill, therefore, is a discovery device of limited utility in almost any court. Such utility as it has in revealing the Government's theory of proof, moreover, is undercut by the liberality with which many courts permit variances and amendments at trial.<sup>295</sup> Apparently, if the Government specifies a particular item or items in the return as the basis of its evasion case, it cannot obtain a conviction solely by proving an entirely different item which was not revealed in the indictment or the bill. Yet if it adduces evidence of the falsity of one of the items alleged (or evidence of a net worth increase, if it claimed a net worth increase), it is apparently free to adduce proof of different, unrelated false entries, not specified in the bill, as "corroborative" evidence.<sup>296</sup> The defendant's main protection against surprise, therefore, seems to be his right to tell the jury that the Government proved something against him which it had not alleged.

A court which is willing to permit substantial variances between allegation and proof would seem to have no good reason for refusing a motion for rather detailed particulars. An analogy to notice pleading in civil cases may easily be overdrawn. Pleadings are vague and general in

[293.] *United States v. Taylor*, 148 F. Supp. 77 (W.D. Pa. 1956); *but see United States v. Kelly*, *supra* note 292.

[294.] See *United States v. Geller*, *supra* note 289.

[295.] See *United States v. Woodner*, 189 F. Supp. 355 (S.D.N.Y. 1960) (Government permitted to amend bill to allege some 60% to 70% more unreported income than stated in the bill); *United States v. Bender*, 218 F.2d 869 (7th Cir. 1955) (Government permitted to amend bill three times, the last time on the day before trial).

[296.] See *United States v. Nunan*, *supra* note 11 (Government stated in its bill of particulars, "no disallowance of deductions or exemptions claimed." Nonetheless, it was permitted to prove that defendant kept no records of his contributions to charities and could not identify any of the contributions from memory. The court held it was not improper to admit this evidence, and to permit the prosecution to comment upon it.); *Harris v. United States*, 243 F.2d 74 (5th Cir.), *cert. denied*, 355 U.S. 817 (1957) (Government alleged in bill that defendant had omitted a \$45,000 commission from his return. *Held*: Not improper to permit proof that he had taken same deductions against his personal return that his solely owned corporation took on its return: "There is no rule of law that would have prevented the Government from showing, if it could, that some of the deductions were of a highly suspicious nature, not in an effort to increase the deficiency of the tax, but to show . . . the defendant's knowledge and thus his intent as to what he was doing . . ."); *United States v. McGuire*, 347 F.2d 99 (6th Cir.), *cert. denied*, 382 U.S. 826 (1965) (specific items case "corroborated" by expenditures evidence); *United States v. Murray*, 297 F.2d 812 (2d Cir.), *cert. denied*, 369 U.S. 828 (1962).

civil actions because their disclosure functions are substantially taken over in the civil rules by elaborate deposition and admissions machinery.<sup>297</sup> There are no comparable disclosure devices in a criminal case.<sup>298</sup>

### *Pre-trial Inspection of Documents*

Under Rule 16, as promulgated in 1946, defendant was entitled to inspect and copy designated documents or tangible objects in the possession of the Government which were "obtained from or belong[ed] to the defendant or [were] obtained from others by seizure or process, upon a showing that the items sought may be material to the preparation of his defense and that the request is reasonable." Most courts held that the defendant's own statements made to government agents were not discoverable because the rule extended only to tangible items in which defendant had a pre-existing proprietary interest.<sup>299</sup> Moreover, since books and records obtained from third parties were discoverable only if the Government had obtained them by seizure or process, discovery by defendant was precluded, when, as was often the case, third parties turned over their records to the Government voluntarily.<sup>300</sup>

Rule 16 was amended by the Supreme Court in February, 1966.<sup>301</sup> The revised rule authorizes discovery by defendant of his own "written or recorded statements" and his own "recorded testimony before a grand jury."<sup>302</sup> Hence, if defendant's statement was recorded verbatim

[297.] See JAMES, CIVIL PROCEDURE 54-99 (1965).

