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THE INVESTIGATIVE PROCEDURE FOR CRIMINAL TAX EVASION

JOSEPH H. MURPHY*

ON AUGUST 3, 1957, the Department of Justice reported a steady increase in the number of convictions for criminal income tax evasion.¹ Convictions in the first six months of 1957, either by trial or by plea, totalled 495.² Those for all of 1956 were fifty less than that number.³

These statistics indicate that the tempo of criminal income tax prosecutions is being stepped up. Projecting the first half of 1957 through the year would bring the number of tax evasion convictions for 1957 to nearly 1,000. This speaks well of the efficiency of the Department of Justice in handling these complicated cases. It is eloquent evidence of the success of the Treasury in tracking down tax evaders, especially considering the chaff which must be eliminated before the wheat is ready for penal leavening.

These figures also show that, more and more, the general practitioner will be called upon to act as counsel to those caught in the Treasury's criminal web. When so summoned, he will find himself confronted with a situation unlike that facing counsel for the defense in most criminal cases. Not only are investigative techniques considerably different, but methods of prosecution and defense must be molded to meet the peculiar aspects of a tax evasion case.

The underlying reasons for tax evasion—high tax rates, prosperity, inflation and the larceny in the hearts of some citizens—have been relatively constant for some years. The ways in which a taxpayer's defections are revealed have changed little over the same period. It is an increase in the number of persons making income tax investigations, an improvement in their skills, and a streamlining of methods of investigation and prosecution which account for the Government's success in this area. This serves to indicate the problems with which counsel for the recreant taxpayer must cope.

He will find, for example, that he is drawn into the case at an early stage of the investigation, rather than following arrest or indictment, customary in most criminal cases. This, of course, offers him an opportunity not necessarily to shape the course of the investigation, but perhaps to convince the investigator that all is not what it appears on the

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2. Ibid.
3. Ibid.
surface and that logical explanations exist for what would otherwise seem to be tax evasive measures.

Taxpayer's counsel will also realize the need for expert accounting assistance to be brought in at the outset, albeit certain risks entailing therefrom. Treasury tax investigators are, in the main, persons trained in accounting and not in law. While it cannot be gainsaid that a criminal investigation mandates a taxpayer to retain an attorney, the latter is compelled, by the same token of protection, to seek the services of a trained accountant.

Lastly, the trial of a criminal income tax evasion case will be found to lack much of the luster of the customary criminal forum. Figures, charts, complex business dealings and bookkeeping transactions will bulk large in the Government's case. Inferences raised by them must be met, and to meet them, a taxpayer's counsel is called upon to cull up the same techniques he employed during investigation in addition to applying forensic skills to their presentation.

It will be the purpose of this article to discuss the progress of a criminal tax evasion case from start to finish, that is, from the time the taxpayer first becomes cognizant that he is involved in a criminal case—when the attorney should be called in—to its ultimate conclusion, either by way of abandoning the investigation, dismissing the indictment or information or pleading to it, or by a final disposition following trial. Along the way an attempt will be made to show what may be expected of the Treasury, the Department of Justice, and, perhaps more pertinent for present purposes, counsel for the taxpayer.

**Revelation of Evasion**

When it comes to the revelation of tax evaders, virtually all roads lead to Rome. An economic avenue is the so-called "Informer's Reward," provided by section 7263 of the 1954 Internal Revenue Code. Under this, the Treasury pays for information leading to the discovery of tax evaders and the recovery of taxes. The amount of the reward is limited to the annual appropriation for it and it is distributed to informers in the discretion of the Commissioner of Internal Revenue. Details for obtaining the reward are set forth in Treasury Decision 5770. At one time the top reward paid was ten per cent of the recovery.

However, monetary gain is by no means the only reason for informing on tax evaders. Neighborhood rivalries, business competition, disgruntled

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5. Special Ruling of The Bureau of Internal Revenue, January 11, 1923. For an interesting decision involving the taxability of an informer's reward and the mechanics of the award procedure, see Elmer J. Faul, 29 T.C. No. 49 (Dec. 22, 1957).
employees and matrimonial difficulties⁶ are but a few of the other inducements to inform. Informers are sufficiently numerous that many local directors' offices have personnel who spend their full time screening these revelations.

Tax evasion is also uncovered by alert Treasury agents who keep a watchful eye on newspaper stories indicating the existence of large cash hoards. They also keep track of large cash transactions in real estate on the public records and, in some instances, through banks. A check against the tax return of the persons involved indicates their ability to accumulate the cash in question.

Probably the greatest number of leads to tax evaders comes through routine investigations by the revenue agents.⁷ For example, it is understood that an audit of a corporation now results in an audit of its officers, particularly in the close corporation field. Likewise, travel and entertainment deductions are being carefully combed. These are but illustrations. However, where fraud is suspected, the intelligence agents are called in and the stage is set for a tax evasion investigation.

THE STATUTES

From the standpoint of taxpayer's counsel, presumably called in by his client at the start of the investigation when the ultimate offense to be charged may be undetermined, a familiarity with the statutory sources of the potential charges is vital. There are a number of criminal offenses against the income tax laws, punishable in varying degrees of severity.

Section 7201 of the 1954 Internal Revenue Code provides:

"Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution."

