

# Tax Enforcement II

## In This Issue

**May  
2013**

**Volume 61  
Number 3**

United States  
Department of Justice  
Executive Office for  
United States Attorneys  
Washington, DC  
20530

H. Marshall Jarrett  
Director

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The United States Attorneys' Bulletin  
is published pursuant to  
28 CFR § 0.22(b).

The United States Attorneys' Bulletin  
is published bimonthly by the  
Executive Office for United States  
Attorneys, Office of Legal Education,  
1620 Pendleton Street,  
Columbia, South Carolina 29201.

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Managing Editor,  
United States Attorneys' Bulletin,  
National Advocacy Center,  
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1620 Pendleton Street,  
Columbia, SC 29201.

**UBS, Wegelin, and Offshore Banking Prosecutions: The Power of  
General Deterrence . . . . .1**  
By David B. Massey, Daniel W. Levy, and Jason H. Cowley

**The Required Records Doctrine and Offshore Bank Accounts . . . . .7**  
By Alexander P. Robbins

**Litigating Fifth Amendment Claims by Non-Filing Taxpayers in  
Response to IRS Summonses . . . . .21**  
By Robert W. Metzler

**Parallel Proceedings in Tax Cases: Avoiding Common Pitfalls . . . 29**  
By Carol Koehler Ide

**Restitution-Based Assessments Pursuant to 26 U.S.C.  
§ 6201(a)(4) . . . . .45**  
By Elissa Hart-Mahan

**Terrorism Tax Evasion: Using Criminal Tax Charges to Combat  
the Use of Charities in Terrorism Financing . . . . .49**  
By Corey J. Smith



# UBS, Wegelin, and Offshore Banking Prosecutions: The Power of General Deterrence

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As Assistant Attorney General Kathryn Keneally noted in the March issue of the United States Attorneys' Bulletin, for the past four years, offshore banking prosecutions have demonstrated the power of cooperation between the Tax Division and United States Attorneys' offices (USAOs) nationwide. In February 2009, the Tax Division shattered Swiss banking secrecy through a landmark deferred prosecution agreement with Swiss banking giant UBS AG. The agreement required UBS to pay \$780 million to the United States and to produce more than 200 customer files for taxpayers with undeclared accounts. Using these files, the Tax Division and USAOs quickly began to prosecute tax evaders with undeclared accounts at UBS and other foreign banks. To date, approximately 56 individual taxpayers have been criminally prosecuted in federal court for various offenses arising from their failure to declare foreign bank accounts and pay taxes on the income earned in the accounts. Numerous taxpayers have received meaningful jail sentences, including two 12-month sentences in the Southern District of New York.

The UBS deferred prosecution agreement set off a tidal wave of applications to the Offshore Voluntary Disclosure Initiative (OVDI) in its various forms, which was crafted in the wake of the UBS deferred prosecution agreement. The IRS has confirmed that more than 38,000 taxpayers have sought to avoid criminal prosecution by disclosing to the IRS all facts relating to their offshore bank accounts, including the bank, bankers, and other professionals who assisted them, and by paying back taxes, interest, and other penalties, typically between 12.5 percent and 27.5 percent of the highest aggregate balance in the undisclosed offshore bank accounts during the period covered by the voluntary disclosure. Payments to the United States under the OVDI now total more than \$5.5 billion. Laura Saunders, *U.S. Is Preparing More Tax-Evasion Cases*, THE WALL STREET JOURNAL, Jan. 31, 2013, at C1.

## **I. The value of the Offshore Voluntary Disclosure Initiative**

Facts provided to the IRS by OVDI applicants have become a prime source of information for follow-on prosecutions of bankers, investment advisers, and other facilitators who helped taxpayers

establish and maintain undeclared overseas accounts, as well as the “structures”—sham corporations and foundations—often used to nominally hold such accounts. To date, the Tax Division and USAOs have indicted a Swiss bank (as described in further detail below), approximately 21 European bankers, 5 asset managers, 4 lawyers, and 1 trust advisor for conspiring with taxpayers to hide offshore bank accounts from the IRS.

## II. Use of grand jury subpoenas

Grand jury subpoenas have proven to be an essential tool in the investigation and prosecution of taxpayers and their facilitators. Starting in the fall of 2009, IRS agents began to serve taxpayers with subpoenas addressed not only to the sham entities that many of them owned and controlled, but also to the taxpayers in their individual capacity for foreign bank records and other information that all holders of foreign bank accounts must maintain under the Bank Secrecy Act. Four United States courts of appeals and numerous district courts have now rejected Fifth Amendment act of production privilege objections to these subpoenas under the “required records” doctrine. *See generally In Re Grand Jury Proceedings, No. 4-10*, 2013 WL 452768, at \*9 (11th Cir. Feb. 7, 2013) (Government’s interest in foreign financial account records was “essentially regulatory” in nature and fell within the required records exception to the Fifth Amendment privilege against self-incrimination for purposes of grand jury subpoena *duces tecum* requesting production of those records); *In re Grand Jury Subpoena*, 696 F.3d 428, 433 (5th Cir. 2012) (holding that the required records doctrine permits the Government to have the means, over an assertion of the Fifth Amendment privilege against self-incrimination, to inspect the records it requires an individual to keep as a condition of voluntarily participating in a regulated activity); *In re Special February 2011-1 Grand Jury Subpoena Dated September 12, 2011*, 691 F.3d 903, 906 (7th Cir. 2012) (holding that the required records doctrine, under which Fifth Amendment privilege against self-incrimination cannot be maintained in relation to records required by law to be kept, applied to records for foreign financial accounts); *In re Grand Jury Investigation M.H.*, 648 F.3d 1067, 1079 (9th Cir. 2011) (holding that requested records fell under the required records doctrine, rendering Fifth Amendment privilege against self-incrimination inapplicable), *cert. denied*, 2012 WL 553924, at \*1 (June 25, 2012); *In re Various Grand Jury Subpoenas, No. 12 Misc. 381*, 2013 WL 604329, at \*5 (S.D.N.Y. Feb. 19, 2013) (granting Government’s motion to compel compliance with grand jury subpoenas seeking foreign bank account information from five taxpayers); *In re Grand Jury Subpoena Dated February 2, 2012*, 2012 WL 6106332, at \*8 (E.D.N.Y. Dec. 10, 2012) (holding that foreign bank records were subject to the required records exception to the Fifth Amendment privilege against self-incrimination); *United States v. John and Jane Doe*, No. 11 GJ 981, slip. op. (E.D. Va. Oct. 2, 2012); *In re Grand Jury Subpoenas Dated September 9, 2011, No. 11 Misc. 747* (E.D.N.Y. Dec. 30, 2011); *In re Grand Jury Subpoenas Dated January 3, 2011, No. 11 Mag. 6164* (S.D. Fla. Mar. 4, 2011); *In re Grand Jury Subpoena No. 10-04-400* (D. Ariz. Feb. 16, 2011).

As a general matter, these courts have held that the privilege against self-incrimination, including the act of production privilege, does not prevent Congress from imposing recordkeeping and reporting requirements as conditions of engaging in an activity that Congress could prohibit entirely. Thus, Congress may legitimately require that those who decide to have an offshore bank account preserve their records and produce those records on demand, even though the act of producing documents may have communicative aspects. Voluntarily engaging in an activity that carries with it a recordkeeping requirement constitutes, in effect, a waiver of the act of production privilege, at least with respect to the grand jury subpoenas in question, where there is a nexus between the Government’s production request and the recordkeeping requirement under the Bank Secrecy Act.

The Tax Division and USAOs have also obtained records relating to undeclared offshore bank accounts directly from the United States financial institutions that house correspondent bank accounts used by foreign banks to access the United States' banking system. Foreign banks use their United States correspondent bank accounts to clear transactions in U.S. dollars, wire money to and from the United States, and write checks in U.S. dollars. In fact, some foreign banks with no physical presence in the United States have permitted checks drawn on their U.S.-based correspondent account to be used to directly pay third parties in the United States for such things as private school tuition and real estate. This practice permits taxpayers with undeclared accounts to repatriate money to the United States in a manner that reduces the risk of detection by law enforcement authorities because the taxpayers' names do not need to appear on these checks. However, Department of Justice (DOJ) attorneys can make additional inquiries to the U.S.-based payees of these checks to determine the identity of the taxpayer whose undeclared funds were used to fund the correspondent bank checks. Through this process, DOJ attorneys can, in principle, identify any U.S. taxpayer who has used his or her foreign bank's United States correspondent bank account to repatriate funds to the United States, regardless of whether that taxpayer's offshore bank is, or ever will be, under investigation by the DOJ.

The USA PATRIOT Act provides yet another mechanism to obtain records relating to correspondent bank accounts. Section 5318(k) of Title 31 of the United States Code requires U.S.-regulated banks that hold correspondent bank accounts for foreign banks to "maintain records in the United States identifying . . . the name and address of a person who resides in the United States and is authorized to accept service of legal process for records regarding the correspondent account." 31 U.S.C. § 5318(k)(3)(B)(i) (2013). As a result, foreign financial institutions with U.S. correspondent bank accounts, even those without a physical presence in the United States, must appoint an agent to receive service of process when the Government seeks these types of records. In addition, the Secretary of the Treasury and the Attorney General have the power to "issue a summons or subpoena to any foreign bank that maintains a correspondent account in the United States and request records related to such correspondent account, including records maintained outside of the United States relating to the deposit of funds into the foreign bank." *Id.* § 5318(k)(3)(A)(i). The Attorney General, in 2007, delegated his authority in this area to local United States Attorneys. While grand jury subpoenas are not issued by the Attorney General, a local United States Attorney can issue an administrative subpoena for these records, subject to appropriate approvals.

### **III. The indictment of Wegelin**

On February 2, 2012, a grand jury sitting in the Southern District of New York indicted Wegelin & Co., Switzerland's oldest bank, for conspiring with United States taxpayers to defraud the IRS, evade taxes, and file false returns from 2000 through 2011. The indictment alleged, among other things, that in 2008 and 2009, Wegelin opened and serviced dozens of new undeclared accounts for taxpayers in an effort to capture clients lost by UBS in the wake of widespread news reports of the Tax Division's criminal investigation of UBS. Wegelin's senior management affirmatively decided to capitalize on the business opportunity presented by UBS's exit from the undeclared offshore banking business to increase Wegelin's assets under management and the corresponding fees. Under the direction of Wegelin's senior management, certain Wegelin client advisers told taxpayers fleeing UBS that Wegelin would not disclose undeclared accounts to the IRS because the bank had a long tradition of secrecy. Some client advisers also persuaded taxpayers to transfer assets from UBS to Wegelin by emphasizing that, unlike UBS, Wegelin did not have offices in the United States and was therefore less vulnerable to United States law enforcement pressure than UBS. By 2010, Wegelin held approximately \$1.5 billion in undeclared U.S. taxpayer funds. The OVDI proved crucial to amassing evidence of Wegelin's illegal conduct. OVDI participants with Wegelin accounts provided much of the information alleged in the indictment.

#### IV. Forfeiture of Wegelin's U.S. correspondent bank account

At the time of Wegelin's indictment, the USAO for the Southern District of New York seized all funds held in Wegelin's U.S. correspondent bank account at UBS in Stamford, Connecticut, approximately \$16.3 million, and filed a civil forfeiture action against those funds. The civil forfeiture complaint alleged that Wegelin used its correspondent account to help its U.S. taxpayer-clients to covertly repatriate undeclared funds to the United States in a manner designed to evade detection by United States authorities. Wegelin assisted these taxpayers by sending checks drawn on its U.S.-based correspondent bank account to payees designated by the taxpayers. In some instances, Wegelin transferred funds via wires. Some of the U.S. taxpayers who took advantage of this service selected amounts for the checks designed to conceal their undeclared accounts from the IRS, a fact that was obvious to Wegelin from the circumstances surrounding the requests. Furthermore, Wegelin also permitted other Swiss banks—described in the complaint and the indictment as Swiss Bank C and Swiss Bank D—to use Wegelin's correspondent bank account in similar fashion, which further insulated taxpayers who held undeclared accounts at Swiss Bank C and Swiss Bank D from scrutiny by United States law enforcement. Wegelin also sent funds through its correspondent bank account to third parties who provided goods or services to U.S. taxpayers, thus allowing the U.S. taxpayers to receive their undeclared funds on U.S. soil in a manner designed to make the offshore source of the funds more difficult to detect.