[298.] For an especially enlightened opinion on the subject, see Judge Foley's confession of past error in *United States v. Eissner*, *supra* note 289. A judge less willing to admit he has been wrong may, however, make a graceful about-face in reliance upon a recent amendment of Rule 7(f). The prior rule said that the "court for cause may direct the filing of a bill of particulars." In February, 1966, the Supreme Court deleted "for cause." This amendment, according to the Advisory Committee, was "designed to encourage a more liberal attitude by the courts toward bills of particulars without taking away the discretion which courts must have in dealing with such motions in individual cases." 86 Sup. Ct. 102.

[299.] See, e.g., *United States v. Murray*, *supra* note 296; *contra*, *United States v. Fancher*, 195 F. Supp. 488 (D. Conn. 1961) (collecting cases on both sides).

[300.] Thus, it was even held that defendant was not entitled to inspect working papers and reports of his public accountant which were delivered voluntarily to the IRS by the accountant. *United States v. Brown*, *supra* note 289. See also *United States v. Duncan*, 22 F.R.D. 295 (S.D.N.Y. 1958).

[301.] 86 Sup. Ct. 184. For a discussion of these rules prior to adoption, together with earlier drafts, see Everett, *Discovery in Criminal Cases—In Search of a Standard*, 1964 DUKE L.J. 477.

[302.] Upon motion of a defendant the court may order the attorney for the government to permit the defendant to inspect and copy or photograph any relevant (1) written or recorded statements or confessions made by the defendant, or copies thereof, within the possession, custody, or control of the government, the existence of which is known or by the exercise of due diligence may become known, to the

he will normally be entitled to inspect it. It is not clear, however, whether the new rule extends to disclosure of an agent's notes or memoranda of conversations with the defendant.<sup>303</sup> If not, IRS agents can avoid disclosing their versions of defendant's statements to the defense prior to trial merely by refraining from recording them verbatim or asking him to sign them.

Rule 16(b), also new, jettisons the absurd requirement that third party documents are discoverable only if obtained from them involuntarily. The new rule allows discovery of any documents "which are in the possession, custody, or control of the government upon a showing of materiality to the preparation of his defense and that the request is reasonable."<sup>304</sup> The rule expressly excludes from its coverage, however, "reports, memoranda, or other internal government documents made by government agents in connection with the investigation or prosecution of the case, or of the statements made by government witnesses or prospective government witnesses (other than the defendant) to agents of the government except as provided in [the Jencks Act]."<sup>305</sup> This exclu-

attorney for the government, (2) results or reports of physical or mental examinations, and of scientific tests or experiments made in connection with the particular case, or copies thereof . . . and (3) recorded testimony of the defendant before a grand jury.

FED. R. CRIM. P. 16(a).

[303.] It seems likely that the draftsmen intended the meaning of the phrase, "written or recorded statements or confessions of the defendant," in Rule 16(a) to be drawn by analogy from the Jencks Act, 18 U.S.C. § 3500(e) (1964), which defines a "statement" as (1) a written statement made by said witness and signed or otherwise adopted or approved by him; or (2) a stenographic, mechanical, electrical, or other recording, or a transcription thereof, which is a substantially verbatim recital of an oral statement made by said witness to an agent of the Government and recorded contemporaneously with the making of such oral statement.

Substituting "defendant" for "witness" in § 3500(e), it would follow that an agent's notes of conversations with defendant would be defendant's "statements" if shown to or read to the defendant, and acquiesced in by him, or if a substantially verbatim account of defendant's oral remarks. However, if the notes were "summaries of an oral statement which evidence[d] substantial selection of material, or . . . were prepared after the interview without the aid of [verbatim] notes . . . [or] contain the agent's interpretations or impressions," *Palermo v. United States*, 360 U.S. 343, 350 (1959), they would not be statements of the witness within § 3500(e) or of the defendant within Rule 16(a).