Other offenses against the tax laws are also specified in chapter 75 of the Code. They include felony penalties for willfully failing to collect or

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⁶ See United States v. Ashby, 245 F.2d 684 (5th Cir. 1957) where an estranged wife turned all of a taxpayer's records over to the Treasury and he was indicted. His motion to suppress was denied because (1) no confidential communication was involved, and (2) the Treasury could use purloined evidence as long as it did not do the purloining.

⁷ Section 7601(a) of the Code requires the Treasury to "proceed" through each Internal Revenue District and "inquire" concerning persons who may be liable for internal revenue taxes. This, of course, is a blanket provision authorizing general "snooping" without reference to any particular case.

Section 7602 directs specific attention to taxpayers under investigation. It authorizes the Treasury to examine their books and records, to summon witnesses to produce papers and to take testimony under oath. Summons are authorized by § 7603, and § 7604 empowers district courts to enforce them by their processes, including civil contempt penalties. In addition to contempt, § 7210 provides that failure to comply with a summons may subject the miscreant to a $1,000 fine and a year's imprisonment.
pay a tax due\textsuperscript{8} and for issuing false and fraudulent statements to the Treasury.\textsuperscript{9} Misdemeanor penalties are provided for failing to file returns, supply information or pay estimated taxes.\textsuperscript{10}

Section 7201 is the statute under which most investigations are made and under which most indictments are sought and obtained. This is probably because a felony conviction is a better reward for a long and tedious investigation and trial than a mere misdemeanor conviction. Furthermore, the deterrent effect of a felony threat is undoubtedly greater from the standpoint of the self-assessment features of the income tax law. This conclusion is supported by the fact that, under the Internal Revenue Code of 1939, the bulk of the prosecutions was brought under the predecessor of section 7201.\textsuperscript{11}

For a time there was some doubt as to whether a prosecution under section 145(b) of the 1939 Code,\textsuperscript{12} providing felony penalties, might not also be the basis for a sentence under section 3616(a) of the 1939 Code,\textsuperscript{13} which provided lesser penalties for submitting false returns.\textsuperscript{14} Under the 1939 Code, however, this question was resolved by a decision that section 145(b) and its predecessors impliedly repealed section 3616(a) as to income tax matters and that the latter had no application thereto.\textsuperscript{15} Section 7207 of the 1954 Code further eliminated the doubt when, in re-enacting 1939 Code section 3616(a), it omitted the words “with intent to evade or defeat,” which caused the overlap with section 145(b).\textsuperscript{16} It would seem, therefore, that any criminal prosecution brought under section 7201 will not be jeopardized by a claim that a lesser penalty is in order under another section.

**ELEMENTS OF THE OFFENSE**

In tax evasion cases, the Government has the burden of proving the crime charged beyond a reasonable doubt.\textsuperscript{17} Thus it must prove a willful attempt in any manner to evade or defeat the tax or its payment.

It should be noted at the outset the offense is complete when the return is filed\textsuperscript{18} and there is no turning back, such as by the filing of an amended

\textsuperscript{8} Int. Rev. Code of 1954, § 7202.
\textsuperscript{9} Id. § 7206.
\textsuperscript{10} Id. § 7203.
\textsuperscript{11} Int. Rev. Code of 1939, § 145(b), 53 Stat. 62.
\textsuperscript{12} Ibid.
\textsuperscript{13} 53 Stat. 440.
\textsuperscript{14} Berra v. United States, 351 U.S. 131 (1956).
\textsuperscript{15} Achilli v. United States, 353 U.S. 373 (1957); Costello v. United States, 352 U.S. 1028 (1957).
\textsuperscript{16} Achilli v. United States, 353 U.S. 373, 375 (1957).
\textsuperscript{17} Holland v. United States, 348 U.S. 121 (1954).
\textsuperscript{18} Bowles v. United States, 73 F.2d 772 (4th Cir. 1934), cert. denied, 294 U.S. 710 (1935).
return, which, rather than ameliorating the situation, may constitute an admission. This is because a fraudulent return is regarded as an attempt to evade. So too, is uttering a false statement to a Treasury representative in the course of an investigation or willfully failing to pay the tax shown to be due on a return that is filed.

**Underpayment of Tax**

The Government must establish that there was a deficiency in taxes for each of the prosecution years involved. In tax evasion cases, underpayment is the *corpus delicti* which must be established, and there are several ways in which the Government may meet this burden. The easiest is to show an omission of specific items of income. However, there are other methods of proof available in the absence of specific items which, while more burdensome of investigation, are nevertheless effective.

Currently, the best known and most used of these indirect methods of establishing tax deficiencies is the “net worth” method. The use of this device involves establishing the total net value of a taxpayer’s assets at the beginning of a given year, proving an increase at the end of the year, adding to the difference the non-deductible expenditures of the taxpayer, and comparing the result with reported income. When non-income items are eliminated, the difference is unreported income.

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22. United States v. Palermo, 152 F. Supp. 825 (E.D. Pa. 1957). This decision burst a bubble for those who felt that filing a correct return, without payment of the tax, avoided criminal penalties. It was made in the face of an argument based on the illegality of imprisonment for debt. See United States v. Miro, 60 F.2d 58 (2d Cir. 1932), where this result may have been indicated.