The sheer volume of transactions in Wegelin's correspondent bank account served to facilitate these transactions by concealing the repatriation of money from U.S. taxpayers' undeclared accounts at Wegelin and the other banks, making such illicit transactions more difficult to detect. Accordingly, all of the funds in the correspondent bank account were forfeited as property involved in money laundering, pursuant to 18 U.S.C. § 981(a)(1)(A), because the transfer of these funds from Switzerland to the United States helped to promote Wegelin's scheme to defraud the United States of taxes due and owing by U.S. taxpayers hiding assets at Wegelin. *See* 18 U.S.C. § 1956(a)(2)(A) (2013). On April 24, 2012, district court judge Laura Taylor Swain entered a final order forfeiting \$16.3 million, the entire amount seized from the U.S. correspondent account of Wegelin.

U.S. taxpayers with undeclared accounts at offshore banks, and the banks themselves, have much to fear from the exposure of the offshore banks' U.S. correspondent accounts to grand jury subpoena or civil forfeiture action. Through grand jury subpoenas to the United States banks that house the correspondent accounts, as well as follow up subpoenas to the payees of wires and checks drawn on those accounts, the DOJ can identify large numbers of undeclared U.S. taxpayers who have not yet entered the OVDI.

In addition, U.S. taxpayers face a risk that their offshore bank's U.S. correspondent bank account could be seized, separate and apart from the risk that the bank could be indicted. While Wegelin's correspondent bank account was seized at the same time the bank was indicted, there was no requirement that these two actions go hand in hand. The standard to indict a corporation is high, as the decision is subject to a detailed set of factors set forth in the United States Attorneys' Manual. *See* DEP'T OF JUSTICE, UNITED STATES ATTORNEYS' MANUAL § 9-28.000 (2008). In any given case, the DOJ could decide to seize a foreign bank's correspondent bank account through a civil forfeiture action without indicting the bank. Because correspondent bank accounts are so critical to the operations of any foreign bank that wishes to conduct transactions in dollars, the prospect of civil forfeiture of such an account has significant implications for any foreign bank that holds undeclared U.S. taxpayer accounts, and for its U.S. taxpayer-clients. At the same time, U.S. banks, which are required to maintain adequate anti-money laundering systems, now have the example of Wegelin to show how foreign banks that maintain undeclared accounts for U.S. taxpayers have been using U.S.-based correspondent bank accounts in furtherance of tax evasion.

Using this information, U.S. banks can and should adjust their anti-money laundering systems to identify and prevent such activity.

## V. The conviction and sentence of Wegelin

On January 3, 2013, Wegelin pled guilty before the Honorable Jed S. Rakoff to the conspiracy charge in the indictment. In its plea agreement, Wegelin agreed to pay \$20 million in restitution to the IRS, a fine of \$22.05 million, and civil forfeiture of \$15.8 million representing the gross fees that Wegelin earned from U.S. taxpayers with undeclared accounts. Wegelin further agreed not to contest the civil forfeiture of its \$16.3 million correspondent bank account. Wegelin was sentenced on March 4, 2013. The district court's sentence largely followed the recommendations of the parties in the plea agreement, making the total recovery to the United States amount to \$74 million.

Wegelin's managing partner, Otto Bruderer, entered the guilty plea for the bank. He admitted in open court that "[f]rom about 2002 through about 2010, Wegelin agreed with certain U.S. taxpayers to evade the U.S. tax obligations of these U.S. taxpayer clients, who, among other things, filed false tax returns with the IRS." Press Release, United States Attorney's Office, Southern District of New York, *Swiss Bank Sentenced In Manhattan Federal Court For Conspiring To Evade Taxes* (Mar. 4, 2013). Bruderer also admitted that, while "Wegelin was aware that this conduct was wrong," it nevertheless believed that

as a practical matter, it would not be prosecuted in the United States for this conduct because it had no branches or offices in the United States and because of its understanding that it acted in accordance with, and not in violation of, Swiss law and that such conduct was common in the Swiss banking industry.

Richard M. Strassberg, *United States v. Wegelin & Co.*, S1 12. Cr 2 (JSR) 10 (2012), <http://www.corporatecrimereporter.com/wp-content/uploads/2013/01/wegelin.pdf>. For the Wegelin plea agreement, allocution, and other exhibits, see <http://www.corporatecrimereporter.com/wp-content/uploads/2013/01/wegelin.pdf>.

## VI. Wegelin and deterrence

The indictment and conviction of Wegelin "sent shockwaves through Switzerland's banking sector." Kara Scannell, *Wegelin guilty plea rattles Swiss banks*, FIN. TIMES, Jan. 10, 2013. In the wake of the Wegelin conviction, Swiss banks have largely stopped doing business with U.S. taxpayers, "so much so that US citizens living in Switzerland find it extremely difficult to open a bank account or get a mortgage." Imogen Foulkes, *Swiss banks' Unease Over Wegelin*, BBC NEWS, Jan. 4, 2013.

News reports noted that the case provides "an illustration of the U.S. Justice Department's increasing reach" in asserting jurisdiction over wrongdoers who do not, as a general matter, have a physical presence in the United States. Reed Albergotti, *Wegelin's Fall to Tax-Haven Poster Child*, THE WALL STREET JOURNAL, Mar. 4, 2013, at C1. The Constitution permits, consistent with constitutional due process, the extraterritorial application of federal criminal law to non-citizens acting entirely abroad "when the aim of that activity is to cause harm inside the United States or to U.S. citizens or interests." *United States v. Al Kassar*, 660 F.3d 108, 118 (2d Cir. 2011); see also *United States v. Mardirossian*, 818 F. Supp. 2d 775, 776 (S.D.N.Y. 2011) (noting that presumption against extraterritorial application of criminal statutes does not apply to statutes that are "not logically dependent on their locality for the government's jurisdiction, but are enacted because of the right of the government to defend itself against obstruction, or fraud wherever perpetrated") (citing *United States v. Bowman*, 260 U.S. 94, 98 (1922)).

Because Wegelin was assisting U.S. taxpayers in depriving the United States of tax revenue, Wegelin plainly had the aim of causing harm in the United States. Nothing more than this conduct was required to subject Wegelin to the jurisdiction of the United States courts.

Wegelin's indictment also had an impact in neighboring Liechtenstein. In March 2012, the Liechtenstein Parliament amended the Liechtenstein Law on Administrative Assistance in Tax Matters to permit Liechtenstein authorities to produce previously-secret U.S. taxpayer bank records to the DOJ. In May 2012, pursuant to the new law, the DOJ formally requested the production of certain U.S. taxpayer bank records held by a Liechtenstein bank. As a result of the new law and the DOJ's document request, "bank secrecy in Liechtenstein effectively no longer exists for U.S. taxpayers." Larry R. Kemm et al., *Liechtenstein and the U.S.: The Long Road to Full Disclosure*, TAX NOTES INT'L, July 23, 2012, at 355.

## VII. Conclusion

The DOJ's offshore banking investigations and prosecutions are active and ongoing. U.S. taxpayers with undeclared accounts—and the banks, bankers, and other professionals who facilitate tax evasion—can expect to hear more from the Tax Division and USAOs, working in close coordination. ❖

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# The Required Records Doctrine and Offshore Bank Accounts

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Can a person refuse, on Fifth Amendment grounds, to comply with a subpoena for the specific bank records he is required to keep and allow inspection of as a condition of maintaining an offshore account?

The doctrine governing this question has been around for over half a century. The Supreme Court’s “required records” doctrine prevents people from refusing to produce records that they are required to keep and produce as a condition of engaging in a regulated activity. The doctrine holds that a person may not use the Fifth Amendment’s privilege against self-incrimination to refuse to produce such “required records,” as long as the underlying regulated activity is (1) constitutionally subject to regulation or prohibition and (2) not inherently criminal. In short, the doctrine applies when someone is engaging in an activity he has no inherent right to engage in (otherwise the recordkeeping requirement could not be a “condition” of engaging in that activity), and where the doctrine is not being used merely as a stratagem to require criminals to self-report (such as labeling the selling of illegal narcotics a “regulated activity” and then requiring all illegal drug dealers to self-report).

The nature of the offshore-banking regulatory scheme is also fairly straightforward. Congress, if it chose to do so, could ban “offshore banking” (that is, financial transactions between foreign financial institutions and American citizens and residents). Instead, Congress has enacted legislation—the Bank Secrecy Act of 1970—allowing offshore banking, subject to laws (and implementing regulations) that require offshore-account holders to keep and allow inspection of records containing certain basic information about their accounts: the name and number of each account, the type of the account, the name and address of the foreign bank, and the maximum value of the account over a one-year period.

Given these premises, the answer to the above question is “no”—a person cannot refuse, on Fifth Amendment grounds, to comply with a subpoena for the specific bank records he is required to keep and allow inspection of as a condition of maintaining an offshore account. Offshore banking is within Congress’s power to regulate or forbid, and it is not inherently criminal. And, over the past two years, the four courts of appeals that have addressed this question have agreed. *See In re Grand Jury Proceedings, No. 4-10*, No. 12-13131, 2013 WL 452768 (11th Cir. Feb. 7, 2013); *In re Grand Jury Subpoena*, 696 F.3d 428, 433 (5th Cir. 2012); *In re Special February 2011-1 Grand Jury Subpoena Dated September 12, 2011*, 691 F.3d 903, 909 (7th Cir. 2012); *In re M.H.*, 648 F.3d 1067, 1071-72 (9th Cir. 2011).

Regardless of how one feels about the required records doctrine as a matter of first impression, the courts’ application of the doctrine is entirely sensible and straightforward. The aim of this article is to explain why. This article begins, in Part I, by laying out the origin and evolution of the required records doctrine. This background also includes a brief description of the “act of production” doctrine, which defines the modern scope of the Fifth Amendment’s protection against compelled self-incrimination when responding to a subpoena for documents. Part II of this article explains why the required records doctrine applies to subpoenas for offshore-account records, and Part III describes the current state of the law in the

circuits. Part IV then responds to some of the more prominent arguments against applying the required records doctrine to subpoenas for offshore-account records.

## I. The Fifth Amendment and the required records doctrine

The Fifth Amendment to the United States Constitution provides that “no person . . . shall be compelled in any criminal case to be a witness against himself . . .” U.S. CONST. amend. V. As the Supreme Court explained, this provision bars the Government from “compelling a person to give ‘testimony’ that incriminates him.” *Fisher v. United States*, 425 U.S. 391, 409 (1976); *see also United States v. Doe*, 465 U.S. 605, 610 (1984) (“[T]he Fifth Amendment protects [a] person . . . from compelled self-incrimination.”) (emphasis omitted). Because the privilege against self-incrimination “protects a person only against being incriminated by his own compelled testimonial communications,” *Fisher*, 425 U.S. at 409, it does not protect the contents of documents that the person prepared voluntarily or that were prepared by someone else. *See id.* at 409-10; *see also United States v. Hubbell*, 530 U.S. 27, 35-36 (2000); *Doe*, 465 U.S. at 610-11. Content in such documents is not protected because it is not compelled testimony: the papers already exist, and so, while forcing someone to hand them over may implicate the Fourth Amendment, it does not implicate the Fifth. *See Fisher*, 425 U.S. at 411 (“The question is not of testimony but of surrender.” (quoting *In re Harris*, 221 U.S. 274, 279 (1911))).

Nevertheless, although the *contents* of subpoenaed documents may not be protected, the act of responding to the subpoena may be. The *Fisher* Court explained that “[t]he act of producing evidence in response to a subpoena” may sometimes constitute “testimony” within the meaning of the Fifth Amendment, “wholly aside from the contents of the papers produced.” *Fisher*, 425 U.S. at 410. This rule is known as the “act of production” doctrine. A subpoena for records commands its recipient to perform certain tasks, namely, to gather up and produce the records. If the very act of complying with the subpoena’s commands would cause someone to incriminate himself, then the Fifth Amendment’s privilege against self-incrimination may apply. Then-Deputy Assistant Attorney General—now Associate Justice—Samuel Alito stated, “When a witness turns over documents in response to a subpoena, he tacitly says two things of potential significance. First, he says: ‘I have these documents.’ Second, he says: ‘These seem to be the documents you want.’” Samuel A. Alito, *Documents and the Privilege Against Self-Incrimination*, 48 U. PITT. L. REV. 27, 46 (1986) (discussing the then-new framework used by the Supreme Court in applying the Fifth Amendment privilege against self-incrimination to compulsory process for documents) (citation omitted). The Supreme Court’s precedents divide Justice Alito’s first testimonial assertion into two parts, but the doctrine is exactly the same. According to the Court’s decision in *Fisher*, a subpoenaed witness’s act of production may implicitly admit (1) “the existence of the papers demanded,” (2) that the papers are in the witness’s “possession or control,” and (3) that the papers are authentic, that is, the papers “described in the subpoena.” *Fisher*, 425 U.S. at 410. If any of these admissions would be incriminating based on the facts of a particular case, then the Fifth Amendment may allow the subpoena recipient to refuse to comply with the subpoena.