One reason why the definition of "statement" in Rule 16(a) should arguably be taken from 18 U.S.C. 3500(e), is that notes and memoranda of a Government agent are statements of that agent, whether or not they are also statements of the defendant. *Cf.* *Clancy v. United States*, 365 U.S. 312 (1961). And if they are statements of the agent and not of the defendant, their pre-trial inspection is precluded by § 3500(a). *Cf.* *Palermo v. United States*, *supra*. It can be urged, however, that an agent's notes, if not transmitted by him to another agent, are not statements by the agent within the meaning of the Jencks Act. *Cf.* *United States v. Johnson*, 337 F.2d 180, 202 (4th Cir. 1964), *aff'd on other grounds*, 86 Sup. Ct. 749 (1966). Thus, the notes might be given no immunity by the Jencks Act, leaving the meaning of "statement" in Rule 16(a) to be shaped without regard to the Act.

[304.] 86 Sup. Ct. 187.

[305.] *Ibid.*

sion exempts most of the items which would really be useful in preparing the defense.<sup>306</sup>

Moreover, in carrying over from the old rule the requirement of "a showing of materiality to the preparation of his defense" and that "the request is reasonable" the draftsmen may have given courts an excuse to deny documentary discovery in all but exceptional cases. Several courts under the old rule held, for example, that the defendant's own statements—perhaps the most important single item of evidence in the typical criminal case—were not "material to the preparation of his defense."<sup>307</sup> Others suggested that demands to see such statements were not "reasonable."<sup>308</sup> Some courts implied that almost any demand, even for defendant's own records or for records obtained from third parties by process, was either unreasonable or immaterial, or both.<sup>309</sup> These strained and hostile interpretations should have been rejected by rephrasing the section.<sup>310</sup>

Insofar as judicial reluctance to grant discovery has truly been based

[306.] Especially if it includes the agent's memoranda of conversations with the defendant. See note 303 *supra* and accompanying text.

[307.] See *United States v. Steely*, 32 F.R.D. 244 (E.D. Pa. 1962); *United States v. Fuentes*, 25 F.R.D. 278 (S.D.N.Y. 1958); *United States v. Acheson*, 25 F.R.D. 349 (S.D.N.Y. 1960).

[308.] *United States v. Bentvena*, 193 F. Supp. 485, 497 (S.D.N.Y. 1960); *United States v. Acheson*, *supra* note 307.

[309.] See, e.g., *United States v. Smith*, 209 F. Supp. 907, 913 (E.D. Ill. 1962); *United States v. Wortman*, 26 F.R.D. 183 (E.D. Ill. 1960); *United States v. Bentvena*, *supra* note 308.

[310.] The most effective doctrinal base upon which a court so inclined could resist defendant's discovery efforts under the former Rule 16 was the requirement that documents sought be "designated." The defendant, who, unlike his counterpart on the civil side of the court, had no deposition or interrogatory procedure to assist him in locating and learning of the existence of documents, often found this condition insurmountable. Frequently denied for insufficient designation were motions for "any and all books, papers, documents or other tangible objects which may have been obtained from [named defendants]," *United States v. Capes*, 193 F. Supp. 627 (D. Md. 1961); "all books, papers, documents and tangible objects, including checks, bills, amounts, books, cancelled check stubs, bank statements, which belonged to the defendant or were obtained from any source or any person by seizure or process," *United States v. Finegan*, *supra* note 285; "each and every document upon which the government will rely," *United States v. Grassman*, 154 F. Supp. 813 (D.N.J. 1957).

The same courts who imposed impossible designation requirements on criminal defendants would readily enforce an administrative summons, see, e.g., *In re International Corporation*, 5 F. Supp. 608 (S.D.N.Y. 1934), or a motion for documentary inspection in a civil case, see 4 MOORE, FEDERAL PRACTICE ¶ 34.07 (2d ed. 1962), cast in equally broad and general terms, despite the fact that the statute authorizing a summons requires that records sought be "described with reasonable certainty," I.R.C. § 7603, and that FED. R. CIV. P. 34 requires the party desiring inspection both to designate the documents and to show "good cause."