24. Holland v. United States, 348 U.S. 121 (1954); Friedberg v. United States, 348 U.S. 142 (1954); Smith v. United States, 348 U.S. 147 (1954); United States v. Calderon, 348 U.S. 160 (1954). The Holland case said that, “increases in net worth, standing alone, cannot be assumed to be attributable to currently taxable income. But proof of a likely source, from which the jury could reasonably find that the net worth increases sprang is sufficient.” In United States v. Massei, 26 U.S.L. Week 4171 (U.S. March 3, 1958) it was held that this is not to say that proof of a likely source is necessary in every case. On the contrary, in establishing net worth there is no necessity for the government to prove a likely source of income giving rise to the net worth provided it negatives all possible sources of non-taxable income.
Another device is the "bank-deposit" method, by which deposits to all bank accounts are compared with reported gross income, with other appropriate adjustments. Still another indirect approach is to add claimed deductions to non-deductible expenditures, compare the total with reported income, and thus show either unreported income or falsified deductions. Variations on this approach are the "living expense" method, by which total living expenses plus savings are compared with reported income, or a method by which total expenditures are added to decreases in net worth and equated with reported income. Lastly, "the percentage of mark-up" method applies a standard percentage of mark-up to the sale of inventory items and compares it to the mark-up reported, to prove that the difference is unreported income.

**Willfulness**

Having established the deficiency, the Government must further prove that it was willfully incurred. The simplest way to achieve this is by extrajudicial admissions or confessions which best serve to indicate the taxpayer's mental state. These, of course, are admissible, subject to their being corroborated by direct substantiation of the facts admitted or by independent evidence, such as net worth or bank deposit computations, tending to show understatement of income for the prosecution years.

Absent such admissions, however, the Government is not helpless. If it proves an understatement of income by one of the methods described above, with other corroborating facts as to the source of that income, it has established its case, and it is up to the taxpayer defendant to offer a reasonable explanation or remain silent at his peril.

The Supreme Court said of willfulness in 1933:

"The word often denotes an act which is intentional, or knowing, or voluntary, as distinguished from accidental. But, when used in a criminal statute it generally means an act done with a bad purpose . . . ; without justifiable excuse . . . ; stubbornly, obstinately, perversely. . . . The word is also employed to characterize a thing done without ground for believing it is lawful . . . , or conduct marked by careless disregard whether or not one has the right so to act. . . ."

Ten years later, in the famous *Spies* case, after pointing out that

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"willful" was a word of many meanings, the construction of which was frequently influenced by its context, the Court said:

"... By way of illustration, and not by way of limitation, we would think affirmative willful attempt may be inferred from conduct such as keeping a double set of books, making false entries or alterations, or false invoices or documents, destruction of books or records, concealment of assets or covering up sources of income, handling of one's affairs to avoid making the records usual in transactions of the kind, and any conduct, the likely effect of which would be to mislead or to conceal."

One of the most onerous obligations of a judge presiding over a criminal tax case is instructing a jury on the question of willfulness. The language of the foregoing cases has frequently been relied upon, particularly with reference to "bad purpose" as an element of willfulness. Recently, however, there has been a noticeable tendency in the Ninth Circuit to condemn an umbrella approach of this kind. There the trend seems to require the court to associate the specific facts of the case with an intent to evade or defeat the tax, the precise statutory language, and to develop its charge on willfulness in this way rather than on the basis of the generality, "bad purpose."

THE TAXPAYER'S SAFEGUARDS

It may be seen from the statutory powers of investigation given the Treasury that, with the exception of a rather bland provision designed to prohibit repeated investigations without complying with certain formalities, the Treasury has been given plenary authority by statute to obtain information. However unrestrained this authority may seem from a statutory standpoint, it does have its constitutional and judicially-imposed limitations.

Self-Incrimination

"Fifth amendment communists" have been the subject of wide notoriety for several years; so too, have various types of racketeers. One hears little, however, of fifth amendment tax evaders. Yet that constitutional safeguard is as readily available to them as to others.

Without going into this matter in great detail, it should be pointed out that the privilege against self-incrimination does not prevent a taxpayer

33. Id. at 497.
34. Id. at 499.
35. Forster v. United States, 237 F.2d 617 (9th Cir. 1956); Herzog v. United States, 235 F.2d 664 (9th Cir.), cert. denied, 352 U.S. 844 (1956); Bloch v. United States, 221 F.2d 786 (9th Cir. 1955).
36. See Bloch v. United States, 221 F.2d 786 (9th Cir. 1955).
37. See note 7 supra.
38. Int. Rev. Code of 1954, § 7605(b); Local 174, Teamsters Union, AFL v. United States, 240 F.2d 387 (9th Cir. 1956).
from being subpoenaed and compelled to appear before a grand jury. However, he may refuse to answer any incriminating questions put to him.

Whether he can claim the privilege with respect to his books and records is less clear. There is some indication that the so-called "required records" doctrine of Shapiro v. United States may apply to taxpayers, although there are decisions indicating that the fifth amendment would cover the compulsory production of books and records.

In other respects the use of the fifth amendment in tax investigation follows the customary pattern. The privilege is personal to the taxpayer and cannot be invoked by anyone on the taxpayer's behalf. It is not available to corporations, nor to corporate officers claiming a privilege based on withholding corporation information, although it is not entirely clear that this is true with respect to closely-held corporations whose officers are also the owners. The privilege against self-incrimination is deemed waived unless asserted by the taxpayer at the first inquiry concerning the subject matter of the privilege and it must be made in a fashion which makes it clear that it is being asserted.