The Fifth Amendment, however, does not prevent the Government from holding people to recordkeeping and reporting requirements that were imposed as conditions of participating in a regulated activity. In *Shapiro v. United States*, 335 U.S. 1 (1948), the Supreme Court held that the Fifth Amendment did not prevent a fruit-and-produce wholesaler from being prosecuted based on documents that he was required to keep under the Emergency Price Control Act. *Id.* at 17-19. *Shapiro* is generally cited as the origin of the required records doctrine, although *Shapiro* cited a prior case—*Wilson v. United States*, 221 U.S. 361, 379 (1911), which involved a witness’s refusal to comply with a grand jury subpoena—as the origin of this “‘required records’ doctrine.” *Shapiro*, 335 U.S. at 18 n.24.

As *Shapiro* explained, if Congress has the power to prohibit an activity entirely, then Congress may legitimately impose recordkeeping and inspection requirements as conditions of engaging in that activity:

It may be assumed at the outset that there are limits which the government cannot constitutionally exceed in requiring the keeping of records which may be inspected by an administrative agency and may be used in prosecuting statutory violations committed by the record-keeper himself. But no serious misgiving that those bounds have been overstepped would appear to be evoked when there is a sufficient relation between the activity sought to be regulated and the public concern so that the government can constitutionally regulate or forbid the basic activity concerned, and can constitutionally require the keeping of particular records, subject to inspection by the Administrator.

*Id.* at 32. In short, the central question under *Shapiro* is whether the activity that triggers the recordkeeping or reporting requirement is within Congress's power to "regulate or forbid." *Id.*

*Shapiro*, however, does not mean that the Government may require its citizens to keep a diary of all their crimes under the guise of administrative regulation. Twenty years after *Shapiro*, in *Marchetti v. United States*, 390 U.S. 39 (1968), the Court held that the Government may not use the required records doctrine to enact "ingeniously drawn legislation" that targets only "those 'inherently suspect of criminal activities.'" *Id.* at 51-52, 57. Although the Court held that the required records doctrine applies to regulatory reporting requirements as well as recordkeeping and inspection requirements, *id.* at 56 n.14, the Court also held that the Government could not compel people to file reports of their illegal "wagering activities" or their possession of illegal firearms. *See id.* at 57 (noting that "wagering" was prohibited in almost every state); *Grosso v. United States*, 390 U.S. 62, 64 (1968) (same); *Haynes v. United States*, 390 U.S. 85, 96-97 n.10 (1968) (holding that the required records doctrine did not extend to a statute requiring registration of illegal firearms, despite the "uncommon" possibility that an innocent person might have found such an illegal firearm, because "the correlation between obligations to register violations can only be regarded as exceedingly high"). In short, these three cases prevent the Government from using a fake "regulatory scheme" to end run the Fifth Amendment and require criminals to self-report.

By contrast, if a statutory scheme is "not designed to forbid certain acts, but only to require that they be done in a certain way, the Government may enforce its requirements by a compulsory scheme of reporting, directed at all who engage in those activities, and not on its face designed simply to elicit incriminating information." *Mackey v. United States*, 401 U.S. 667, 709 (1971) (Brennan, J., concurring); *see also Haynes*, 390 U.S. at 98 ("[T]he constitutional privilege does not prevent the use by the United States of information obtained in connection with regulatory programs of general application."). The Supreme Court has therefore applied the required records doctrine to enforce recordkeeping and reporting requirements directed at people involved in automobile accidents and those adjudged "unable or unwilling" to care for their children—requirements which, although clearly useful to law enforcement, do not purport to regulate inherently criminal activity. *See California v. Byers*, 402 U.S. 424, 430 (1971) (plurality opinion) (noting that a hit-and-run statute contained a reporting requirement not "to facilitate criminal convictions but to promote the satisfaction of civil liabilities"); *see also Byers*, 402 U.S. at 456 (Harlan, J., concurring) ("[T]he 'hit-and-run' statute in the present case predicates the duty to report on the occurrence of an event which cannot, without simply distorting the normal connotations of language, be characterized as 'inherently suspect[.]' "); *Baltimore City Dep't of Soc. Services v. Bouknight*, 493 U.S. 549, 559-60 (1990) (explaining that a parent could not invoke the Fifth Amendment to defeat a child-welfare reporting requirement because, even when the state has intervened to place limits on a parent's custody of his or her own child, the "parent is not one singled out for criminal conduct").

In sum, the required records doctrine prevents people from invoking the Fifth Amendment to disobey recordkeeping or reporting requirements when (1) the Government imposes such a requirement on an activity within its power to “regulate or forbid,” *Shapiro*, 335 U.S. at 32, and (2) that activity is a *bona fide* regulated activity—that is, an activity which, although it *could* be forbidden, has not actually been made criminal, *see Marchetti*, 390 U.S. at 57 (holding that the recordkeeping or reporting requirement may not be “directed at a selective group inherently suspect of criminal activities” (internal quotation marks omitted)).

Finally, it is worth noting that a number of courts, based on a statement appearing in *Grosso* and *Marchetti*—although not *Haynes*—have introduced a third requirement into the doctrine: that the records at issue be of a type “customarily kept.” *See M.H.*, 648 F.3d at 1076 (citing cases invoking this phrase but declining to decide whether this is actually a requirement). Not all courts of appeals, however, have treated this “customarily kept” factor as an element of the doctrine. *See, e.g., United States v. Garcia-Cordero*, 610 F.3d 613, 616-17 (11th Cir. 2010) (discussing and applying the required records doctrine but not using the phrase “customarily kept” or any equivalent); *In re Grand Jury Proceedings (McCoy and Sussman)*, 601 F.2d 162, 168 (5th Cir. 1979) (same). And a close reading of *Shapiro*, *Marchetti*, and *Grosso* supports the conclusion that no such requirement exists. The Supreme Court, in *Grosso*, did not state that a record’s being “customarily kept” was a necessary condition for application of the required records doctrine. *Grosso* simply noted that the record’s being “customarily kept” was one of three “premises” or “factors” in *Shapiro*, and then disposed of the case on other grounds. *See Grosso*, 390 U.S. at 68; *see also Haynes*, 390 U.S. at 98-99 (never mentioning any “customarily kept” requirement). Moreover, the part of *Shapiro* cited by *Grosso* and *Marchetti* makes clear that there was no independent “customarily kept” requirement in that case. *See Grosso*, 390 U.S. at 67-69; *Marchetti*, 390 U.S. at 55-57. In *Shapiro*, the recordkeeping provision at issue covered *not only* specifically enumerated records, but also *any other* records “customarily kept” in the industry. *See Shapiro*, 335 U.S. at 5 n.3; *see also id.* at 71 (Jackson, J., dissenting) (assailing the Court’s decision for applying the required records rule “*not merely* to records specially required under the Act *but also* to records ‘customarily kept’ ” (emphases added)). Records “customarily kept” were but one type of record covered by the particular regulatory regime at issue in *Shapiro*—the Court did not suggest that a record’s being “customarily kept” was a prerequisite for falling within the required records doctrine. More recently, the Supreme Court’s decisions in *Byers*, 402 U.S. at 430, and *Bouknight*, 493 U.S. at 559-60, have continued to apply the required records doctrine without mentioning any “customarily kept” element of the doctrine.

In any event, in cases involving offshore bank accounts, this “customarily kept” issue is largely beside the point, because it is difficult to dispute that basic account records are “customarily kept” by the account holder. As the Ninth Circuit pointed out, account holders keep basic account information (such as their account numbers) “because they need the information to access their . . . accounts,” and even if someone’s offshore bank maintains physical custody of certain records on the account holder’s behalf, that “does not mean [the account-holder] lacks access” to those records. *M.H.*, 648 F.3d at 1076; *see also In re Citric Acid Litigation*, 191 F.3d 1090, 1107 (9th Cir. 1999) (defining possession in the context of a subpoena as “the legal right to obtain documents upon demand”). Accordingly, all four of the courts of appeals to have addressed this issue simply assumed *arguendo* that there was a “customarily kept” element and then held that it was satisfied.

## **II. Why the required records doctrine applies to the recordkeeping provisions of the Bank Secrecy Act**

A court evaluating whether the required records doctrine applies to a subpoena for offshore-account records must answer two questions. First, does the subpoena demand the production of only those

records that are required to be kept as a condition of engaging in an activity that Congress has the power to “regulate or forbid”—in this case, maintaining an offshore bank account? And second, is maintaining an offshore bank account inherently criminal? The answers are straightforward.

Offshore banking is regulated by the Currency and Foreign Transactions Reporting Act (Bank Secrecy Act of 1970), Pub. L. 91-508, Title II, 84 Stat. 1118-24, which contains a number of reporting and recordkeeping provisions. One of these provisions is § 241(a), codified as amended at 31 U.S.C. § 5314(a). This provision instructs the Secretary of the Treasury to require United States citizens, residents, and institutions to “keep records and file reports” regarding their foreign financial transactions and relationships. *See id.* Following this statutory command, the Secretary of the Treasury issued implementing regulations in 1972. *See* 37 Fed. Reg. 6912, 6913-14 (Apr. 5, 1972). These regulations require United States citizens and residents to file annual reports of their foreign bank accounts, *see* 31 C.F.R. § 1010.350 (2012), and they also require that the records for such accounts “be retained by each person having a financial interest in or signature or other authority over any such account” for at least five years and be kept “available for inspection as authorized by law,” *id.* § 1010.420. (These two regulations were recently transferred from 31 C.F.R. §§ 103.24 and 103.32, respectively. *See* 75 Fed. Reg. 65806, 65808 (Oct. 26, 2010).) One of the types of inspection authorized by law is an administrative summons issued by the Internal Revenue Service, *see* 31 U.S.C. § 5318(a)(4) (2012) (authorizing the Secretary of the Treasury to “summon . . . any person having possession, custody, or care of the reports and records required under this subchapter . . . to produce such books, papers, records, or other data”). Another type is a grand jury subpoena. *See United States v. R. Enterprises Inc.*, 498 U.S. 292, 297-98 (1991).

There can be no doubt that the Bank Secrecy Act’s recordkeeping, inspection, and reporting requirements apply to activity—maintaining an offshore bank account—within Congress’s power to “regulate or forbid.” *Shapiro*, 335 U.S. at 32. Congress has the power to “regulate Commerce with foreign Nations.” U.S. CONST. art. I, § 8, cl. 3. Indeed, the Supreme Court has explained that the federal Government’s authority is “at its zenith at the international border.” *United States v. Flores-Montano*, 541 U.S. 149, 152-53 (2004) (explaining that neither probable cause nor even reasonable suspicion is generally required for border searches). The Supreme Court has even explicitly noted, in a case addressing other constitutional challenges to the Bank Secrecy Act, that “Congress could have closed the channels of commerce entirely to negotiable instruments, had it thought that so drastic a solution were warranted.” *Cal. Bankers Ass’n v. Shultz*, 416 U.S. 21, 46-47 (1974). Accordingly, there can be “no serious misgiving that” the Government has overstepped its legitimate regulatory powers by “requir[ing] the keeping” of offshore bank-account records. *Shapiro*, 335 U.S. at 32; *see also Cal. Bankers*, 416 U.S. at 46 (citing *Shapiro*).

Nor are the recordkeeping and reporting requirements of the Bank Secrecy Act “ingeniously drawn” requirements “directed at a selective group inherently suspect of criminal activities.” *Marchetti*, 390 U.S. at 52, 57 (internal quotations omitted). There is nothing illegal about having an offshore bank account. Although one purpose of the Bank Secrecy Act was “to detect criminal activity,” the Supreme Court explained in *Cal. Bankers* that Congress “seems to have been *equally* concerned with civil liability which might go undetected by reason of transactions of the type required to be recorded or reported . . . .” 416 U.S. at 76 (emphasis added). The Court also noted that “the fact that a legislative enactment manifests a concern for the enforcement of the criminal law does not cast any generalized pall of constitutional suspicion over it.” *Id.* at 77. And the Supreme Court’s characterization of the multiple purposes of the Bank Secrecy Act is entirely consistent with the Act’s express statement of its own multiple purposes: “to require certain reports or records where they have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities . . . .” 31 U.S.C. § 5311 (2012). *Compare* 31 U.S.C. § 5311 (setting forth the

stated purposes above) *with Shapiro*, 335 U.S. at 8 (listing the express purposes of the “record-keeping and inspection requirements” in that case as being “not merely to ‘obtain information’ for assistance in prescribing regulations or orders under the statute, but also to aid ‘in the administration and enforcement of this Act and regulations, orders, and price schedules thereunder’ ”).