The new Rules delete the designation requirement but it is not clear whether the purpose was to liberalize discovery or whether, as a court might conclude, the requirement was deleted as superfluous. If the courts continue to impose a heavy burden on the defendant to show that what he seeks is "material to the preparation of his defense" and that his demands are "reasonable," he will still have to designate with particularity in order to meet his burden.

upon the belief that discovery should be mutual, then the new rules may help soften judicial attitudes. For new Rule 16(c) allows the court to condition any discovery order in favor of the defendant (other than an order permitting inspection of his own statements) upon the defendant's permitting the Government to inspect or copy any tangible evidence, other than investigative reports and statements of witnesses, in defendant's possession or control which "defendant intends to produce at the trial," upon a showing by the Government of materiality and reasonableness.<sup>311</sup> This procedure, the constitutionality of which is unclear,<sup>312</sup> seems unnecessary in most criminal cases, including tax prosecutions. The notion that the Government lacked substantial discovery against the defendant was a myth under prior procedure. Moreover, any implication that there is now mutuality and reciprocity in criminal cases akin to that in civil cases is wrong. Yet this innovation may result in some additional disclosure for the defendant, though optimism seems premature.

In summary, the tax evasion defendant did get to see more documents in the Government's custody under the old rules and will probably get more under the new than the average criminal defendant. But he will get to see very little. Even under the new rules, the defendant will see and hear virtually all of the prosecution's evidence for the first time at the trial.

3. *Is the jury uniquely reliable in screening out the innocent in tax evasion prosecutions?*

It is frequently asserted by proponents of the status quo that alleged defects in criminal procedure are illusory because they are counterbalanced by the requirement that all twelve jurors be personally persuaded of guilt beyond a reasonable doubt.<sup>313</sup> It could be urged that this is especially true in tax evasion prosecutions because the defendant is frequently articulate and attractive—a person with whom the jurors can readily identify and sympathize—and because the offense itself is not generally regarded with abhorrence. Thus, the unanimity and

[311.] 86 Sup. Ct. 187.

[312.] The question, of course, is whether this provision can be squared with the Fifth Amendment. See *Jones v. Superior Court*, 58 Cal. 2d 56, 372 P.2d 919 (1962); Note, 76 HARV. L. REV. 838 (1963); Louisell, *Criminal Discovery and Self-Incrimination: Roger Traynor Confronts the Dilemma*, 53 CALIF. L. REV. 89 (1965); see also statement of Mr. Justice Douglas, dissenting in part to adoption of Amendments to Rules, 86 Sup. Ct. 203 (1966).

[313.] Flannery, *The Prosecutor's Case Against Liberal Discovery*, 33 F.R.D. 74, 75 (1963); *United States v. Garsson*, 291 Fed. 646, 649 (S.D.N.Y. 1923) (opinion of Judge Learned Hand).

reasonable doubt requirements may afford even more protection to the accused than in other criminal cases.

This argument sounds plausible, but, in fact, it does not justify the procedural hobbling of tax evasion defendants.<sup>314</sup> It has no application to defendants with criminal records, unsavory associates, disreputable businesses, or even affiliation with unpopular political or social causes. Such defendants do not get favored treatment in a tax evasion case; juries frequently pack them away on very thin evidence.<sup>315</sup>

The typical tax evasion defendant may not be regarded by the jurors as a "surrogate self." He will often enjoy an income and standard of living far higher than most jurors. His financial pressures, his temptations, the customs and values of his social milieu, will often be quite different from those of the clerks and pensioners on the jury.

