Income Tax Evasion and the Privilege against Self-Incrimination

Bruce Peterson
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"Really, now you ask me," said Alice, very much confused, "I don't think—"

"Then you shouldn't talk," said the Hatter.

Alice in Wonderland
by Lewis Carroll

The privilege against self-incrimination has had a long and illustrious history as a part of the English law. In American jurisprudence we find it's embodiment in the Fifth Amendment to the Constitution. Chief Justice John Marshall in an early decision stated the scope of the privilege thusly:

"Many links frequently compose that chain of testimony, which is necessary to convict any individual of a crime. It appears to the court to be the true sense of the rule that no witness is compellable to furnish any one of them against himself. It is certainly not only a possible but a probable case that a witness, by disclosing a single fact, may complete the testimony against himself, and to every effectual purpose accuse himself as entirely as he would by stating every circumstance which would be required for his conviction. That fact of itself might be unavailing, but all other facts without it would be insufficient."

Nowhere is this summation more applicable than in the field of taxation. A bit of information can quickly fill in a "net worth" investigation where the taxpayer failed to disclose all of his income. Yet, on the other side of the coin, an efficacious tax system must

1 "No person . . . shall be compelled in any criminal case to be a witness against himself . . ." U. S. Const. amend. V.
by its very nature see to it that there is a continuous flow of information relative to the status of compliance with the taxing laws. Because of its pervasive nature, perhaps no other phase of the law has a more direct impact on so vast a number of people.

Since the birth of the modern income tax in 1913, not only have the rates multiplied, but also the number of taxpayers. The combination of high rates, coupled with taxpayer knowledge that not all returns are audited, plus the American gambling spirit has led one author to speculate on the advent of a new national pastime called "Treasury Roulette." While the number of petty infractions is more than likely quite high, substantial evasion is deterred by the criminal sanctions imposed by the Internal Revenue Code. The principal provision is found in Section 7201 making it a felony, punishable by a fine up to $10,000 or imprisonment up to five years, or both, "wilfully" to attempt "in any manner to evade or defeat any tax . . . or the payment thereof . . . ." The statute of limitations is six years. Section 7203 sets forth misdemeanor offenses, punishable by fines up to $10,000 and imprisonment for not more than one year, or both, for willful failure to make a return, "keep any records, or supply any information" required by law or regulations. The statute of limitations is three years as to misdemeanors.

Even though the number of criminal prosecutions is not large in comparison to the number of taxpayers, the threat of imprisonment is undoubtedly the greatest single deterrent to willful evasion. Fines, penalties and interest when weighed against tax-free income are simply inadequate. The number of prosecutions for willful evasion of income taxes has increased notably over the past decade.

Even so, the prison terms have been comparatively light compared with those meted out for such other financial offenses as larceny and embezzlement. But the fact nonetheless remains, that even the lightest of prison sentences is the single most effective deterrent to willful tax evasion.

The number of devices utilized to willfully evade the payment of taxes is few in number, the variations occurring in degree only. Normally tax evasion is uncovered through routine audits conducted by revenue agents. Suspicious circumstances revealed during the audit are turned over to the Intelligence Division. If, upon review,

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4 INT. REV. CODE OF 1954, § 7201.

5 INT. REV. CODE OF 1954, § 6531(2).

6 INT. REV. CODE OF 1954, § 6531.

7 In 1949, the government tried 356 taxpayers for willful tax evasion and got 346 convictions or guilty pleas. See, AMERICAN BAR ASSOCIATION SECTION ON TAXATION, SYMPOSIUM IN TAX FRAUD CASES 17 (1950). In 1962, of all criminal cases reaching the courtroom for willful evasion of federal taxes, 5,263 defendants pleaded guilty or nolo contendere, 856 were convicted after trial, 402 were acquitted and 760 were either nol-prossed or dismissed. ANNUAL REPORT OF THE COMMISSIONER OF INTERNAL REVENUE, 44 (1962).
they are deemed sufficient to warrant an investigation a Special Agent from the Intelligence Division is assigned to the case. If the case, as it is developed, involves the willful evasion of taxes the Internal Revenue Service will recommend prosecution. The final determination lies with the Tax Division of the Justice Department. Undoubtedly, great weight is accorded the recommendations of the Service, however, there may be underlying policy considerations as to whether an individual case is acutally prosecuted. Inasmuch as these are criminal prosecutions brought in the United States Courts, all of the constitutional protections are available to the taxpayer indicted for the willful evasion of taxes.