While the subject of taxpayer co-operation during investigation will be discussed later, it should be pointed out here that the fifth amendment must be kept in mind during the course of the investigation. It is to be hoped that taxpayers are now urbane enough to retain an attorney at the first blush of criminal investigation. While the better part of wisdom is to keep the taxpayer and the investigating agent apart and let the attorney do the talking, this is not always possible. However, there is one rule which should never be broken. Whenever the occasion arises that the special agent will be in contact with the taxpayer, counsel should always be present.

The fifth amendment also raises the issue as to what is and is not incriminating in a particular case. Of course, only a complete understanding of the case can resolve this problem. Therefore, it behooves counsel to make an investigation of his client at least as searching as that

40. Ibid.
41. 335 U.S. 1 (1948).
43. Blumberg v. United States, 222 F.2d 496 (5th Cir. 1955); In the Matter of Daniels, 140 F. Supp. 322 (S.D.N.Y. 1956).
47. Nicola v. United States, 72 F.2d 780 (3d Cir. 1934).
being conducted by the Treasury. And in the early stages it should be as impartial, because the taxpayer's counsel must see the case as it appears to the special agent. After such an impartial investigation, gaps can be filled in by personal contacts with the taxpayer, and if they are not filled in, an area covered by the fifth amendment may be indicated.

Deception

Information obtained from taxpayers must be adduced voluntarily. As with evidence obtained in violation of the fourth amendment, if facts are obtained by fraud, duress, threats or promises of immunity they may be suppressed.\textsuperscript{49} However, there is no obligation on the part of the Treasury to warn a taxpayer that information he furnishes may form the basis of subsequent criminal action against him.\textsuperscript{50}

If a revenue agent, special or otherwise, obtains information voluntarily upon request, without any representation as to its intended use, there is no basis for suppressing it.\textsuperscript{51} It is evidently permissible for the agent to describe his visit as a "routine audit," even though he is in fact on a criminal mission.\textsuperscript{52} It is possible, however, for an agent to carry equivocation so far that it borders on affirmative deception, at which point the courts may consider suppression.\textsuperscript{53}

The problem in this regard is one of taxpayer education. It can be solved by an alert taxpayer requiring the agent to identify himself. If he is a special agent, criminal investigation is indicated. If he is an internal revenue agent, criminal investigation may perhaps be unlikely, but the nature of his business should still be explored because revenue agents and special agents frequently work in teams, and the former may occasionally act as a decoy. In other words, if there is any likelihood of any inquiries being a prelude to a criminal investigation, caution dictates against blanket revelations.

\textsuperscript{49} White v. United States, 194 F.2d 215 (5th Cir.), cert. denied, 343 U.S. 930 (1952).
\textsuperscript{50} Powers v. United States, 223 U.S. 303 (1912); Turner v. United States, 222 F.2d 926 (4th Cir.), cert. denied, 350 U.S. 831 (1955); Hanson v. United States, 186 F.2d 61 (8th Cir. 1950).
\textsuperscript{51} Turner v. United States, 222 F.2d 926 (4th Cir.), cert. denied, 350 U.S. 831 (1955); Scanlon v. United States, 223 F.2d 382 (1st Cir. 1955); Blumberg v. United States, 222 F.2d 496 (5th Cir. 1955); Bateman v. United States, 212 F.2d 61 (9th Cir. 1954); Hanson v. United States, 186 F.2d 61 (8th Cir. 1950); Moyer v. Brownell, 137 F. Supp. 594 (E.D. Pa. 1956).
\textsuperscript{52} United States v. Frank, 245 F.2d 284 (3d Cir. 1957); Montgomery v. United States, 203 F.2d 887 (5th Cir. 1953).
The attorney-client privilege is, of course, available in criminal tax cases. However, it may not be employed to suppress matters which are not properly the subject of the attorney-client relationship. Thus, since no accountant-client privilege is recognized in federal tax matters, accountant's papers in an attorney's hands are not privileged. This is a harsh rule in the light of the necessity to obtain accounting services in a criminal income tax investigation. It has been suggested that these rules might be circumscribed by having the accountant employed, not by the taxpayer, but by the attorney and there is some authority to support this. It has also been suggested that the accountant's work sheets belong to the client and when in the hands of his attorney, are covered by the taxpayer's privilege against self-incrimination. While neither of these safeguards is bottomed on unshakable authority, either should be availed of if the occasion arises, because both are last resort remedies in any event. There are no other present solutions to this problem.

The Investigative Process

In Washington, the Assistant Commissioner (Operations) has over-all operational responsibility for tax evasion investigations. Functioning under him, in Washington, is the Intelligence Division, composed of the Intelligence Program Branch and the Intelligence Investigation Branch. Neither branch conducts investigations. Their functions are basically planning, training and coordinating.

In the Office of the Chief Counsel in Washington there is an Assistant Chief Counsel (Enforcement), who has general supervision over the legal phases of tax evasion, including maintaining a liaison with the Criminal Section of the Tax Division of the Department of Justice. He also acts as a mediator between Regional Counsel and the Intelligence Division. These functions are performed through the Enforcement Division, which

56. Ibid.
57. Ibid.
60. In the Matter of House, 144 F. Supp. 95 (N.D. Cal. 1956).
62. The material following this footnote is all taken from "Internal Revenue Service, Organization and Functions," 21 Fed. Reg. 10418 (1956).
has authority to make determinations in such tax evasion cases as are referred to it.