The common assumption that jurors in tax prosecutions are loathe to convict suffers from a paucity of evidence. The evidence points the other way: While the proportion of non-racketeer tax defendants has increased over the past several years, as has the incidence of prosecutions for small deficiencies,<sup>316</sup> the number of convictions has steadily increased<sup>317</sup> with no fall-off in rates of conviction. In 1948 the rate was 95%,<sup>318</sup> in 1965, 96%.<sup>319</sup> Moreover, of the cases actually tried before

[314.] As has earlier been shown, see text accompanying notes 79-141 *supra*, the requirement of proof "beyond a reasonable doubt" is not one which the courts seriously supervise, but a jury instruction only. Not only do courts fail to evaluate the evidence independently before letting the case go to the jury, they do almost nothing after verdict to see if their instructions were followed. Quizzing of jurors after the verdict, by court or counsel, is widely regarded as unethical. See *Opinion 109*, OPINIONS OF THE COMMITTEE ON PROFESSIONAL ETHICS AND GRIEVANCES 231 (A.B.A. 1957). The so-called "requirement" of unanimity is also unenforced. A quotient or majority verdict is a valid verdict, if only for the reason that a court will not permit anyone to prove the facts. See 6 MOORE, FEDERAL PRACTICE ¶ 59.08[4]. Moreover, the Chicago Jury Studies, confirming common sense on the matter, have shown that dissenting jurors virtually always give in to the majority anyway. See Broeder, *The University of Chicago Jury Project*, 38 NEB. L. REV. 744, 747-48 (1959).

[315.] See, e.g., *Janko v. United States*, 281 F.2d 156 (8th Cir. 1960), *rev'd on confession of error*, 366 U.S. 716 (1961). It is noteworthy, moreover, that while in most criminal cases the unsavory character and prior bad acts of the defendant are inadmissible, this is not true in tax fraud cases as to prior bad acts which may involve the making of money. In a net-worth case, the Government is free to prove how the defendant came by his money, or might have come by it, during any relevant period. Thus, his associations with gamblers, racketeers, etc., his offers to accept bribes, almost any prior evil act with a mercenary flavor to it, is admissible against him. See *United States v. Keenan*, 267 F.2d 118 (7th Cir. 1959).

[316.] See, on the history of tax prosecutions, Schmidt, *Current Department of Justice Criminal Income Tax Policies*, 38 TAXES 293 (1960). See also Lyon, *The Crime of Income Tax Fraud: Its Present Status and Function*, 53 COLUM. L. REV. 476 (1953).

[317.] In the eleven-year period from 1953 to 1964, there were 7035 convictions for tax fraud. In the preceding twenty-two year period, there were a total of only 2900 convictions. There were 607 convictions in 1964, compared with 552 in 1962, 492 in 1958. 1964 ATT'Y GEN. ANN. REP. 317.

[318.] *Ibid.*

[319.] 1965 ATT'Y GEN. ANN. REP. 312.

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juries, (some 89% of tax fraud defendants are convicted on guilty or *nolo* pleas)<sup>320</sup> the percentage of convictions in recent years has been as high as the average of all federal criminal cases. In 1964, the percentage of convictions in all federal criminal trials by jury was 73%.<sup>321</sup> The percentage in jury trials in criminal tax cases during 1964 was 71%, and in 1963, 74%.<sup>322</sup> The statistics suggest that juries in criminal tax cases are usually willing to convict. Many jurors may, in fact, feel a strong urge to exhibit outrage by convicting one who appears to have done what they too have either done or been tempted to do.<sup>323</sup> This propensity may be fed by the fact that the jurors themselves know that their tax returns can be inspected by the IRS as easily as the defendant's was.<sup>324</sup>

Thus, even though jurors may sometimes disregard their own common sense to acquit a tax fraud defendant, there are many occasions in which they do not—in which the best the defendant can hope for is a rational evaluation of the evidence. In these cases, defendant's ability to expose weaknesses in the prosecution's case and his capacity to explain will be crucial. The strength which the jury ascribes to the Government's case will depend upon its assumptions about the motives, opportunities, and abilities of the defendant to contradict or rebut. Yet for many of the same reasons which make it difficult for jurors to identify or to sympathize with the accused, the jury is not well equipped to see all the weaknesses in the Government's case, nor to understand why an honest taxpayer could not have provided more cogent proof in his defense. It surely flatters the average jury to suggest that it collectively understands the bookkeeping practices of the myriad of taxpayers who can be brought before it; or that it can be relied upon to locate un-

[320.] Of 627 defendants in 1964, 30 were acquitted and 597 convicted, 507 (89%) by pleas. 1964 ADMINISTRATIVE OFFICE OF UNITED STATES COURTS ANN. REP. 256.