Two facets of the audit or investigation of taxpayers need to be stressed. First, the fusion of the civil aspects of a routine audit of the taxpayer and that of an investigation that may ultimately lead to criminal prosecution. In a vast majority of cases no distinguishable line of demarcation exists to differentiate when a civil investigation fades into a criminal investigation. Secondly is the controverted fact that almost every conceivable fact is relevant in an investigation involving willful tax evasion. Even the most innocuous question may form a link in the chain of evidence necessary to complete a case for criminal prosecution. In the construction of a taxpayer's income for a period through the use of the “net worth” method, the most insignificant scrap is of, or is capable of, damning consequences.

Thus it becomes quite apparent that one of the chief safeguards a taxpayer may turn to during an investigation for possible tax evasion is the Fifth Amendment’s privilege against self-incrimination. The Justice Department has compiled a very successful record in prosecutions of this type, partly because only those cases with an overwhelming possibility of conviction are tried by the government. Glib taxpayers more often than not contribute to the overwhelming possibility of conviction classification of their cases.

While the privilege against self-incrimination remains as the greatest single weapon in the taxpayer's arsenal of defense, the armor is not without chinks through which prison sentences may blow. One such chink may best be termed the “required records

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8 These are: due process of law, security from unreasonable search or seizure, the independent judgments of grand jury, trial by jury, privilege against self-incrimination, a speedy and public trial, confrontation with the witnesses against him, the right to have the assistance of counsel, the right and freedom from excessive fines, cruel or unusual punishments and double jeopardy.


doctrine,” although there has been scant use of it by the Internal Revenue Service to date.

THE REQUIRED RECORDS DOCTRINE

Born of World War II and the O.P.A. was the 1948 case of Shapiro v. United States.\(^\text{11}\) In a sharply divided five-to-four opinion the Supreme Court held that a statutory requirement that records be maintained, removed the constitutional privilege against self-incrimination as to these records. The Court reasoned that the privilege extended only to records that the accused had a right to withhold, and did not extend to records that the statute compelled him to maintain. The records thus could be labeled “semi-public” or “quasi-official” in nature and beyond the scope of the privilege.

The Shapiro case, while not involving income, estate or gift taxes, does take on sizeable proportions in the tax field when viewed against the background of Section 6001 and others of the Internal Revenue Code.\(^\text{12}\) Section 6001 provides that “every person . . . shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary or his delegate may from time to time prescribe . . . to show whether or not such person is liable for tax under this title.”

The privilege against self-incrimination can and does operate most effectively in the field of taxation, as well as other regulatory areas. However, it must be realized that any widespread resort on the part of a substantial number of taxpayers to the Fifth Amendment privilege against self-incrimination would undoubtedly seriously jeopardize, if not cause a complete breakdown in the continuous audit and investigation program carried on by the Internal Revenue Service. Congress has resorted to the passage of immunity acts in other areas of the law to cope with the privilege against self-incrimination as an obstacle to the flow of information necessary for regulation and fact finding.\(^\text{13}\)

It should be noted that in the Shapiro case the only requirement imposed by the Court on the statutory record keeping doctrine was that the “basic activity” come within the legitimate scope of

\(^{11}\) 335 U.S. 1, 68 Sup.Ct. 1375, 92 L.Ed. 1787 (1948). For an excellent discussion of the withdrawal of the privilege against self-incrimination from records required by law see Meltzer, Required Records, the McCarran Act, and the Privilege Against Self-Incrimination, 18 U. of Cin. L. Rev. 887 (1951).