At the field level of the Regional Commissioner, there is an Assistant Regional Commissioner (Intelligence), who reviews reports submitted by district special agents, makes recommendations and holds conferences. The Office of the Regional Counsel handles enforcement matters by reviewing recommendations, by preparing and referring cases to the Department of Justice or, when authorized by the Department of Justice, directly to the United States Attorney for the district involved. Regional Counsel also assist the United States Attorneys in the presentation of criminal cases.

At the field level of the District Director there is an Intelligence Division, headed by a chief. To this division are assigned the special agents who actively conduct the investigation of tax evaders. This division makes recommendations as to the disposition of cases investigated.

Investigative technique

The Internal Revenue Service has an elaborate Statement of Procedural Rules covering its entire operations. It provides a minutiae of detail with respect to civil tax procedure. Its information with respect to the criminal investigative process is understandably like an iceberg. Only a very small portion of the whole is visible.

In the Statement, allusion is made to criminal penalties and informants' rewards. It is pointed out, however, that ordinary audit procedures do not apply in criminal cases, except where the criminal aspects are closed and only the civil fraud penalty remains, and even this cannot be eliminated without the consent of Regional Counsel. It is also pointed out that ordinary civil appellate procedures do not apply in any case in which prosecution has been recommended until final disposition of that phase of the case.

Under section 7122 of the 1954 Code the Commissioner may compromise any civil or criminal case prior to its referral to the Department of Justice. However, the Statement makes it clear that a criminal liability

64. Id. § 601.104(c)(4).
65. Id. § 601.104(c)(5).
66. Id. § 601.105(g).
67. Id. § 601.106(a)(2)(ii). Rather than require specific consent of the Regional Counsel to the civil settlement of all cases which have been the subject of a special agent's investigation, it is now possible for the special agent to withdraw from the case. Where he does so, he can authorize the revenue agent to settle the case without exacting fraud penalties.
68. Id. § 601.106(a)(2)(iii).
will not be compromised unless it involves only regulatory provisions and then only if it is not deliberate with intent to defeat a tax.\(^{69}\)

Skimpy as these rules are with respect to criminal procedures, they do make several points clear. First, when criminal investigation is undertaken, the revenue agent no longer controls the case. The special agent is in charge. Secondly, the special agent or his counterpart along the line will continue in charge until final disposition is made of the criminal aspects of the case, and even then he may have the last word as to elimination of the civil penalties. Finally, no discussion or settlement of the case either by way of an offer in compromise or a civil adjustment is possible until disposition of its criminal features.

These rules point up a previously alluded to feature of criminal tax cases which distinguishes them from most other fields of criminal law. Most criminal cases come to an attorney after arrest and perhaps even after indictment. However, if an attorney has a client in tax trouble, the attorney may be in the case at the start of the investigation, since a taxpayer has a right, not necessarily constitutional, to be represented by an attorney during the course of an investigation.\(^{70}\) However, the Treasury has been upheld in its policies of refusing to permit the taxpayer's attorney to represent other witnesses questioned during the investigation,\(^{71}\) or to have his accountant\(^{72}\) or transcribing secretary\(^{73}\) attend hearings.

**The Investigation**

Once the case has been assigned to the Intelligence Division of the District Director's Office it will be turned over to a special agent. A revenue agent of the Audit Section will be assigned to work with him.

If the case is not one arising de novo in the hands of the special agent, the latter will, of course, familiarize himself with the material developed by the revenue agent. He will also, in all probability, pull available data on the taxpayer from the files. This would include, for example, prior returns and any reports, adjustments and investigations which have been conducted with respect to them. Having digested this material he is in a position to commence his own investigation.

He and the revenue agent will then proceed to investigate the information furnished to him and to run down leads indicated by the facts on hand. They will undoubtedly make a thorough analysis of the bank

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69. Id. § 601.203(a)(1), (2).
71. United States v. Smith, supra note 70.
records of the taxpayer, first by requesting that they be turned over by them and, failing in that, by going to the banks themselves. They will also consult the various people with whom the taxpayer does business as, for example, his brokers and his employer.

The tack that such an investigation will take is entirely fluid and depends, of course, upon the kind of taxpayer under investigation. With respect to doctors, for example, the special agent may request complete hospital records on all patients treated, and then check with these patients to ascertain what was paid by them. With attorneys, it is not uncommon for revenue agents to send out mimeographed requests for information to clients whose names have been discovered. Many of these requests for information will be followed up personally by the agent who may, if he chooses, take testimony under oath.

At none of these points of investigation will the agent necessarily be in touch with the taxpayer. However, he may come to him from time to time with requests for information. The agent may ask the taxpayer to submit to a question and answer examination under oath, a transcript of which will be later presented to the taxpayer for signature. On this score it might be noted that transcripts are, as a matter of policy, generally not turned over to the taxpayer or his attorney before signing. They must be read in the presence of the special agent and executed or not as the case may be, and if executed the taxpayer receives a copy.

This phase of the investigation is a one way street insofar as the taxpayer is concerned. He is not being given any information as to the purpose of the inquiry except for the general statement that his returns for the years involved are being investigated. However, an astute attorney can frequently ascertain, from the nature of the inquiries made, the type of case the Government is seeking to develop. For example, inquiries concerning particular transactions may indicate a specific item case, whereas inquiries concerning the method of living or the location and nature of various assets may indicate a net worth case or a living expenditures case.