Moreover, the relevant question under the *Marchetti* line of cases is not whether Congress was concerned about crime when it enacted a given recordkeeping or reporting requirement, but whether the group subject to the recordkeeping or reporting requirement is one “inherently suspect of criminal activities.” *Marchetti*, 390 U.S. at 57; *see also Grosso*, 390 U.S. at 68 (“The principal interest of the United States must be assumed to be the collection of revenue, and not the prosecution of gamblers, but we cannot ignore either the characteristics of the activities about which information is sought, or the composition of the group to which the inquiries are made.”) (internal citation omitted). The offshore-banking laws may contain provisions that help detect and deter illegal activity, but in this respect they are no different from the recordkeeping and reporting requirements that apply to the sale of legal firearms, which the courts of appeals have held to be within the required records doctrine. *See United States v. Resnick*, 488 F.2d 1165, 1168 (5th Cir. 1974) (holding that the required records doctrine applied to firearms-transaction records because the recordkeeping provisions were “not directed at a highly selective group inherently suspect of criminal acts, as was the situation in *Marchetti* and its progeny,” but instead “regulate[d] an essentially noncriminal activity, the sale of firearms”); *United States v. Scherer*, 523 F.2d 371, 375 (7th Cir. 1975) (same); *see also United States v. Crawford*, 906 F.2d 1531, 1533-34 (11th Cir. 1990) (rejecting a felon’s Fifth Amendment challenge to his conviction for failing to register a firearm, despite the fact that the felon could not lawfully possess the firearm in the first place).

The courts of appeals have also applied the required records doctrine to a variety of other regulated activities, such as offering securities, *see SEC v. Fehn*, 97 F.3d 1276, 1292-93 (9th Cir. 1996); *United States v. Stirling*, 571 F.2d 708, 728 (2d Cir. 1978); running a sexually oriented business, *see Stansberry v. Holmes*, 613 F.2d 1285, 1290 (5th Cir. 1980); being an alien present in the United States, *see Garcia-Cordero*, 610 F.3d at 616; *Rajah v. Mukasey*, 544 F.3d 427, 442 (2d Cir. 2008); *United States v. Sacco*, 428 F.2d 264, 271 (9th Cir. 1970); distilling and selling alcohol, *see Henderson v. Blackwell*, 436 F.2d 1081, 1082 (5th Cir. 1971) (per curiam); selling automobiles, *see In re Grand Jury Subpoena (Spano)*, 21 F.3d 226, 230 (8th Cir. 1994); *In re Grand Jury Subpoena Duces Tecum (Underhill)*, 781 F.2d 64, 70 (6th Cir. 1986); and practicing medicine, *see In re Grand Jury Proceedings*, 801 F.2d 1164, 1167-68 (9th Cir. 1986); *United States v. Anderson*, 523 F.2d 1192, 1197 (5th Cir. 1975); *United States v. Rosenberg*, 515 F.2d 190, 199-200 (9th Cir. 1975). Such recordkeeping and reporting requirements may well be useful to law enforcement and they may even have been intended, at least in part, to provide law enforcement with tools to fight crime. But because they do not apply exclusively to criminals, they are not invalid under the Fifth Amendment.

Maintaining an offshore bank account is no different from these other regulated activities. Like these other recordkeeping and reporting requirements, the offshore-account recordkeeping requirement does not apply exclusively to criminals. Indeed, it applies to hundreds of thousands of foreign-account holders—over 500,000 in 2009. *See* TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, NEW LEGISLATION COULD AFFECT FILERS OF THE REPORT OF FOREIGN BANK AND FINANCIAL ACCOUNTS, BUT POTENTIAL ISSUES ARE BEING ADDRESSED 7 (Sept. 29, 2010) (listing the numbers of Foreign Bank Account Reporting forms filed annually), *available at* <http://www.treasury.gov/tigta/auditreports/2010reports/201030125fr.pdf>. There is no reason to believe that a majority of offshore accounts are held by criminals, and certainly there is nothing “inherently . . . criminal” about maintaining a foreign bank account. *Marchetti*, 390 U.S. at 57. Maintaining a foreign bank account is at least as legally innocuous as selling firearms, *see Resnick*, 488 F.2d at 1168, bringing an unauthorized alien into the country, *Garcia-*

*Cordero*, 610 F.3d at 618, getting in an automobile accident, *see Byers*, 402 U.S. at 430-31, or being adjudged incompetent to care for one's own child without state supervision, *see Bouknight*, 493 U.S. at 559-60—and quite far afield from those inherently criminal activities to which the required records doctrine does not apply, such as illegal gambling, *see Marchetti*, 390 U.S. at 44-45, possessing illegally obtained firearms, *see Haynes*, 390 U.S. at 96-97, and possessing marijuana, *see Leary v. United States*, 395 U.S. 6, 17-18 (1969).

### **III. The courts of appeals have uniformly upheld the Bank Secrecy Act's recordkeeping and reporting requirements against Fifth Amendment challenges**

Recently, the courts of appeals for the Eleventh, Fifth, Seventh, and Ninth Circuits have held that the required records doctrine applies to a subpoena for those records required to be kept and subject to inspection under the Bank Secrecy Act. *See In re Grand Jury Proceedings*, 2013 WL 452768; *In re Grand Jury Subpoena*, 696 F.3d 428; *In re Special February 2011-1 Grand Jury Subpoena*, 691 F.3d 903; *M.H.*, 648 F.3d 1067. Each of these four cases involved a substantively identical subpoena, which demanded

[a]ny and all records required to be maintained pursuant to 31 C.F.R. § [1010.420] relating to foreign financial accounts that you had/have a financial interest in, or signature authority over, including records reflecting the name in which each such account is maintained, the number or other designation of such account, the name and address of the foreign bank or other person with whom such account is maintained, the type of such account, and the maximum value of each such account during each specified year.

*In re Special February*, 691 F.3d at 905.

Each court concluded, unanimously, that such a subpoena fell within the required records doctrine—and that, accordingly, the recipient could not invoke the privilege against self-incrimination to refuse to comply with the subpoena. All four courts of appeals agreed that “there is nothing inherently illegal about having or being a beneficiary of an offshore foreign banking account.” *M.H.*, 648 F.3d at 1074; *see also In re Grand Jury Subpoena*, 696 F.3d at 435 (quoting this observation from *M.H.*); *In re Special February*, 691 F.3d at 909 (adopting *M.H.*'s analysis). And each court also addressed various arguments against this conclusion, some of which are discussed in Part IV, below.

Although significant, these four decisions were not unprecedented. In analogous circumstances, the Second and Sixth Circuits (as well as the Ninth Circuit) had previously held that the reporting requirements of the Bank Secrecy Act fell within the required records doctrine. The Second and Ninth Circuits held that the required records doctrine applies to a reporting provision of the Bank Secrecy Act regulating cross-border monetary transactions. *See United States v. Des Jardins*, 747 F.2d 499, 508 (9th Cir. 1984) (“It is not a crime to transfer more than \$5,000 in monetary instruments out of the country; nor is such activity invariably or even usually connected with illegality.”); *United States v. Dichne*, 612 F.2d 632, 638-40 (2d Cir. 1979). The Sixth Circuit came even closer, holding that that the required records doctrine applies to the offshore-account reporting requirements of the Bank Secrecy Act. *United States v. Sturman*, 951 F.2d 1466, 1486-87 (6th Cir. 1991). As noted above, this reporting requirement—currently contained in 31 C.F.R. § 1010.350—requires offshore-account holders to annually report, on a Foreign Bank Account Reporting form (FBAR), the same basic account information required to be kept and produced on demand by the recordkeeping-and-inspection provision, 31 C.F.R. § 1010.420. As noted above, the Supreme Court has held that there is “no meaningful difference between” a reporting requirement and a recordkeeping requirement. *Marchetti*, 390 U.S. at 56 n.14; *see also M.H.*, 648 F.3d at 1077.

Notwithstanding these precedents, there was—until the Seventh Circuit’s recent decision—hope in certain quarters that the Government’s required records argument would fail in the Seventh Circuit. *See, e.g.*, Petition for Certiorari, *M.H.*, 2012 WL 549259, \*11-12 (Jan. 3, 2012). The hope rested on the Seventh Circuit’s line of precedent that refused to extend the required records doctrine to taxpayer records. *See Smith v. Richert*, 35 F.3d 300, 304-05 (7th Cir. 1994); *United States v. Porter*, 711 F.2d 1397, 1400-03 (7th Cir. 1983). Given that these recent required records cases involved criminal tax investigations—and, indeed, were being argued by the Tax Division of the Department of Justice—there was at least superficial appeal to the notion that *Porter* and *Smith* posed a bar to the Government’s required records theory, at least in the Seventh Circuit.

*Porter* and *Smith*, however, are distinguishable for a very important reason: being a taxpayer does not necessarily mean one is engaging in a regulated activity, because Congress’s power to tax is broader than its power to “regulate or forbid.” *Shapiro*, 335 U.S. at 32. In *Porter* and *Smith*, the Seventh Circuit distinguished between unconditional recordkeeping requirements directed at the public at large, and recordkeeping requirements imposed as a condition of engaging in an activity legitimately subject to governmental approval and regulation. *See Smith*, 35 F.3d at 303 (“The hypothetical case in which every individual is required to maintain a record of everything he does that interests the government is remote from the case of the individual who enters upon a regulated activity knowing that the maintenance of extensive records available for inspection by the regulatory agency is one of the conditions of engaging in the activity.”); *Porter*, 711 F.2d at 1405 (noting that “the taxpayer is not, as in *Shapiro*, required to keep such records as an ongoing condition of operating his business under a comprehensive government regulatory scheme”). But while the required records doctrine applies only to activity that Congress “can constitutionally regulate or forbid,” *Shapiro*, 335 U.S. at 32, Congress can tax activity that it cannot regulate or forbid. *See Nat’l Fed’n of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566, 2600 (2012) (“[T]he breadth of Congress’s power to tax is greater than its power to regulate commerce . . . .”); *Dep’t of Revenue of Mont. v. Kurth Ranch*, 511 U.S. 767, 780-81 (1994) (distinguishing between a tax on an activity and its prohibition); *United States v. Sanchez*, 340 U.S. 42, 44 (1950) (noting that Congress has the power to tax “activities which [it] might not otherwise regulate”). Accordingly, because simply being a taxpayer does not necessarily mean one is engaging in an activity that “the government can constitutionally regulate or forbid,” *Shapiro*, 335 U.S. at 32, *Porter* and *Smith* are entirely consistent with *Shapiro*.

Unlike in *Porter* and *Smith*, the Government can legitimately regulate—and, if it chooses, forbid—the underlying regulated activity of offshore banking. Thus, as the courts have held, Congress may legitimately require that one of the conditions of engaging in this regulated activity is that those who do so preserve their records and produce those records on demand. *See M.H.*, 648 F.3d at 1078 (explaining that these Seventh Circuit precedents “fail to support [the witness’s] position” because they did not involve subpoenas for documents “related to a regulated activity”). Moreover, because “there is nothing inherently illegal about having or being a beneficiary of an offshore foreign banking account,” *id.* at 1074, this recordkeeping provision does not constitute the sort of sham regulatory scheme to which the required records doctrine does not apply.

In short, every court of appeals to have addressed the issue has concluded that the required records doctrine applies to a subpoena for offshore-account records. And, in light of the Supreme Court’s precedents, these courts are right.



## IV. Responses to some prominent objections

The most straightforward response to all of the foregoing is that *Shapiro* is simply wrong. And this argument is perfectly reasonable. After all, Justices Frankfurter, Murphy, Jackson, and Rutledge thought *Shapiro* was wrong, too, which is why they dissented.

But the *Shapiro*-is-wrong argument is a non-starter legally—the Supreme Court is right because it is final, *see Brown v. Allen*, 344 U.S. 443, 540 (1953) (Jackson, J., concurring) (stating that the Supreme Court is “not final because [it is] infallible, but [it is] infallible only because [it is] final”). *Shapiro*’s detractors have therefore turned to a variety of more oblique attempts to get out from under the Supreme Court’s precedent. *See, e.g.*, Christopher M. Ferguson, *The Required Records Doctrine: The Fifth Amendment Privilege under Attack*, 115 J. TAX’N 218, 221-23 (2011) (laying out some of them).

Below is a selection of some of the more prominent arguments against applying the required records doctrine to the recordkeeping requirement for offshore bank accounts, along with brief responses to those arguments.

### A. The required records doctrine cannot require me to incriminate myself

One variation on the *Shapiro*-must-be-wrong argument is that the required records doctrine should be held not to apply whenever it might matter. This argument, in effect, is what the district court held in *In re Special February 2011-1 Grand Jury Subpoena*, 852 F. Supp. 2d 1020 (N.D. Ill. 2011)—that the required records doctrine does not apply if “producing the required records will compel the individual engaging in the regulated activity to admit his participation in the regulated activity,” when such an admission would be incriminating. *Id.* at 1025.