\(^{12}\) Int. Rev. Code of 1954 §§ 6001, 7602 & 7604. Section 6001 relates to the kind or type of record required to be kept while § 7602 provides “For the purpose of ascertaining the correctness of any return . . . the Secretary . . . is authorized — (1) to examine any books, papers, records, or other data which may be relevant or material to such inquiry;.” Section 7604 pertains to the jurisdiction of the district courts and enforcement of summons under § 7602.

Congressional regulation. The statutory language in the Code providing that taxpayers must keep adequate records for the determination of their tax liability would appear to fall well within this restriction of the Shapiro case without distorting the rule itself. Even though the Internal Revenue Service has not pressed for adoption of the “required records” doctrine in those tax cases involving the privilege against self-incrimination, nonetheless several courts have taken the bit in their teeth and used the rule to justify the disclosure of taxpayer records.

The first case to follow Shapiro in the tax field was decided by the Fifth Circuit in 1953. It is somewhat anomalous that the case is correctly decided, but for the wrong reason. The government sought, by subpoena, the disclosure of certain records belonging to the taxpayer, but in the hands of his accountant. The accountant refused to comply with the subpoena, raising the privilege against self-incrimination in behalf of his client. The court, in rejecting the accountant’s defense, cited the Shapiro case as authority for its holding. It is suggested that a sounder basis for the result would have been to rely on the rule that the privilege is personal to the taxpayer and cannot be pled by a third party on his behalf.

In 1955 a District Court in Georgia held that where an attorney held records reflecting the gross amount of wages taken by his client, the attorney could not refuse to produce these records relying on the attorney-client privileged communication. The court reasoned that even if the taxpayer was in possession of these records, he could not have refused their inspection by the Internal Revenue Service as “they involved records which the law requires to be kept.” Thus the taxpayer could not insulate these “required records” from inspection by placing them in the hands of his attorney. The court rejected the attorney’s claim that these records were protected as privileged or confidential communications between client and attorney and then went on to opine that even had the attorney raised the privilege against self-incrimination on behalf of his client that also would have been of no avail.

In 1960 the Seventh Circuit in United States v. Clancy upheld the conviction of a taxpayer for evasion of federal wagering taxes. The court held that a seizure of the taxpayer’s books and accounts by federal revenue agents did not violate either the Fourth or Fifth Amendments because, inter alia, they were records that the taxpayer was required by law to keep and to make available to internal revenue officials. The court was careful to point out that these were

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14 Falsone v. United States, 205 F.2d 734 (5th Cir. 1953); See Note, 32 Tex. L. Rev. 453 (1954).
17 276 F.2d 617 (7th Cir. 1960).
not private records subject to the privilege against self-incrimination.

The foregoing cases, while not overwhelming in number, are at least an entering wedge in the tax field of the "required records" doctrine. The Shapiro court invoked long-standing principles when it stated:

"... the privilege which exists as to private papers cannot be maintained in relation to 'records 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.'"^{18}

Thus it would appear, not withstanding some writers in the field, that the "required records" doctrine has a good foundation in law upon which a workable theory can be introduced into the collection of taxes.^{19} Chief Justice Vinson's sole limitation in the Shapiro case was that the basic activity be one properly within the scope of Congressional regulation. I would add one more limitation so that the Fifth Amendment protection as to self-incrimination would not become a hollow mockery. Records, required by statute to be maintained, should be limited to a specified purpose, i.e., the correctness of the taxpayer's income tax liability as disclosed on his return. These records should not be available for inspection or audit for the purpose of prosecution under the Robinson-Patman Act^{20} or the anti-trust laws. In other words, use by the government of records required to be kept under the Internal Revenue Code would, or should, be restricted for that purpose alone and utilization of these records for any other purpose would be subject to a motion to suppress their introduction into evidence.

Concomitant with the ever-increasing costs of national and local government and the correlation with an increased tax burden on a large segment of our population it is imperative that each citizen taxpayer pay his fair share. The recent legislation concerning the so-called "T. & E." deductions is an illustration of an aroused majority passing restrictive and punitive type legislation in an effort to prevent a small minority from abusing the tax law.^{21} If taxpayer cooperation on the scale presently known is going to continue we must insure that insofar as possible all persons pay

^{18} 335 U.S. at 33, 69 Sup.Ct. at 1392, 92 L.Ed. at 1807.
their just share of the tax burden. Not only this, but the citizenry must be aware that such an effort is being made by the taxing officials.