[321.] There were 2671 decisions by juries in federal criminal prosecutions during 1964. 1955 (73%) were convictions; 716 (27%) were acquittals. See 1964 ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS ANN. REP. 256.

[322.] 1964 ATT'Y GEN. ANN. REP. 317. Similar data is not contained in the 1965 report which lumps together all "cases which went to trial" and which reports a "70% margin of success." 1965 ATT'Y GEN. ANN. REP. 312.

[323.] Cf. ALEXANDER & STAUB, *THE CRIMINAL, THE JUDGE, AND THE PUBLIC* 213-17 (rev. ed. 1956).

[324.] In *United States v. Costello*, 255 F.2d 876 (2d Cir.), *cert. denied*, 357 U.S. 937 (1958), the United States attorney had selected his jury with the help of the tax returns of 150 of the veniremen, choosing, on the basis of the information he gleaned from the returns, which of the prospective jurors would be most favorable to the Government. The Court held this practice was lawful. For a recent, rather cryptic statement of Justice Department policy regarding tax investigations of prospective jurors, see testimony of Attorney General Katzenbach in *Hearings Before the Subcommittee on Administrative Practice and Procedure of the Senate Comm. on the Judiciary*, *supra* note 155, at 1164, 1641.

erringly those instances in which a taxpayer has merely been careless, rather than dishonest, in his approach to record keeping; or that its members whose average annual income may be \$6,000 can easily understand how a taxpayer could simply have forgotten to record an income item of \$10,000 or could really have spent \$20,000 entertaining customers in a single year.

The jury is further hampered in its evaluation of proofs by ignorance of the pre-trial context. The defendant might have been uncooperative with the Internal Revenue agents on grounds having little to do with consciousness of guilt. He might have failed to cooperate on the advice of a lawyer who, perhaps for quite personal reasons or out of ignorance of the consequences, advises non-cooperation to his clients as a matter of course. The taxpayer or his attorney might merely have been obstinate, or have felt oppressed by seemingly unreasonable demands of the examining agent. And even if the trial judge permits defense counsel to explain his client's pre-trial conduct fully, including taking the testimony of those who advised the taxpayer, the defense risks bewildering an already confused jury and inflating a collateral issue if he explores the pre-trial context in detail.

Virtually always complex, a tax prosecution usually involves accounting operations outside the experience of most jurors and accounting concepts often beyond their comprehension. It hardly follows, however, that the jury will understand the defendant's inability to comprehend and cope with the Government's figures or to correct errors and omissions in them.

#### 4. *Are trials superfluous?*

A final possible justification for the advantages conferred on the Government is the assumption that the administrative selection process is a substitute for trial safeguards. There is an elaborate hierarchy of administrative screens between the taxpayer and the petit jury—a more intricate screening process, containing more layers, than virtually anywhere else in the criminal process.<sup>325</sup> But it does not follow that the administrative selection procedure is unlikely to produce an innocent accused.

Consider first the ability of administrative officials to determine the facts—that there was a substantial deficiency and that it was “willful.” IRS and Justice Department officials are undeniably expert in evaluat-

[325.] See text accompanying notes 250-53 *supra*.



ing evidence, but their ability to utilize their expertise is limited by the fact that not until trial can the defendant be expected to reveal all the evidence he has which tends to exculpate him. Frequently, of course, he will offer palliating evidence or explanations, but often, on the advice of his attorney, he will save some of his defense for the trial. Moreover, any explanation will suffer from the guarded vagueness with which questions are put to the taxpayer by the investigator. Because a tax investigation is an adversary proceeding, the Government is neither motivated nor equipped to ferret out evidence which vindicates the taxpayer. Piling up tiers of reviewing officials does not alter this fact.