But as the Seventh Circuit explained when it reversed the district court’s decision, *see In re Special February 2011-1 Grand Jury Subpoena*, 691 F.3d 903, 908-09 (7th Cir. 2012), this holding is wrong. Indeed, this holding would defeat the whole purpose of the required records doctrine. The required records doctrine exists as a means to overcome an otherwise-valid assertion of the Fifth Amendment’s privilege against self-incrimination. It can hardly be construed to apply only when a person is not going to incriminate himself in the first place. Nor can this argument be squared with the Supreme Court’s precedents, which make clear that the required records doctrine forecloses whatever self-incrimination claim a person might otherwise have. *See, e.g., Byers*, 402 U.S. at 455-57 n.9 (Harlan, J., concurring) (explaining that the required records doctrine applied because the hit-and-run statute at issue did not generally require the reporting of “inherently suspect” conduct, even though the particular defendant in that case “faced a ‘real’ and not ‘imaginary’ risk of self-incrimination at the time he had to make his decision whether or not to stop”); *Shapiro*, 335 U.S. at 35-36 (declining to address whether the defendant had an otherwise-valid self-incrimination claim because the required records doctrine rendered the question moot).

This result also makes sense as a practical matter. It would be highly anomalous to hold that the required records doctrine applies only when the Government already knows of the subpoenaed person’s “participation in the regulated activity.” *In re Special February*, 852 F. Supp. 2d at 1025. A firearms dealer with a storefront, for example, would be subject to the doctrine, *see Resnick*, 488 F.2d at 1168, while someone selling firearms out of the back of a van would not. Similarly, a legitimate securities broker-dealer would have no right to claim any Fifth Amendment privilege against examiners from the Securities and Exchange Commission, *see Fehn*, 97 F.3d at 1292-93 (9th Cir. 1996), but boiler-room fraudsters would. The Supreme Court’s case law rightly rejects such a result.

## **B. *Shapiro* was decided before the act-of-production doctrine came along, and so it does not apply to an act-of-production claim like mine**

A somewhat related argument is that *Shapiro* is no longer applicable under the Supreme Court’s “modern” act-of-production doctrine. The trouble with this argument is not only that the lower courts are obligated to follow non-overruled Supreme Court precedent, *see Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 484 (1989), but also that there is no tension between the act-of-production doctrine and the required records doctrine.

Although *Shapiro* was decided before the Supreme Court *limited* the scope of the privilege against self-incrimination to the “communicative aspects” of “producing evidence in response to a subpoena,” *Fisher*, 425 U.S. at 410, the proposition that a person could be forced to incriminate himself through the act of responding to a subpoena—the act-of-production doctrine—was established well before *Shapiro* was decided in 1948. *See Fisher*, 425 U.S. at 410, 413 nn.11 & 12 (relying on a 1911 decision, *Wilson v. United States*, 221 U.S. 361, 377 (1911)); Samuel A. Alito, *Documents and the Privilege Against Self-Incrimination*, 48 U. PITT. L. REV. 27, 46 (1986) (noting that the act-of-production theory was advanced by Professor Wigmore as early as 1904 and adopted by a number of courts, including the Seventh Circuit, in *Haywood v. United States*, 268 F. 795, 802-03 (7th Cir. 1920)). If the required records doctrine applied to an incriminating act of production then, there is no reason it cannot do so now. Moreover, as a matter of precedent, both the Supreme Court and the courts of appeals have continued to apply the required records doctrine since *Fisher* was decided in 1976. *See Bouknight*, 493 U.S. at 556-61; *see, e.g., Garcia-Cordero*, 610 F.3d at 616-17; *Spano*, 21 F.3d at 230; *United States v. Lehman*, 887 F.2d 1328, 1332 (7th Cir. 1989); *In re Grand Jury Proceedings*, 801 F.2d 1164, 1168-69 (9th Cir. 1986); *In re Two Grand Jury Subpoenae Duces Tecum*, 793 F.2d 69, 73 (2d Cir. 1986); *Underhill*, 781 F.2d at 70.

## **C. Many of the Government’s precedents involve reporting requirements, which do not necessarily apply to a recordkeeping requirement like the one at issue in my case**

Most of the cases cited in the discussion in Parts I–III above—although not all—dealt with reporting requirements, rather than recordkeeping-and-inspection requirements. (That is, they involved requirements to produce information periodically, such as every year, rather than on demand, such as in response to a subpoena or summons.) Accordingly, some have tried to distinguish all of these reporting cases as inapplicable to a case involving a subpoena based on a recordkeeping-and-inspection requirement. *See, e.g., Ferguson*, 115 J. TAX’N at 226-29 (laying out arguments opposing the Ninth Circuit’s *In re M.H.* opinion). Thus—the argument runs—the annual FBAR reporting requirement may be perfectly valid (even where filing an FBAR would require someone to admit criminal activity, such as disclosing a previously undisclosed account), but a subpoena or summons for the very same account information cannot compel someone to incriminate himself.

The proposition that there might be some distinction between recordkeeping and reporting requirements for purposes of the required records doctrine has an impressive pedigree: both the Solicitor General and Professor Charles Alan Wright endorsed such a distinction when they were opposing counsel before the Supreme Court in *Marchetti* and *Grosso*. But there, the argument ran in the opposite direction. Professor Wright argued that *Shapiro* applied *only* to recordkeeping requirements, and not to reporting requirements, and the Government conceded this point. *See* Brief for Petitioner on Reargument, *Grosso v. United States*, 1967 WL 113564, \*12-15 (Aug. 18, 1967) (“The distinction we here urge is between reports and registration statements, which must be filed with the government, and records, which must be maintained and may be subject to inspection by the government. . . . The registration statement and the tax return, with their questions calling for incriminating answers, seem more akin to testimony on the

witness stand than they do to the keeping of routine business records.”); Brief for Respondent on Reargument, *Marchetti v. United States*, 1967 WL 113560, \*4 (Sept. 21, 1967) (“The ‘required records’ doctrine of *Shapiro v. United States*, 335 U.S. 1, is not, in the government’s view, directly applicable in the instant cases. That doctrine relates to records which are required to be kept as distinguished from reports which are required to be filed with the government.”); *see also* Reply Brief for Petitioner, *Marchetti v. United States*, 1967 WL 129562, \*3 (Oct. 5, 1967) (arguing that Government improperly applies *Shapiro* to the present case).

The Supreme Court, however, disagreed. The Court expressly rejected both parties’ arguments that “this case is not reached by *Shapiro* simply because petitioner was required to submit reports, and not to maintain records.” *Marchetti*, 390 U.S. at 56 n.14.

Insofar as this is intended to suggest the crucial issue respecting the applicability of *Shapiro* is the method by which information reaches the Government, we are unable to accept the distinction. We perceive no meaningful difference between an obligation to maintain records for inspection, and such an obligation supplemented by a requirement that those records be filed periodically with officers of the United States. We believe, as the United States [itself] argued in *Shapiro*, that regulations permit records to be retained, rather than filed, largely for the convenience of the persons regulated.

*Id.* (alteration omitted). Or, as the Ninth Circuit stated, “[f]or purposes of the Required Records Doctrine, it does not matter whether the production of . . . information is requested through a subpoena (as in this case and *Shapiro*), a court order (as in *Bouknight*), or the regulation itself (as in *Byers*).” *M.H.*, 648 F.3d at 1077.

In short, the required records doctrine applies to a subpoena for offshore-account information just as much as it applies to the annual FBAR reporting requirement.

#### **D. The Bank Secrecy Act originally contained its own immunity provision, and that means the required records doctrine does not apply to it**

This argument is something of a non sequitur, but the gist of it is that the inclusion of a statutory-immunity provision in the Bank Secrecy Act shows that Congress did not intend for the required records doctrine to apply to the Act. This argument is wrong.

The Bank Secrecy Act, like scores of other regulatory schemes enacted before 1970, originally contained an immunity provision specific to proceedings involving violations of its provisions. This immunity provision was subsequently superseded by 18 U.S.C. § 6002, which now governs all grants of statutory immunity. *See Pillsbury Co. v. Conboy*, 459 U.S. 248, 253-54 (1983) (describing the procedures required for a grant of immunity under § 6002); *Kastigar v. United States*, 406 U.S. 441, 447 (1972) (explaining that § 6002 superseded specific immunity provisions in over 50 different federal regulatory schemes).

Statutory immunity, however, applies more broadly than the required records doctrine, and it therefore does not make the required records doctrine superfluous. For example, if a grand jury was investigating willful failures to report currency transactions as required by 31 U.S.C. § 5313(a), *see United States v. Camarena*, 973 F.2d 427, 428-29 (5th Cir. 1992) (per curiam), and demanded testimony unrelated to the existence, possession, or authenticity of required records—asking a witness a question such as, “Are you a smuggler?”—then the required records doctrine would not apply. Statutory immunity would then be necessary because the witness would have a valid Fifth Amendment claim and thus could not, without immunity, be compelled to answer the question. But if the subpoena demanded only that a

witness produce currency transaction reports, then the required records doctrine would apply, *see id.* at 429, and so statutory immunity would be unnecessary. Similarly, although a person in the securities industry cannot invoke the Fifth Amendment to refuse to file reports and produce records required under the securities laws, *see Fehn*, 97 F.3d at 1292-93 (applying the required records doctrine), he or she can still generally refuse to answer incriminating questions in a deposition, *see United States v. Stringer*, 535 F.3d 929, 934-35 (9th Cir. 2008), and therefore would have to receive immunity before being compelled to answer such questions. Thus, statutory immunity and the required records doctrine are not inconsistent: they are simply two different ways for the Government to overcome an otherwise-valid self-incrimination claim.

Indeed, the original required records case, *Shapiro*, also contained a statute-specific immunity provision—as did numerous other federal regulatory schemes at the time. *See Shapiro*, 335 U.S. at 5-6 (“[T]he instant case turns on the construction of a compulsory testimony-immunity provision which incorporates by reference the Compulsory Testimony Act of 1893. This provision, in conjunction with broad record-keeping requirements, has been included not merely in a temporary wartime measure, but also, in substantially the same terms, in virtually all of the major regulatory enactments of the Federal Government.”). The primary question presented in *Shapiro* was whether this immunity provision applied to a defendant who had previously been compelled to comply with a subpoena for records, and the Court held that the immunity provision would apply only if the required records doctrine did not apply. *See id.* at 3-32. The existence of a statutory immunity provision is the reason why the Court in *Shapiro* even discussed the required records doctrine. Ultimately, the Court concluded, as explained above, that the immunity provision did not apply *because* the subpoenaed records fell within the required records doctrine. *See id.* at 20 (“Since [the defendant] could assert no valid privilege as to the required records here in question, he was entitled to no immunity under the statute.”); *see also id.* at 25 n.30 (noting the “non-privileged (and hence non-immunizing) status [of] the sales record involved in the present case”). *Shapiro* therefore makes clear that statutory immunity and the required records doctrine are not in tension, but are simply opposite sides of the same coin. *See id.* at 3-5.

#### **E. The “public aspects” prong from *Shapiro* applies only when the regulated activity requires individually approved licenses or substantive restrictions**

Yet another argument against applying the required records doctrine to the regulatory scheme governing offshore banking is that the “public aspects” prong of the doctrine is satisfied only by regulatory schemes with licensing requirements and substantive restrictions on the regulated person’s underlying activity. *See, e.g., Ferguson*, 115 J. TAX’N at 225, 230 (laying out arguments against the Ninth Circuit’s *In re M.H.* opinion). The gist of this argument appears to be that offshore banking somehow feels different than other regulated activities like selling guns, dispensing medicines, dealing in securities, or distilling alcohol. Perhaps this feeling results because most people do not engage in any of these activities, but they do have bank accounts (albeit not offshore ones).

Whatever the underlying intuition, this argument is wrong, unsupported by precedent, and, if accepted, would lead to absurd results. None of the authorities discussed above held that the required records doctrine applied because those who engaged in the regulated activity were required to obtain pre-approval from a regulator or were subject to substantive restrictions on their activities. The only authority that might plausibly support the “licensing” part of the argument is *Shapiro*’s use of the word “licensee.” *Shapiro* held that the records in that case had “public aspects” (or, in the words of *Grosso*, were “analogous to public documents,” *Grosso*, 390 U.S. at 68) because the defendant “was required to keep [them] as a licensee under the Price Control Act . . .” *Shapiro*, 335 U.S. at 34. But, as explained above, the key factor in *Shapiro* was that the defendant was required to keep the documents as a condition of

engaging in an activity that Congress had the power to “regulate or forbid.” *Id.* at 32.