Within recent years the privilege against self-incrimination in the tax field has ranged beyond the “required records” doctrine and into other equally vital aspects of the law. Quite often the question before the court turns on who may properly raise the question of self-incrimination. This can be sub-divided into two situations, one where a third party pleads the privilege in behalf of another, and secondly where the taxpayer has in his possession records and books of an organization of which he is an officer or employee.

WHO MAY PLEAD THE PRIVILEGE

The privilege against self-incrimination has been available only to the person who would be incriminated. This characterization that the privilege is intensely personal is best typified by the statement of the Court in *Hale v. Hinkle*:

“The right of a person under the 5th Amendment to refuse to incriminate himself is purely a personal privilege of the witness. It was never intended to permit him to plead the fact that some third person might be incriminated by his testimony, even though he were the agent of such person.”

Even assuming that the privilege is personal in nature, the question of whether an attorney may plead the privilege against self-incrimination for his client has never been specifically answered by the Supreme Court.

Unfortunately the few cases that have been presented to the inferior courts on this question of the attorney’s raising the privilege on behalf of his client, have been superimposed on some rather sophisticated property concepts. The pattern has developed, with some variations, that the taxpayer’s accountant has prepared work papers during the normal preparation of returns for the client over the years. The taxpayer comes under investigation for possible income tax evasion and either the accountant turns over these working papers to the taxpayer, who in turn transmits them to his attorney, or the accountant turns them over to the taxpayer’s attorney.

In *Application of House* the federal district court was faced with an application by the Internal Revenue Service to enforce a subpoena for the production of certain documents. The subpoena was served on the taxpayers’ attorneys and demanded production

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23 As to the other side of the coin respecting accountants and the confidential communication privilege see *Fahey, Testimonial Privilege of Accountants in Federal Tax Fraud Investigations*, 17 Tax L. Rev. 491 (1962).

24 144 F.Supp. 95 (N.D. Cal. 1956).
of accountant's work papers which had, at the request of the taxpayers, been delivered to such attorneys. The court denied enforcement of the subpoena, holding valid the taxpayers' refusal, voiced by their attorneys, to produce such documents in reliance on the privilege against self-incrimination.

In so holding, the Court stated that the work papers were "the property of the taxpayers," but then went on to say that the Fifth Amendment does not turn on any "narrow concept of property law," and that it could be effectively pled if the taxpayers or their attorneys were "in rightful, indefinite possession of the documents."

The district court of New Jersey in United States v. Boccuto refused to invoke the privilege against self-incrimination as to work papers turned over to the attorney by the taxpayer's accountant. The court concluded that the work papers were the property of the accountant, not the taxpayer, therefore the attorney could not plead the privilege against self-incrimination on behalf of his client. It is submitted that this slavish adherence to property concepts in an area such as this serves no useful purpose, but further muddies already murky waters unnecessarily.

Judge Madden, in the Boccuto case relies in part on dicta appearing in the Willis opinion regarding whether the attorney can claim for the client the privilege against self-incrimination. The first point made in the Willis case is that "The mere assertion of privilege does not immunize him . . . ." but that the court must then pass on the correctness of the assertion that disclosure of such information might tend to incriminate. The second point touched on by the court is stated thusly:

"When we are dealing not with communications as to which the attorney has full knowledge but with the broad field of self-incrimination, the attorney speaking for an absent client with whom he probably has been unable to communicate can hardly be presumed to be well enough informed either to decide for the client whether the client would, if present, elect to claim the privilege or to support the claim when made."