The Justice Department purports, however, to make two decisions before commencing a prosecution: (1) Is the taxpayer guilty? (2) Is he likely to be convicted? A negative answer to either question, we are told, results in no prosecution.<sup>326</sup> Yet officials cannot be expected to perform these disparate roles with equal vigor. The effectiveness of the official in both capacities is inevitably reduced when he is required to search for, solicit, and select evidence with which to convict his adversary at the same time he is deciding if the subject is innocent.

Moreover, even if the administrative hierarchy were animated and equipped to determine the facts with a high degree of accuracy, it would not follow that a decision to prosecute was a reliable determination that a defendant was guilty. For the selection procedure is also a definitional process. The IRS and Justice Department select as targets people whom they think ought to and can be punished. Their decision to prosecute is, therefore, an inseparable blend of fact determination and law application.

Administrative officials bent on maximizing revenue are tempted to tacitly broaden the scope of the sanction by prosecuting persons whose derelictions are quite common and ordinary and against whom little proof can be mustered—to convert a civil offense into a criminal one. While flagrant violators will always have to be included in the mixture of criminal defendants—lest people learn that the way to evade successfully is to do it on a grand scale—the batch, for maximum deterrent value, should arguably include a sizeable number of persons whose deficiencies are small and in no way unusual.<sup>327</sup> At least IRS officials could plausibly so conclude. Great deference to the administrative process in selecting appropriate subjects for the criminal sanction cannot be justi-

[326.] Schmidt, *supra* note 316, at 295.

[327.] Cf. Long, *The Use of Criminal Sanctions for Tax Violations*, 1963 TULANE TAX INST. 389, 394-401.

fied, therefore, unless we are willing to permit administrators to define the crime.

It is by no means obvious that administrative officials ought to wield substantial power to define the offense by applying criteria aimed at enhancing the revenue potential of the criminal sanctions. Moreover, even if this proposition were tenable in the abstract, there is no way to compel officials to employ only criteria relevant to promoting tax compliance. Every procedural or substantive rule which broadens prosecutorial discretion, ostensibly to permit more effective use of expertise in selecting revenue-raising targets, permits officials to employ criteria for selecting defendants which are unrelated to the production of revenue. The history of tax prosecutions shows clearly that where this discretion exists, it will be exercised. A few decades ago, virtually all taxpayers who were criminally prosecuted were suspected gangsters or racketeers.<sup>328</sup> A few years ago, the Commissioner of Internal Revenue told a congressional committee that the Internal Revenue Service was cooperating "with the Justice Department and all other law enforcement agencies in rooting out of our society certain undesirables as well as carrying out our normal tax enforcement program."<sup>329</sup> A sizeable portion of the defendants currently being prosecuted for tax evasion still fall into the "racketeer" category, a larger proportion than can be justified on revenue considerations.<sup>330</sup> There is, moreover, evidence of

[328.] See Schmidt, *supra* note 316, at 294.

[329.] Testimony of Commissioner Caplin in *Hearings Before the House Committee on Appropriations Regarding 1962 Appropriations for the Treasury Department*, 87th Cong., 1st Sess. 471 (1961).