Read in this context, “licensee” most naturally means someone with permission to do something that he has no right to do—something that could legitimately be forbidden. *See* BLACK’S LAW DICTIONARY 938 (8th ed. 2004) (defining “license” as “permission, usu[ally] revocable, to commit some act that would otherwise be unlawful”). The word “licensee” does not refer only to someone who explicitly requests some privilege from the government and then receives some document (or a piece of plastic) memorializing that permission. And the regulatory scheme at issue in *Shapiro* confirms this interpretation: the scheme in *Shapiro* automatically “licensed” almost all fruit-and-produce wholesalers, not just those who affirmatively asked for permission to operate their businesses. The Court explained that “nonretail fruit dealers, including petitioner in the present case, were licensed under § 9a of Maximum Price Regulation No. 426, 8 F.R. 16411 (1943).” *Shapiro*, 335 U.S. at 15. Section 9a of that regulation, *see* 8 Fed. Reg. 16409, 16411 (Dec. 7, 1943), cross-referenced “Licensing Order No. 1,” a prior regulation “licensing all persons who make sales under price control.” *Id.* Licensing Order No. 1, in turn, contained § 1305.73, which provided that “[a] license to make sales under price control is automatically granted to all persons who now or hereafter make such sales.” 8 Fed. Reg. 13240, 13240-41 (Sept. 29, 1943) (emphasis added).

Moreover, if the required records doctrine could not apply to a regulatory scheme that lacked substantive restrictions, then Congress would be prohibited from imposing the minimum regulatory burden necessary to carry out its desired policies. In enacting the Bank Secrecy Act, Congress explicitly sought “to avoid burdening unreasonably a person making a transaction with a foreign financial agency,” 31 U.S.C. § 5314 (2012), and accordingly required only that United States financial institutions and individuals keep basic account records, allow inspection of those records, and file periodic reports based on the information in those records. But under this licensing-and-restrictions argument, as the Fifth Circuit noted, “Congress would be prohibited from imposing the least regulatory burden necessary; it would instead be required to supplement a reporting or recordkeeping scheme with additional and unnecessary substantive restrictions for the sole purpose of upholding its record keeping and reporting requirements.” *In re Grand Jury Subpoena*, 696 F.3d at 436 (internal quotations omitted). Such a result would defy common sense.

## **F. Legislative history shows that the Bank Secrecy Act is targeted at criminals**

A final argument is that the offshore-account recordkeeping requirement fails under *Marchetti* and *Grosso* because, when the Bank Secrecy Act was enacted, Congress was concerned only with catching criminals. *See, e.g.,* Ferguson, 115 J. TAX’N at 224.

The first problem with this argument is that its premise is wrong. The Supreme Court has explicitly stated that Congress, when it enacted the Bank Secrecy Act, was “equally concerned with civil liability which might go undetected by reason of transactions of the type required to be recorded or reported.” *Cal. Bankers*, 416 U.S. at 76 (emphasis added). Indeed, the Bank Secrecy Act expressly states its own multiple purposes: “to require certain reports or records where they have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities.” 31 U.S.C. § 5311 (2012); *see also* H.R. REP. NO. 91-975, at 10 (1970), *reprinted in* 1970 U.S.C.C.A.N. 4394, 4404-05 (capitalization altered) (listing the purposes as: (1) “facilitat[ing] the supervision of financial institutions,” (2) aiding the “authorities in lawful investigations,” and (3) “provid[ing] for the collection of statistics necessary for the formulation of monetary and economic policy”).

More important, as explained above, the Supreme Court has held that the required records doctrine does not allow the Government to create a sham “regulatory scheme” that does nothing other than require criminals to self-report. When evaluating this limitation on the required records doctrine, the Court has held that the relevant question is not legislative intent, but whether the recordkeeping and reporting requirement at issue applies exclusively or almost exclusively to people engaged in criminal activity. *See, e.g., Marchetti*, 390 U.S. at 57 (explaining that “wagering” was generally prohibited in every state but Nevada); *Grosso*, 390 U.S. at 68 (noting that the “principal interest” of the reporting requirement at issue “must be assumed to be the collection of revenue, and not the prosecution of gamblers,” but declining to apply the required records doctrine anyway because illegal gamblers were the only group subject to the requirement); *Haynes*, 390 U.S. at 96-97 (evaluating whether there was any realistic possibility that an innocent person might find an illegal firearm or whether the reporting requirement applied only to criminals).

Whatever else may be said about the recordkeeping and reporting requirements of the Bank Secrecy Act, they do not apply exclusively to criminals—a fact recognized by the courts of appeals, *see M.H.*, 648 F.3d at 1074 (“There is nothing inherently illegal about having or being a beneficiary of an offshore foreign banking account.”). In short, an argument based on the legislative history of the Bank Secrecy Act is irrelevant: malign legislative intent does not invalidate an otherwise-valid recordkeeping or reporting scheme any more than benign legislative intent saves it, *see Grosso*, 390 U.S. at 68 (striking down a reporting scheme that applied only to criminals, despite the Court’s observation that government’s “principal interest . . . must be assumed to be the collection of revenue”).

## V. Conclusion

In sum, the Supreme Court’s required records precedents apply to the provision of the Bank Secrecy Act that requires offshore-account holders to keep and allow inspection of records containing basic information about their accounts. Following these Supreme Court precedents, the courts of appeals have correctly held that a person who receives a subpoena for such required records must comply with the subpoena. ❖

## ABOUT THE AUTHOR

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# Litigating Fifth Amendment Claims by Non-Filing Taxpayers in Response to IRS Summonses

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## I. Introduction

The Internal Revenue Service estimates that \$25 billion of the total tax gap of \$450 billion is attributable to individuals who do not timely file their income tax returns. *See* OVERVIEW TAX GAP FOR TAX YEAR 2006, available at <http://www.irs.gov/uac/The-Tax-Gap>. In seeking to reduce this tax gap, the IRS, in the course of its audits, issues administrative summonses under § 7602(a)(2) of the Internal Revenue Code (I.R.C. or Code). When these taxpayers fail to comply with the summonses, the task of enforcing the summonses falls upon either an attorney from the Tax Division or a local Assistant United States Attorney.

Enforcing summonses against non-filers calls for particular sensitivity to the Fifth Amendment privilege against self-incrimination. The Code provides that “[a]ny person . . . required by this title or regulations made under the authority thereof to make a return . . . who willfully fails to . . . make such return . . . at the time or times required by law or regulations, shall . . . be guilty of a misdemeanor . . . .” I.R.C. § 7203 (2012). Further, whether an individual is required to file an income tax return depends on the individual’s income level. *See* I.R.C. § 6012(a)(1)(A) (2012). Because an IRS summons issued to an individual who has not filed an income tax return typically seeks information about his income, the individual may contend that providing the summonsed information would tend to incriminate him.

Normally, “the Fifth Amendment privilege is not self-executing.” *Minnesota v. Murphy*, 465 U.S. 420, 434 (1984). To successfully advance a Fifth Amendment privilege claim, a non-filing taxpayer must demonstrate that a number of requirements are satisfied. This article explores the showing that is required of a non-filing taxpayer to assert a viable Fifth Amendment privilege claim, as well as how the IRS might overcome an asserted claim.

## II. Requirements for raising the privilege

The Fifth Amendment to the United States Constitution states that “no person . . . shall be compelled in any criminal case to be a witness against himself.” U.S. CONST. amend. V. While a summons enforcement proceeding is not a criminal case, the Supreme Court has long recognized that the Fifth Amendment privilege “can be asserted in any proceeding, civil or criminal, administrative or judicial, investigatory or adjudicatory; and it protects against any disclosures which the witness reasonably believes could be used in a criminal prosecution or could lead to other evidence that might be so used.” *Kastigar v. United States*, 406 U.S. 441, 444-45 (1972). The courts, however, have also established a number of requirements for asserting a valid Fifth Amendment privilege claim.

## A. No blanket assertions

An initial hurdle that must be cleared to assert a valid Fifth Amendment claim is the familiar rule that “[a] mere blanket assertion of the privilege will not suffice.” *United States v. Hatchett*, 862 F.2d 1249, 1251 (6th Cir. 1988); accord *United States v. Argomaniz*, 925 F.2d 1349, 1356 (11th Cir. 1991) (“[A] blanket refusal to produce records or to testify will not support a fifth amendment claim.”). Rather, “[t]he recipient of a summons properly must appear before the IRS agent and claim the privilege on a question-by-question and document-by-document basis.” *United States v. Allee*, 888 F.2d 208, 212 (1st Cir. 1989). Thus, a non-filing taxpayer who merely asserts that providing any information in response to a summons issued to him violates his Fifth Amendment right against self-incrimination should have his claim rejected.

When a taxpayer makes a blanket assertion of a Fifth Amendment privilege claim, it is preferable for the district court to provide the taxpayer asserting the blanket claim with the opportunity to make an assertion of privilege on a question-by-question and document-by-document basis. Otherwise, there is a substantial risk that a court of appeals may remand the case to the district court to provide the taxpayer with the opportunity to make such a showing. See *United States v. Grable*, 98 F.3d 251, 255 (6th Cir. 1996); *Argomaniz*, 925 F.2d at 1355-56; *United States v. Roundtree*, 420 F.2d 845, 852 (5th Cir. 1969). Because a taxpayer may need to provide incriminating information to show that he has a valid Fifth Amendment claim, the particularized inquiry in many instances may best be accomplished by an *in camera* inspection by the district court. *Argomaniz*, 925 F.2d at 1355. See also *IRS v. Lanoie*, 403 F. App’x 328, 334 (10th Cir. 2010) (observing that *Argomaniz* does not require an *in camera* inspection and finding that the taxpayer did not establish a valid claim at a particularized inquiry accomplished through a transcribed appearance before an IRS agent after the enforcement proceeding commenced).

A related question is whether a taxpayer who merely makes a blanket Fifth Amendment privilege claim in a summons enforcement proceeding, and is ordered to comply with the summons, has fully litigated the privilege issue and, therefore, cannot raise it in a subsequent proceeding seeking to have the taxpayer held in contempt for failing to comply with the enforcement order. In *United States v. Rylander*, 460 U.S. 752 (1983), the United States sought to have an individual subject to a summons held in contempt for failing to produce documents following a summons enforcement order. The Supreme Court held that because the summons enforcement order was final, “[t]he only issue open to [the summonsed individual] in defending the contempt proceeding was to show inability to *then* produce . . .” *Id.* at 760 (emphasis in original). The Court, nonetheless, recognized that if the summonsed individual testified regarding his present inability to comply, then “a claim of Fifth Amendment privilege may be an adequate reason for the court not compelling [the summonsed individual] to respond to cross-examination at the contempt hearing . . .” *Id.* at 761. That claim of privilege, however, was “not a substitute for relevant evidence,” *id.*, and did not rebut “the presumption of continuing possession arising from the enforcement order . . .” *Id.* at 760.

Subsequent to *Rylander*, the courts of appeals have generally allowed a taxpayer to assert the Fifth Amendment privilege in response to an oral question at the contempt stage, if the taxpayer previously had not been asked the question. See, e.g., *United States v. Edgerton*, 734 F.2d 913, 917-18 (2d Cir. 1984). The courts of appeals do not appear to have reached a consensus regarding document production, however. Three appellate courts have allowed a summonsed taxpayer to assert the privilege as to document production in a contempt proceeding despite the fact that the taxpayer was subject to an order enforcing the summons. See *Grable*, 98 F.3d at 254-55; *Allee*, 888 F.2d at 213; *United States v. Sharp*, 920 F.2d 1167, 1172 (4th Cir. 1990). The Third Circuit in *Allee*, concluded that the Fifth Amendment issue was not “ripe” when the enforcement order was issued. *Allee*, 888 F.2d at 213. The



Sixth and Fourth circuits concluded that when the taxpayer is unrepresented by counsel, he should not have to forfeit a constitutional privilege. *Grable*, 98 F.3d at 254-55; *Sharp*, 920 F.2d at 1172.

One criticism of the decisions tolerating Fifth Amendment privilege claims as to document production at the contempt stage is that they allow delinquent taxpayers and tax defiers to delay the enforcement of a summons, the accompanying IRS investigation, and, thereby, their eventual day of reckoning. This delay is inconsistent with Congress's desire that summons enforcement proceedings be summary in nature. *See United States v. Stuart*, 489 U.S. 353, 369 (1989). *Cf. Rylander*, 460 U.S. at 762 (rejecting the court of appeals' willingness to provide additional proceedings at the contempt stage because "a plainer guide to the successful frustration of [our self-assessment tax] system could hardly be imagined."). Indeed, if a circuit tolerates a Fifth Amendment privilege claim for document production at the contempt stage, delinquent taxpayers who merely seek to delay their day of reckoning would appear to benefit from a strategy of appearing *pro se* at the summons enforcement proceeding and of obtaining counsel to litigate their Fifth Amendment claim in the contempt proceeding.