In a rather tersely worded opinion by the Eighth Circuit in

25 Id. at 102.
26 Id. at 101.
29 145 F.Supp. at 368. Until the taxpayer becomes a defendant in an action for willful evasion of income taxes the court must pass on the justification of his refusal. Just when the taxpayer ceases to be a suspect and becomes a defendant in a criminal action has generated a good deal of litigation, not only in the tax field, but the criminal law generally. United States v. Lipton, 115 F.Supp. 674 (S.D.N.Y. 1953). See also Lipton, Safeguarding Constitutional Rights in Tax Fraud Investigations, 32 Taxes 263 (1954).
30 145 F.Supp. at 368.
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Bouschor v. United States,31 a case almost identical in nature to that of Application of House,32 the court rejected the House rationale and cited with approval the Boccuto decision based on the property concepts enunciated therein. About the only comment one could make on disarray of the authorities on this question was that there was some authority for either side.

The Ninth Circuit had pending an almost identical case at the time Bouschor was decided by the Eighth Circuit. Judge Jertberg of the Ninth Circuit in United States v. Judson33 in a well thought out opinion reviewed the cases in the field and came to the same conclusions as Judge Murphy in Application of House, but not without a sharp dissenting opinion. What went unsaid in Application of House as to the dangers inherent in what the government urged upon the courts, Judge Jertberg sums up in the closing paragraph of his opinion:

"The government has at its disposal inquisitorial powers and administrative procedures which it may invoke at its pleasure. If the government's position were sustained here, those powers could be utilized to stimulate a taxpayer's consultation with his attorney and the predictable transfer of his records. The government's powers could then be utilized to compel disclosure of those matters by the attorney whenever the taxpayer were not available to utter the magic words. In our judgment, the inherent power thus to compel indirectly an individual's self-incrimination is curbed by the Fifth Amendment as effectively as the power to compel the same result directly."34

It is the sincere hope that the rationale of the Judson case will prevail over the Bouschor-Boccuto-Willis reasoning. To emasculate the Fifth Amendment protection against self-incrimination through the use of tenuous property concepts and strict construction of the personal element in the privilege itself does a dis-service to the freedoms guaranteed under the Constitution. In each of the foregoing cases the attorney was the sole party to the proceedings, the subpoena being directed to the attorney to produce the papers without the taxpayer being made a party. The better rule might be to limit the claim of the privilege by the attorney on behalf of his client to those cases where the client is not made a party until this is done and the court may properly pass on the justification of the privilege with the client as a party to the proceedings.

31 316 F.2d 451 (8th Cir. 1963).
32 In both the Bouschor and House cases the accountants' work papers had been turned over to the taxpayer's counsel at the direction of the taxpayer. In both instances the court finds that technically the work papers are the property of the accountants as only possession is surrendered.
33 322 F.2d 460 (9th Cir. 1963).
34 Id. at 468.
The second facet of this problem of who may claim the privilege against self-incrimination concerns the dichotomy of what is a "private" record as distinguished from a record or paper held in a custodial capacity for an organization.

PRIVATE OR PERSONAL RECORDS

The seminal decision of depersonalized group records is the 1911 Supreme Court case of Wilson v. United States. The Court here held that the Fifth Amendment privilege against self-incrimination did not extend its protection to corporations or to corporate officials when compelled to produce corporate documents which tend to incriminate themselves. This doctrine was extended to unincorporated associations such as labor unions in the case of United States v. White. The rationale of these decisions is that the state has reserved visitorial power over the conduct of certain organizations and that they have a "character so impersonal in the scope of their membership and activities that it cannot be said to embody or represent the purely private or personal interests of its constituents, but rather to embody their common or group interests only." The labor union represented organized institutional activity as contrasted with wholly individual activity and therefore there was no personal privilege available to its officers of records in their possession.

In 1963 the Second Circuit extended this doctrine to limited partnerships in United States v. Silverstein. The court points out that the limited partners are similar to small corporate shareholders and that the limited partners have "the right to have the partnership books kept at the principal place of business, and to inspect and copy them." Also seized upon as significant in the Silverstein case is the fact that limited liability was sought by the organization and this was tantamount to an election by the partners, both general and limited, to submit to a greater degree of governmental intervention.