[330.] 32 "rackets figures or corrupt public officials" were indicted and convicted of tax offenses in 1964. 1964 ATT'Y GEN. ANN. REP. 326. In recent testimony before the Long Committee, the Attorney General stated that "more than 60 per cent of our racketeering convictions stem from devoted investigative work by intelligence agents of I.R.S." *Hearings Before the Subcommittee on Administrative Practice and Procedure of the Senate Comm. on the Judiciary*, *supra* note 155, at 1159. It could be argued, of course, that revenue considerations alone justify some emphasis on taxpayers deriving income from illegal activities. The illegality often makes the expenses non-deductible and thus forces the individuals either to commit tax evasion or to quit their nefarious activities. Furthermore, since disclosure of illegal income will virtually assure exposure of the illegal conduct, the temptation to omit such income from a tax return is compelling. Thus, an investigation of one suspected of unlawful income-producing activities is likely to bear fruit. Moreover, it may be relatively easy to get convictions and long prison terms in cases involving reputed racketeers or hoodlums. Such prosecutions get good news coverage and strengthen the statistics on conviction rates and sentences. Militating heavily against emphasis on such persons as targets, however, are at least two factors: (1) A rank-and-file taxpayer is unlikely to perceive the conviction of a gambler or hoodlum as being very relevant to himself—such prosecutions may even suggest to him that he need not fear the criminal sanction; (2) in the minds of many citizens, the use of criminal tax sanctions is an unfair method of convicting people for other crimes—those who feel this way may consciously or unconsciously reflect their disapproval in their own tax returns and in their other dealings with the Government.

## Income Tax Prosecutions

current efforts to convict "corrupt public officials"<sup>331</sup> and political deviates<sup>332</sup> of tax evasion.

The fact is that the income tax sanctions have proven enormously effective in putting into prison individuals who are suspected of other illegal or immoral activities for which they cannot be convicted. It is clear that many people in the future, as in the past, will be selected for tax prosecution not because they are the best examples for promoting tax compliance but because the officials believe such persons can be convicted and feel that they ought to be. The reasons may be as varied as the values of those who make the decisions.

### IV. Conclusion

Administrative discretion pervades the tax prosecution from commencement of the audit to appellate review. The values behind deference to the administrator in civil cases are well served in criminal tax prosecutions. At every step in the process, basic safeguards and Fifth Amendment rights are subtly sliced away beneath a cloak of conceptualism. The Government is permitted, with its audit procedures and its administrative summons, to gather information from the taxpayer which may be used to convict him of crime. Right up to indictment, its civil-criminal investigation is treated as purely civil. Yet when the taxpayer who is a potential criminal defendant seeks civil discovery in a civil case, discovery is denied because he may use the information in defending the criminal charge. Thus, whether the civil or criminal aspects of the ambiguous pre-trial process predominate depends on which characterization disadvantages the taxpayer. Moreover, if the prosecution at the trial meets what is no more than a civil burden of proof, the taxpayer must establish his innocence. Yet he is denied the means of doing so which he would have if he were truly involved in a civil case. He is not granted significantly more pre-trial disclosure than other criminal defendants.

If increased recognition of criminal safeguards seriously threatened to curtail tax compliance, the burden might be heavy on one who urges even-handed treatment of tax and other criminal defendants. But there

[331.] See 1964 ATT'Y GEN. ANN. REP. 326, 328-29.

[332.] See *Lenske v. United States*, 18 AFTR 2d 5813 (9th Cir. 1956), where the court reversed what it characterized as a "witch hunt." The court considered, improperly according to the dissent, the special agent's report, which stated that the defendant was a suspected Communist and that he and another lawyer had formed a local chapter of the Lawyer's Guild. The report also contained newspaper clippings which revealed the ominous fact that the taxpayer had expressed opposition to this country's activities in Cuba, Laos and China. The grounds of reversal were multifarious.

is neither evidence nor plausible argument that this is so. Since not one audit in a thousand results in criminal prosecution, revenue agents could be required to adequately warn a taxpayer and to refrain from using the summons to gain evidence for a criminal case without affecting any but a fraction of the confrontations between agent and taxpayer. The investigative process could continue virtually as before, yet taxpayers would not be convicted of crime on evidence obtained from them involuntarily. There is, moreover, no cause to believe that tightening the Government's burden of proof in the criminal case, and liberalizing pre-trial disclosure, would signally interfere with normal tax administration. It would merely make it more costly to convict the guilty and more difficult to convict the innocent. The price seems right.