This scenario was precisely the case in *United States v. Bright*, 596 F.3d 683 (9th Cir. 2010). In *Bright*, the Ninth Circuit issued a well-reasoned opinion rejecting a Fifth Amendment claim for document production asserted at a contempt proceeding. The Government argued that the taxpayers' Fifth Amendment claim in the contempt proceedings was barred by the summons enforcement order. The Ninth Circuit explained that summons interview questions and document production should be treated differently. The court held that the Fifth Amendment privilege claim was not finally resolved in the enforcement proceeding as to oral questioning because "[a]n unscripted interview is undefined, so a court cannot make a reasoned assessment of privilege before particular questions have been posed." *Id.* at 691. The court, however, went on to hold that "the same cannot be said of a claim of privilege over documents." *Id.* at 692. The court explained that

a document request [in a summons] lays out categories of documents requested. A claim of privilege over *all* documents can be assessed as repeated assertions of privilege in response to each category. *See United States v. Grable*, 98 F.3d 251, 255 (6th Cir. 1996) ("[T]he effect . . . was as if [the revenue agent] had asked . . . 'for each document listed in the summons, and [the taxpayer] had responded by repeatedly raising his fifth amendment privilege in response.' ") (quoting *United States v. Argomaniz*, 925 F.2d 1349, 1356 (11th Cir. 1991)). The scope of the assertion is clear and circumscribed.

*Id.* at 691-92 (emphasis in original) (footnote omitted).

The *Bright* court's approach of refusing to allow the assertion of the privilege at the contempt proceedings for document production finds support in the decisions of other circuits. *See United States v. Rue*, 819 F.2d 1488, 1495 (8th Cir. 1987) (affirming a contempt order against a summonsed taxpayer for failing to produce the summonsed documents as required by an enforcement order and distinguishing the situation from being held in contempt for failure to answer questions); *United States v. Sorrells*, 877 F.2d 346, 352 n.8 (5th Cir. 1989) (applying "the rule that defenses to production that are available at the time of the enforcement proceeding cannot be raised for the first time in a contempt proceeding" and affirming a lower court order holding a summonsed taxpayer in contempt for refusing to produce documents in compliance with summons enforcement order); *Edgerton*, 734 F.2d at 920 (observing that a summonsed taxpayer at a contempt proceeding "was foreclosed from objecting to compelled production of documents prepared by third parties by virtue of the unappealed enforcement order," but holding that "he [was not] foreclosed from objecting to the giving of answers to questions, whether about those records or others").

## B. Reasonable fear of incrimination

A second requirement for the assertion of a valid claim of privilege under the Fifth Amendment is that the individual claiming the privilege must have a “‘reasonable cause to apprehend danger’ upon giving a responsive answer that ‘would support a conviction,’ or ‘would furnish a link in the chain of evidence needed to prosecute’ [the individual] for a violation of the criminal statutes.” *United States v. Schmidt*, 816 F.2d 1477, 1481 (10th Cir. 1987) (quoting *Hoffman v. United States*, 341 U.S. 479, 486 (1951)). “The central standard for the privilege’s application [is] whether the claimant is confronted by substantial and ‘real,’ and not merely trifling or imaginary, hazards of incrimination.” *Marchetti v. United States*, 390 U.S. 39, 53 (1968) (citations omitted). The party cannot escape answering questions “merely because he declares that in so doing he would incriminate himself—his say-so does not of itself establish the hazard of incrimination.” *Hoffman*, 341 U.S. at 486. In addition, “the mere fact that evidence might be used against [the taxpayer] in a later prosecution will not support a claim of self-incrimination.” *Roundtree*, 420 F.2d at 852; *accord Lanoie*, 403 F. App’x at 334. *See also United States v. Euge*, 444 U.S. 707, 715 (1980) (The Supreme Court has “refused to hold that the summons authority could not be used whenever there was a potential that the civil investigation might later lead to criminal prosecution.”).

As noted above, a taxpayer who has not filed a return may argue that he has a reasonable belief that requests for income information will show that he has willfully failed to file a return and that, therefore, he or she is guilty of a misdemeanor under I.R.C. § 7203. But, the taxpayer must still make his or her showing as to each document and each question. *See United States v. Rendahl*, 746 F.2d 553, 556-57 (9th Cir. 1984); *Argomaniz*, 925 F.2d at 1355. Thus, while a non-filing taxpayer might be able to show that a request for income information pursuant to a summons provides him or her with a reasonable fear of incrimination, it does not necessarily follow that a request for information regarding deductions also does so.

One possible basis for refuting an otherwise valid reasonable-fear-of-incrimination assertion is a showing that the statute of limitations on criminal prosecution under I.R.C. § 7203 has run with respect to the tax years at issue. *See United States v. Garrett*, 6 F. App’x 573 (9th Cir. 2001) (rejecting Fifth Amendment objection to summons based on willful failure to file returns for which prosecution is time barred); *United States v. Aeilts*, 855 F. Supp. 1114, 1119 (C.D. Cal. 1994) (same); *see also Rendahl*, 746 F.2d at 557 (“There may also be a remaining issue as to whether a statute of limitation protects respondents from criminal liability for some of the years in question, thus eliminating the possibility of self-incrimination.”). The maximum period of time during which the IRS may prosecute a person for any offense under I.R.C. § 7203 is six years after the commission of the offense. I.R.C. § 6531(4) (2012). Where the six-year period has expired, an asserted claim of Fifth Amendment privilege normally should fail.

Finally, showing that the taxpayer is “not the subject of any criminal investigation” is not sufficient, by itself, to refute a taxpayer’s claim that he has a reasonable fear of incrimination. *Rendahl*, 746 F.2d at 556; *accord Argomaniz*, 925 F.2d at 1353. Rather, “[t]he existence of a criminal investigation serves only to establish that answers are likely to be incriminating.” *Rendahl*, 746 F.2d at 556. Similarly, the fact that there is no referral by the IRS to the Justice Department for criminal prosecution does not defeat an assertion of a reasonable fear of incrimination. The provision in I.R.C. § 7602(d) regarding “Justice Department referral[s]” provides a bright line rule for determining whether the summons has a proper purpose (*see Scotty’s Contracting and Stone, Inc. v. United States*, 326 F.3d 785, 788-91 (6th Cir. 2003)), but does not speak directly to the Fifth Amendment privilege against self-incrimination. Accordingly, an opposition to a Fifth Amendment privilege claim should not be based solely upon either the lack of a currently existing criminal investigation or the lack of a Justice Department referral.

### C. Compelled testimony

The Fifth Amendment privilege is “a bar against compelling ‘communications’ or ‘testimony . . . .’ ” *Schmerber v. California*, 384 U.S. 757, 764 (1966). It “does not independently proscribe the compelled production of every sort of incriminating evidence but applies only when the accused is compelled to make a Testimonial Communication that is incriminating.” *Fisher v. United States*, 425 U.S. 391, 408 (1976). Accordingly, to properly assert the privilege, the non-filing taxpayer, in addition to showing that he has a reasonable fear of incrimination, must establish that the communication at issue is testimonial and that it is compelled.

In the case of a response to a question in an interview conducted pursuant to an IRS summons, the taxpayer should have little trouble establishing that compelled testimony is sought. The summons represents compulsion, *id.* at 409, and there seems to be little basis for contending that the taxpayer’s response would not be testimonial.

The testimonial aspects of document requests in a summons require a more sophisticated analysis. At one time, the Supreme Court provided protection to the contents of business records summonsed from an individual taxpayer even though those records were voluntarily prepared. *See Boyd v. United States*, 116 U.S. 616, 630 (1886) (“[A]ny forcible and compulsory extortion of a man’s own testimony, or of his private papers to be used as evidence to convict him of crime, or to forfeit his goods, is within the condemnation of that judgment. In this regard the fourth and fifth amendments run almost into each other.”). After significant evolution in Fourth and Fifth Amendment jurisprudence, the Supreme Court, in a pair of cases, *Fisher v. United States*, 425 U.S. 391, and *United States v. Doe*, 465 U.S. 605 (1984), adopted a different approach. Thereafter, if the documents requested were prepared by a third party or were business records voluntarily prepared by the summonsed taxpayer, *the contents* of the documents themselves do not represent compelled testimony and, therefore, are not privileged. *See Doe*, 465 U.S. at 610-11; *Fisher*, 425 U.S. at 409.

This change, however, did not mean that the documents whose contents were no longer protected could necessarily be obtained through a summons. Instead, in *Fisher* and *Doe*, the Supreme Court articulated an “act of production” doctrine and a “foregone conclusion” rationale to guide the Fifth Amendment privilege analysis. As the Supreme Court explained in *Fisher*:

The act of producing evidence in response to [an administrative] subpoena . . . has communicative aspects of its own, wholly aside from the contents of the papers produced. Compliance with the subpoena tacitly concedes the existence of the papers demanded and their possession or control by the taxpayer. It also would indicate the taxpayer’s belief that the papers are those described in the subpoena.

*Fisher*, 425 U.S. at 410.

The Court in *Fisher*, however, went on to hold that in the situations before it,

[t]he existence and location of the papers are a foregone conclusion and the taxpayer adds little or nothing to the sum total of the Government’s information by conceding that he in fact has the papers. Under these circumstances by enforcement of the summons “no constitutional rights are touched. The question is not of testimony but of surrender.”

*Id.* at 411 (quoting *In re Harris*, 221 U.S. 274, 279 (1911)).

On the other hand, in *Doe*, the factual context before the Court did not present the same “foregone conclusion” that it did in *Fisher*, and the Supreme Court held that the act of production there was testimonial. The Court emphasized that it had an “explicit finding of the District Court that the act of

producing the documents would involve testimonial self-incrimination.” *Doe*, 465 U.S. at 613. In this regard, the Court observed that the lower court found that if the production request was enforced, the respondent would be compelled “to admit that the records exist, that they are in his possession, and that they are authentic.” *Id.* at 613 n.11 (internal quotation marks and citation omitted). *See also United States v. Hubbell*, 530 U.S. 27, 45 (2000) (rejecting the Government’s reliance on the “foregone conclusion” rationale where “the Government has not shown that it had any prior knowledge of either the existence or the whereabouts of the 13,120 pages of documents ultimately produced by respondent.”).

Subsequently, some courts of appeals have viewed protection for the act of production as a general rule that is subject to a “foregone conclusion exception.” *See Bright*, 596 F.3d at 692; *In re Grand Jury Subpoena*, 973 F.2d 45, 51 (1st Cir. 1992). “For this foregone conclusion exception to apply, the government must establish its independent knowledge of three elements: the documents’ existence, the documents’ authenticity and [the summonsed individual’s] possession or control of the documents.” *Bright*, 596 F.3d at 692; *see also United States v. Hubbell*, 167 F.3d 552, 570 n.24 (D.C. Cir. 1999), *aff’d*, 530 U.S. 27 (2000). Whether the showing made by the Government is sufficient to establish a foregone conclusion is a fact question reviewed under the clearly erroneous standard. *Doe*, 465 U.S. at 613-14; *Bright*, 596 F.3d at 693-94; *United States v. Norwood*, 420 F.3d 888, 895 (8th Cir. 2005).

Exactly how much knowledge of the documents the IRS must possess to satisfy the foregone conclusion rationale is not entirely clear. The rule does not require the IRS “to have actual knowledge of the existence and location of each and every responsive document.” *In re Grand Jury Subpoena Dated April 18, 2003*, 383 F.3d 905, 910 (9th Cir. 2004). On the other hand, the IRS cannot establish a foregone conclusion merely through “the overbroad argument that a businessman . . . will always possess general business and tax records that fall within the broad categories described in the [summons].” *Hubbell*, 530 U.S. at 45. Three circuits have adopted a “reasonable particularity” standard to describe the quantum of knowledge that the Government must possess. *In re Grand Jury Subpoena Duces Tecum Dated March 25, 2011*, 670 F.3d 1335, 1344 n.20 (11th Cir. 2012); *United States v. Ponds*, 454 F.3d 313, 320-21 (D.C. Cir. 2006); *In re Grand Jury Subpoena, Dated April 18, 2003*, 383 F.3d at 910 (9th Cir. 2004). In addition, another circuit has held that demonstrating knowledge with “reasonable particularity” is sufficient for a foregone conclusion. *In re Grand Jury Subpoena Duces Tecum Dated Oct. 29, 1992*, 1 F.3d 87, 93 (2d Cir. 1993).