It is submitted that the first factor emphasized by the Silverstein case regarding a centralized repository for records would be true of both a limited and general partnership arrangement. The second factor of limited liability would be absent as to general partnerships, however, it is difficult to believe that even they would not be characterized as impersonal as to membership and activities so as to come within the rule that the privilege against self-incrimination does not apply to the organi-

35 221 U.S. 361, Sup.Ct. 538, 55 L.Ed. 771 (1911).
36 322 U.S. 694, 64 Sup.Ct. 1246, 88 L.Ed. 1542 (1943).
37 Id. at 701, 64 Sup.Ct. at 1252, 88 L.Ed. at 1547.
39 314 F.2d at 791.
zation's records. This would be especially true if the partnership was formed under a state partnership statute.

The "required records" doctrine, discussed earlier, finds its roots in the Wilson case, and undoubtedly is analogous to the privilege against self-incrimination except as to corporate or association records held in a representative capacity. What remains in doubt as to this residual visitation power of the state as to group records is the definitional problems inherent in the terms "personal" and "representative of a non-privileged organization". During 1961 and 1962 a number of states passed statutes permitting attorneys and physicians as well as other semi-professional persons to organize "professional corporations" for the practice of their professions. The passage of these statutes were motivated solely for the enjoyment of federal income tax advantages and their status is neither atypical of business corporations generally or unincorporated associations.

Is this the type of corporation that the Court had in mind in the Wilson case? Perhaps not, but the transition is not difficult. Even though the White case applied the Wilson doctrine to unincorporated associations and Silverstein to limited partnerships, there nonetheless is considerable doubt whether informal partnerships of two or three partners common to attorneys, physicians, dentists, accountants, etc. come within the definition of an organization of a character so impersonal in the scope of its membership and activities that it cannot be said to embody or represent purely private or personal interests of its constituents.

CONCLUSION

The practitioner representing taxpayers under investigation or indictment for income tax evasion have a very narrow and tortuous path to follow if they wish to avail their client protection under the Fifth Amendment's self-incrimination privilege. Beset with the question of who may plead the privilege plus the "required records" doctrine and the possibility of group records not available for the protection the privilege has suffered substantial erosion in a field that is becoming of wider importance.

There has been less of an emphasis on constitutional safeguards in the tax evasion field by the courts, even though as a general rule taxpayers have been represented by extraordinarily competent counsel. The sharpness and clear delineation of constitutional issues in willful tax evasion cases is remarkable; one only wishes that all persons accused of crimes could be afforded the same opportunity of counsel. Undoubtedly some of the very best decisions in the field of constitutional law are a result of

49 For an excellent presentation of the background and problems relating to the enactment of state legislation in this area see Bittker, Professional Associations and Federal Income Taxation: Some Questions and Comments, 17 Tax L. Rev. 1 (1961).
criminal prosecution in tax evasion cases. This is due, at least in good part, by the fact that as a general rule taxpayers are able to afford top-notch counsel who in turn are able to pin-point constitutional problems and elucidate far better than their cohorts who defend accused of the more prosaic crimes of murder, larceny, burglary, etc.

On the other hand the courts as a rule have been less perceptive to pleas of taxpayers that their constitutional liberties have been exposed to delimiting factors such as the “required records” and group records doctrine.41 Certainly both the “required records” doctrine and the group records approach are in for further development as the courts become more aware of their existence. It is but a matter of time until the highest court is presented with the issue of whether an attorney can, on behalf of his client, plead the privilege against self-incrimination. The attorney should be aware of the uncertainties in this area and until more definitive bench marks are set out in the form of decisions his will be an uneasy path at best.

41 Indicative of this approach is the language of the Court in United States v. White, 322 U.S. at 700, 64 Sup.Ct. at 1252, 88 L.Ed. at 1547: “The reason underlying the restriction of this constitutional privilege to natural individuals acting in their own private capacity is clear . . . . The greater portion of evidence of wrongdoing by an organization or its representatives is usually to be found in the official records and documents of that organization. Were the cloak of the privilege to be thrown around these impersonal records and documents, effective enforcement of many federal and state laws would be impossible.”