An investigation of this intensity is a time-consuming process, taking two or perhaps even three years to complete. For this reason the statute of limitations on criminal prosecution should be kept in mind, because the chances are it may be some considerable time after the filing of the return before it reaches the point where investigation is undertaken.

Section 6531(2) provides a six year limitation on prosecution for willfully attempting in any manner to evade or defeat income taxes. The period starts to run on the date the return is actually filed and not, as with civil cases, on the last date the return could have been filed without

74. In re Albert Lindley Lee Memorial Hospital, 209 F.2d 122 (2d Cir. 1953).
penalty.\textsuperscript{75} It expires on midnight of the day following the expiration of six years from the date of filing.\textsuperscript{76} The time during which a taxpayer under investigation is outside of the United States or is a fugitive from justice tolls the statute of limitations.\textsuperscript{77}

An indictment against the taxpayer need not be returned nor need he consent to the filing of an information against him within the statutory period. It is sufficient if a complaint is instituted before a United States Commissioner within such time, provided an indictment or information is obtained within nine months thereafter.\textsuperscript{78} A complaint must be based upon personal knowledge, that is, it cannot be made by an Assistant United States Attorney not familiar with the case but must be made by the agent who looked into the facts.\textsuperscript{79} However, hearsay evidence is admissible.\textsuperscript{80}

Following the completion of the investigation, the special agent, with the assistance of the revenue agent working with him, who has meanwhile been preparing the mathematical features of the case, will write his report. A draft of this report may be submitted to the head of the local Intelligence Unit. If the conclusion is not to recommend prosecution, a formal report to this effect will be written and the taxpayer called in to discuss civil settlement of his case.

If prosecution is to be recommended, the head of the Intelligence Unit, reviewing the draft report of the special agent, may very well require it to be tightened up perhaps by affidavits or documentary evidence not already included. In some areas a draft report of this nature may be submitted to the office of the Assistant Regional Commissioner (Intelligence) and perhaps to the Regional Enforcement Counsel for their recommendations as to the manner in which the report could be improved. It is then returned to the special agent for preparation in final form.

After the preparation of the final report in which prosecution is recommended the taxpayer will be afforded a conference. There he will be handed a slip of paper showing the alleged understatement of income, together with taxes and penalties. It is believed that the general practice at this conference is also to tell the taxpayer whether the alleged understatement is based upon specific items, net worth, or any of their variations.

This is all the information he will obtain at this conference, for the

\textsuperscript{77} Int. Rev. Code of 1954, § 6531.
\textsuperscript{78} Ibid.
\textsuperscript{80} Costello v. United States, 350 U.S. 359 (1956).
Government is understandably reluctant to reveal its case where prosecution is to be recommended. He will, however, be afforded an opportunity to submit any explanations he may have. This may be done via affidavits or by submitting to a question and answer examination.

The taxpayer's situation at this point is not entirely hopeless. The chances may be fair that his counsel, together with the accountant retained to assist him during the investigation, will have some idea of the Government's case. Having seen the amounts claimed due they may now be in a position to pinpoint a defense by way of explanation, and if persuasive enough, the evidence adduced may change the opinion of the special agent and his local chief.

The procedure followed by the investigating officers is to recommend prosecution where the evidence is sufficient to indicate guilt beyond a reasonable doubt, and where there appears to be a reasonable probability of conviction. Since this is the gauge for the Treasury recommendation, it should be the focal point of defense efforts. Taxpayer's representatives should attempt to raise an element of doubt, or failing that, show the improbability of conviction in any event.

Assuming that the taxpayer has failed to induce the local Intelligence Unit not to recommend prosecution, the file is then transmitted to the Assistant Regional Commissioner (Intelligence). The report is reviewed and endorsed or returned for civil settlement. It is believed that before this recommendation becomes final the file in question is assigned to the Office of Regional Counsel.

Upon transmission of the file from the local director's office to the Regional Commissioner's Office, a letter is sent to the taxpayer advising him of this action and informing him that he has a right to a conference at the Regional Commissioner's level. If such a conference is requested, it will be granted, providing the statute of limitations is not too rapidly expiring. While some of the material referred to above indicates that these conferences are held by staff members assigned to the Assistant Regional Commissioner (Intelligence), most of these conferences are conducted by a member of the staff of the Regional Counsel handling enforcement matters. At such a conference testimony may be taken under oath and whatever further information desired, submitted.

It is not the usual practice of attorneys working in this field to make a formal affair of this conference. Generally speaking, they have had adequate opportunity to do this beforehand. These conferences consist, in the main, in the taxpayer's attorney discussing in an informal way what he thinks to be the weak points in the Government's case, his efforts

directed to obtaining a reconsideration of the case in the light of these arguments. As a result of such a conference the file may be returned again to the special agent for verification of certain facts which may have been cast into doubt or for the checking of additional evidence.

With the whole report before him, the Assistant Regional Commissioner (Intelligence) then decides whether to endorse the prosecution recommendation. If he does not, the file will be returned to the local District Director's Office and a civil adjustment will be sought, the criminal phase of the case being terminated. If he endorses the recommendation, the general practice is to transmit the whole case directly to the Criminal Section of the Tax Division of the Department of Justice. Occasionally, it may be transmitted to the Enforcement Division in the Office of the Chief Counsel for consideration there. Also, occasionally with the consent of the Department of Justice, the file may be transmitted directly to the United States Attorney for prosecution, although this step is usually taken only where time limitations are pressing.

When and if the case is forwarded to the Criminal Division of the Tax Section of the Department of Justice, the taxpayer is notified. Only upon request will he be given an opportunity for another conference to be held in Washington, this time by the Justice Department's attorney to whom the case has been assigned. The technique at this level is roughly the same as at the conference with the Regional Enforcement Counsel. Following this conference the Department of Justice decides either to return the file to the Treasury, in which case a civil adjustment will be sought, or to forward the file to the United States Attorney with instructions to seek an indictment.

Co-operation

The most difficult decision to be made in handling a criminal income tax case during the investigative period is the extent to which the taxpayer should be permitted to co-operate with the investigating agents.

Quite obviously, nothing is to be gained by refusing to furnish information which can be obtained elsewhere, such as bank and broker's statements, and matters which are of public record. Not only does the furnishing of this information make the task of the special agent somewhat less arduous (with perhaps some psychological value) but it also may be a method of keeping the facts of the investigation from becoming public knowledge. It would seem that only most unusual circumstances would dictate non-co-operation in this respect.

However, it is quite a different situation when the requested co-operation requires divulging information not otherwise obtainable and which is safeguarded by the fifth amendment. This would include net worth statements, and various types of affidavits and question and answer statements which reveal facts peculiarly within the knowledge of the tax-
payer. If the information submitted is true and incriminating, the taxpayer may be hanging himself. If this is not true and its falsity is discovered, this, of course, upon the assumption that the taxpayer's representative believes it to be true, the penalties for issuing false statements to the Government may perhaps be more severe than for the original crime investigated.

Unfortunately, the decisions do not help much in this regard. They indicate that failure to produce records for inspection by an agent is a circumstance which may be pointed to by the court as bearing upon willfulness, one of such cases indicating that this is not a violation of the fifth amendment. On the other hand, the cases seem to be fairly clear that the assertion of the privilege against self-incrimination would preclude the court from drawing unfavorable inferences. Perhaps the distinction lies between the taxpayer's insistence on keeping silent and his refusal to produce books and records, for it is at least argumentative that the latter may be covered by the "required records" doctrine and not a proper subject of the privilege.

It would seem the better part of wisdom to refuse to disclose any information not otherwise obtainable, which would incriminate the taxpayer and assist the Government in its case. While it is unlikely that the Treasury at this point would care to test the applicability of the "required records" doctrine to the taxpayer's situation, it might be better to put it to this test rather than submit. This is an area, of course, in which each case must be resolved upon its own facts and there is little help in generalities.

IN THE COURTS

Theoretically, the United States Attorney has the final decision to make with respect to the presentation of a case to a federal grand jury and forcing its subsequent trial. In tax cases, however, a prosecution recommendation to the United States Attorney is understood to be equivalent to a royal invitation. This being the case, about all there is to be gained by conferring with the United States Attorney in advance of indictment is to have him request further consideration of the case from the Department of Justice.

82. Beard v. United States, 222 F.2d 84 (4th Cir.), cert. denied, 350 U.S. 846 (1955); Olson v. United States, 191 F.2d 985 (8th Cir. 1951); Myres v. United States, 174 F.2d 329 (8th Cir.), cert. denied, 338 U.S. 849 (1949); Paschen v. United States, 70 F.2d 491 (7th Cir. 1934).

83. Myres v. United States, supra note 82.


Neither the taxpayer nor his attorney may, as a matter of right, attend the grand jury session at which the case is presented. Since an indictment may be based on hearsay evidence, the principal witnesses will be the Treasury agents who made the investigation, with such others as may be summoned. Since the case will probably be complicated and the witnesses testifying expert, failure to indict in these cases is understandably rare.

After indictment, the taxpayer is arraigned, posts bond, and prepares to enter his plea. Generally speaking, a not guilty plea is entered first, the taxpayer preserving his rights to move against the indictment at a later date.

The type of motion to be made will, of course, depend on the nature of the case. Some very unusual motions are made in tax cases. However, the one most frequently made is for a bill of particulars, since the taxpayer may still be very much in the dark as to the exact nature of the charges.

Granting such a motion is discretionary with the court. Some judges have forced the Government to disclose the theory of its case and, if based on specific items, the items. Others have refused to be as liberal. On an analogous score, inspection of grand jury minutes is rarely permitted.

On the trial of the case, the Government's proof will consist basically of the testimony of the agents who conducted the investigation. They are entitled to testify from summaries prepared by them from the taxpayer's records, even though such records are not themselves in evidence, provided the records are available for cross examination. Charts are also admissible to explain the agents' testimony.

Where an agent is testifying from notes, the taxpayer is entitled to examine them. The First Circuit held in 1955 that the taxpayer was

88. Goldberg v. Hoffman, 226 F.2d 681 (7th Cir. 1955), where on the basis of the defendant's health, it was attempted to mandamus the judge to dismiss after conviction.
89. O'Connor v. United States, 175 F.2d 477 (9th Cir. 1949); Maxfield v. United States, 152 F.2d 593 (9th Cir. 1945), cert. denied, 327 U.S. 794 (1946); See Singer v. United States, 58 F.2d 74 (3d Cir. 1932).
93. Paschen v. United States, 70 F.2d 491 (7th Cir. 1934); Cooper v. United States, 9 F.2d 216 (8th Cir. 1925).
94. Smith v. United States, 236 F.2d 260 (6th Cir. 1956).
95. Montgomery v. United States, 203 F.2d 887 (5th Cir. 1953).
not entitled to inspect the report of a witness contained in the Government's files, in the absence of a showing that it was inconsistent with his testimony.\footnote{96} For a while, validity of this decision was cast into doubt by the decision of the Supreme Court in the \textit{Jencks} case,\footnote{97} but the so-called "F. B. I. Files Bill"—in reality of much broader import—has modified the impact of \textit{Jencks}, and probably vitiated its use in tax cases,\footnote{98} this upon the assumption that the new law is constitutional.

Following conviction, the taxpayer is faced with a sentence of up to five years on each count of the indictment or a fine of $10,000, or both.\footnote{99} The severity of the fine and sentence lies in the discretion of the trial court.\footnote{100} He may also be taxed with the costs of prosecution,\footnote{101} which would include witness fees, etc.\footnote{102} While acquittal would obviate these penalties, neither it nor conviction has any bearing upon the civil collection of the deficiency in taxes, interest and fraud penalties, which are regarded as entirely separate matters.\footnote{103}

The foregoing indicates the wisdom of defense counsel in tax cases giving serious thought to the entry of a plea of guilty, especially if it would result in a relatively lower fine and a suspended sentence. It should be understood that a plea, coupled with a satisfactory civil settlement, frequently made a condition of the pre-sentence investigation,\footnote{104} will not, \textit{ipso facto}, avoid a prison term.\footnote{105} However, since these are discretionary matters with the trial court and tax trials are long, complicated and costly, elements of this nature are bound to enter into judicial consideration.

Alternative to either a plea of guilt or a trial, and hinging upon consent of the court, is a plea of \textit{nolo contendere}, which is a mere statement of unwillingness to contest, generally carrying no criminal stigma.\footnote{106} In

\footnote{96} Scanlon v. United States, 223 F.2d 382 (1st Cir. 1955); United States v. Palermo, 57-2 U.S.T.C. \# 9911 (S.D.N.Y. 1957).
\footnote{99} Int. Rev. Code of 1954, \S\ 7201.
\footnote{100} Jolly v. United States, 229 F.2d 180 (6th Cir.), cert. denied, 331 U.S. 963 (1956), where ten years' imprisonment and a $40,000 fine were termed unduly severe but not subject to being disturbed.
\footnote{101} Int. Rev. Code of 1954, \S\ 7201.
\footnote{102} Gleckman v. United States, 80 F.2d 394 (8th Cir. 1935), cert. denied, 297 U.S. 709 (1936); See United States v. Rosenblum, 182 F.2d 956 (7th Cir.), cert. denied, 340 U.S. 826 (1950).
\footnote{103} Helvering v. Mitchell, 303 U.S. 391 (1938); Slick v. United States, 1 F.2d 897 (7th Cir. 1924).
\footnote{104} United States v. Steiner, 239 F.2d 660 (7th Cir.), cert. denied, 353 U.S. 936 (1957).
\footnote{105} Burr v. United States, 86 F.2d 502 (7th Cir. 1936), cert. denied, 300 U.S. 664 (1937); United States v. La Fontaine, 54 F.2d 371 (D. Md. 1931).
\footnote{106} Mickler v. Fahs, 243 F.2d 515 (5th Cir. 1957).
effect, it amounts to a plea of guilt only in the case where made,\textsuperscript{107} although, in a civil case such a plea was held admissible in the Tax Court for impeachment purposes.\textsuperscript{108}

Be that as it may, however, it is believed that most United States attorneys are unwilling, in the run-of-the-mill criminal tax cases, to accept a \textit{nolo contendere} plea. District judges incline to go along. At the present writing, it would appear very difficult to enter such a plea and have it accepted.

\textbf{CONCLUSION}

As the writer has endeavored to indicate, criminal income tax cases do not closely resemble other criminal matters. Mainly, this stems from the fact that the taxpayer is aware of the investigation long before it comes to fruition and is in a position to protect himself during its course. Criminal tax cases may also differ from other criminal matters in that quite frequently the taxpayer is "an otherwise respectable citizen" who is experiencing his first brush with the law. The disastrous effects of a wide-spread inquiry into his financial affairs, with perhaps the agent indicating why the taxpayer is being investigated, must also be reckoned with.

Therefore, the duties of counsel representing such a taxpayer are somewhat different from those of an attorney in an ordinary criminal case. Because he is in at an early stage of the case, he may be in a position to persuade the Treasury Department that the case should be relegated to a purely civil settlement. Where he has a client who is having his first experience on the criminal side of the law and to whom an indictment, even though followed by a subsequent acquittal, would be socially and economically calamitous, this is perhaps the greatest service he can perform.

Along the same lines, by proper co-operation with the investigating agents, counsel for the taxpayer may be able to prevent the investigation from becoming public knowledge, with its unfortunate results. This he may be able to do by making it unnecessary for the investigating agent to go to the public records, to the banks, to the brokers, and to the taxpayer's business associates for information. Since none of this would be privileged, it is something the taxpayer himself could furnish without having to reveal the reasons why he requests it.

All in all, then, the unusual service which can be performed in a criminal tax case are performed at the investigative level. Following indictment the case pursues the familiar federal criminal pattern with a few of the ramifications alluded to above.

\textsuperscript{107} Ibid.
\textsuperscript{108} Kilpatrick v. Commissioner, 227 F.2d 240 (5th Cir. 1955).