The Government has been able to successfully invoke the foregone conclusion rationale in a number of offshore credit card cases where the IRS had obtained information about the types of records offshore banks made available to their customers and where the IRS knew the account numbers of the accounts that the summonsed individuals maintained at the offshore banks. *See Bright*, 596 F.3d 683; *Norwood*, 420 F.3d 888; *United States v. Taylor*, 2007 WL 805662, at \*4-6 (D. Ariz. Mar. 14, 2007). The IRS has also been able to successfully invoke the foregone conclusion rationale based upon taxpayer admissions. *See United States v. Teeple*, 286 F.3d 1047 (8th Cir. 2002); *United States v. Rue*, 819 F.2d 1488 (8th Cir. 1987); *see also United States v. Sideman & Bancroft LLP*, 2013 WL 71777, at \*6 (9th Cir. Jan. 8, 2013) (ruling that foregone conclusion rationale was established through statements of taxpayer’s tax return preparer).

In sum, there is little prospect for defeating a Fifth Amendment privilege claim asserted in response to a summons interview question based upon a taxpayer’s failure to satisfy the compelled-testimony requirement. Whether the compelled-testimony requirement has been satisfied regarding all or part of a document production demand in a summons will depend on the particular context. The inquiry will focus on the information about the existence and location of the summonsed documents that the IRS possesses, independent of the summons and the possibility of authenticating the summonsed documents through a means other than the taxpayer.

### III. The required records exception

The “required records” exception to the Fifth Amendment privilege applies to the disclosure of documents that a person in a regulated industry is required by the Government to maintain. The Supreme Court first recognized the required records exception in *Shapiro v. United States*, 335 U.S. 1 (1948), and formulated the standards for the exception in *Grosso v. United States*:

The premises of the doctrine, as it is described in *Shapiro*, are evidently three: first, the purposes of the United States’ inquiry must be essentially regulatory; second, information is to be obtained by requiring the preservation of records of a kind that the regulated party has customarily kept; and third, the records themselves must have assumed “public aspects” that render them at least analogous to public documents.

*Grosso*, 390 U.S. 62, 67-68 (1968).

The prospects for successfully invoking the required records exception to defeat a Fifth Amendment privilege claim in response to an IRS summons asserted by a taxpayer who has not filed a return appear to be limited. The Second Circuit has held that the required records exception applies to Forms W-2. *In re Doe*, 711 F.2d 1187, 1191 (2d Cir. 1983); *see also Rajah v. Mukasey*, 544 F.3d 427, 442 (2d Cir. 2008). The Seventh Circuit, on the other hand, has held that “[a] statute that merely requires a taxpayer to maintain records necessary to determine his liability for personal income tax is not within the scope of the required-records doctrine.” *Smith v. Richert*, 35 F.3d 300, 303 (7th Cir. 1994) (addressing Indiana tax statute); *accord United States v. Porter*, 711 F.2d 1397, 1404-05 (7th Cir. 1983) (making the same ruling with respect to a records-maintenance requirement in Treas. Reg. §1.6001-1(a)); *see also United States v. Fox*, 721 F.2d 32, 35 n.3 (2d Cir. 1983) (declining to consider required records exception where the Government did not rely on it).

Although there have been some recent decisions favorable to the Government regarding the required records exception in the Bank Secrecy Act context, those decisions do not provide a basis for disagreeing with the decisions of the Seventh Circuit in *Smith* and *Porter*. *See In re M.H.*, 648 F.3d 1067, 1078 (9th Cir. 2011), *cert. denied*, No. 11-1026, 133 S. Ct. 26 (June 25, 2012) (distinguishing *Smith* on the grounds that the decision to become a taxpayer cannot be viewed as voluntary and that the case did not involve a regulated activity); *In re Special February 2011-1 Grand Jury Subpoena Dated September 12, 2011*, 691 F.3d 903, 908-09 (7th Cir. 2012), *reh’g and reh’g en banc denied* (Oct. 24, 2012) (concluding that its reasoning in *Smith* and *Porter* was consistent with its Bank Secrecy Act ruling); *In re Grand Jury Subpoena*, 696 F.3d 428, 433 (5th Cir. 2012) (citing *Smith* with approval); *see also In re Grand Jury Proceedings, No. 4-10*, 2013 WL 452768, at \*12 (11th Cir. Feb. 7, 2013) (distinguishing *United States v. Argomaniz, No. 4-10*, 925 F.2d 1349, 1355-56 (11th Cir. 1991), which involved an IRS summons).

### IV. Immunity

In cases where a non-filing taxpayer has successfully asserted a Fifth Amendment privilege claim in response to a summons, several courts of appeals have observed that the IRS could obtain the summonsed information by providing the taxpayer with use immunity. *See Grable*, 98 F.3d at 257; *United States v. Bodwell*, 66 F.3d 1000, 1002 n.2 (9th Cir. 1995); *Sharp*, 920 F.2d at 1172. The granting of immunity is authorized by the provisions of the United States Code. *See* 18 U.S.C §§ 6001-6005 (2012). The procedures for seeking an immunity order in a summons proceeding are discussed in the Internal Revenue Manual (IRM) at §§ 38.1.2.3 and 38.1.2.4 (08-11-2004). An application for a grant of immunity must be approved by the Attorney General or his delegate. *See* 18 U.S.C. §§ 6003(b), 6004(a)

(2012); *see also* IRM §§ 38.1.2.3 and 38.1.2.4. In addition, the IRS can issue an immunity order in the summons proceeding “only if in its judgment . . . the testimony or other information [sought] from [the summonsed] individual may be necessary to the public interest . . . .” 18 U.S.C. § 6004(b) (2012).

If an immunity order is granted, no testimony or other compelled information or information derived therefrom, may be used against the witness in a criminal case, except in a prosecution for perjury, giving a false statement, or otherwise failing to comply with the order. 18 U.S.C. § 6002(3) (2012). The immunized witness may be prosecuted, however, for matters to which he or she testified if the Government has evidence of those crimes independent of the testimony. *See United States v. Streck*, 958 F.2d 141, 144 (6th Cir. 1992). In addition, a grant of immunity does not prevent the IRS from pursuing the taxpayer’s civil tax liabilities. *See United States v. Cappetto*, 502 F.2d 1351, 1358 (7th Cir. 1974).

Absent unusual circumstances, there is little reason to pursue immunity to obtain the testimony of a non-filing taxpayer who establishes a viable Fifth Amendment privilege claim. If the summons was issued in connection with an investigation into whether the taxpayer had committed a criminal offense, providing use immunity with respect to the summonsed information would make the summons of limited value. *See* I.R.C. § 7602(b); *Scotty’s Contracting*, 326 F.3d at 788-91. Moreover, in the typical case where the summons is issued for a civil investigation, the taxpayer’s assertion of the Fifth Amendment privilege suggests that there may be reason to open a criminal investigation, and not that the IRS should issue an order that would restrict the evidence that the Government could use in any subsequent criminal proceeding. Finally, the taxpayer’s refusal to respond to the summons could prove to be useful in a subsequent civil case inasmuch as a Fifth Amendment claim does not prevent an adverse inference from being drawn in a *civil* case from a taxpayer’s failure to provide requested information regarding his tax liability that he would be expected to possess. *See Baxter v. Palmigiano*, 425 U.S. 308 (1976); *United States v. Ianniello*, 824 F.2d 203, 208 (2d Cir. 1987); *Meier v. Comm’r*, 91 T.C. 273, 290 (1988).

## V. Conclusion

Through appropriate arguments, many Fifth Amendment privilege claims asserted by non-filing taxpayers in summons enforcement cases can be successfully defended. To assert a viable claim, the taxpayer must do more than assert generally that providing the information sought violates his Fifth Amendment rights against self-incrimination. There must be a showing with respect to each document request and each question asked that the taxpayer has reasonable cause to apprehend danger that providing the information summonsed would support a conviction for violation of a criminal statute or would provide a link in the chain of evidence needed to prosecute the taxpayer. When the statute of limitations on criminal prosecution has expired, there should be no reasonable fear of incrimination. In addition, the taxpayer’s responses to document requests will not be sufficiently testimonial to satisfy the Fifth Amendment if the IRS can establish that it has knowledge independent of the summons of the existence of the documents summonsed and of the taxpayer’s possession of, or control over, those documents and that there is a reasonable possibility of authenticating the documents through some means other than the taxpayer. Ultimately, the IRS has the ability to defeat any Fifth Amendment privilege claim through a grant of use immunity, but there typically is no reason to provide such immunity. ❖

## ABOUT THE AUTHOR

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# Parallel Proceedings in Tax Cases: Avoiding Common Pitfalls

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## I. Introduction

The Federal Government has a myriad of options for combating abusive tax avoidance schemes. We criminally prosecute tax return preparers who file fraudulent returns seeking millions of dollars in improper refunds (often without the knowledge of their clients) and obtain civil injunctions to put those same preparers out of business for long after their sentence is served. We collect unpaid income and employment taxes from individuals who have not complied with the tax laws, and prosecute them for tax evasion. The goal is to both punish those who violate the law and restrain future violations. The challenge is to use the proper remedy in the proper way, to serve justice, and to respect taxpayers' rights. The challenge is particularly acute when, by happenstance or design, the Government proceeds along parallel civil and criminal enforcement tracks.

In this article, we identify common issues raised in parallel proceedings and provide practical guidance for resolving them. We do not attempt to cover each issue that may arise, and caution that there is no one-size-fits-all resolution. We do suggest that, if you have a case that implicates these issues, you discuss it with a supervisor and the Tax Division's Counsel for Civil/Criminal Coordination.

## II. What are parallel proceedings?

### A. Definition

The term "parallel proceedings" refers to the simultaneous or successive investigation or litigation of separate criminal, civil, administrative, or regulatory matters involving a common set of facts. Courts have approved of the Federal Government's use of parallel proceedings:

The civil and regulatory laws of the United States frequently overlap with the criminal laws, creating the possibility of parallel civil and criminal proceedings, either successive or simultaneous. In the absence of substantial prejudice to the rights of the parties involved, such parallel proceedings are unobjectionable under our jurisprudence.

*Sec. and Exch. Comm'n v. Dresser Indus., Inc.*, 628 F.2d 1368, 1374 (D.C. Cir. 1980) (en banc). *See also United States v. Kordel*, 397 U.S. 1, 11 (1970) (Government's prosecution of parallel civil and criminal proceedings against defendant approved where no showing that "a violation of due process or a departure from proper standards in the administration of justice" occurred); *In re Grand Jury Subpoena*, 920 F.2d 235, 240 n.5 (4th Cir. 1990) ("[I]t is generally accepted that related IRS criminal and civil proceedings may be pursued simultaneously and that information may be shared between the divisions, absent a showing of bad faith on the part of the IRS.").

When we refer to "parallel proceedings" in the tax context, we most often refer to the Government taking civil enforcement action—seeking a judgment, collecting tax due, or working to enjoin promoters of abusive tax schemes or unscrupulous tax return preparers—and also prosecuting the

same individual or entity for tax-avoidance. The Government is both the plaintiff and prosecutor, by design. Typically, the civil tax case will be handled by a Tax Division trial attorney, while the criminal prosecution will be handled by a Tax Division prosecutor or an Assistant United States Attorney (AUSA). Other times, parallel proceedings arise for reasons beyond the Government's control, for example:

- The target of a criminal investigation might file a bankruptcy case and object to the IRS tax claim, creating a civil matter for litigation
- Civil discovery is sought of the Government by private civil litigants, one of whom is the subject of an IRS criminal investigation
- The subject of an IRS criminal investigation might be a claimant in a quiet title action, or
- A participant in an abusive tax shelter might file a case in the United States Tax Court when the shelter promoter is a criminal target

These cases, too, raise the same issues and require the same type of coordination efforts as traditional "parallel proceedings" where the Government initiates both the civil and criminal proceedings.

## **B. DOJ policy**

In her July 28, 1997 memorandum, Attorney General Reno strongly encouraged the use of parallel proceedings to combat white collar crime:

When appropriate, criminal, civil, and administrative attorneys should coordinate an investigative strategy that includes prompt decisions on the merits of criminal and civil matters; sensitivity to grand jury secrecy, tax disclosure limitations and civil statutes of limitation; early computation and recovery of the full measure of the Government's losses; prevention of the dissipation of assets; global settlements; proper use of discovery; and compliance with the Double Jeopardy Clause. By bringing additional expertise to our efforts, expanding our arsenal of remedies, increasing program integrity and deterring future violations, we represent the full range of the Government's interests.

Memorandum from the Attorney General to Federal Attorneys (July 28, 1997). She mandated institution of coordinators in each litigating unit to ensure:

- Timely assessment of the civil and administrative potential in all criminal case referrals, indictments, and declinations
- Timely assessment of the criminal potential in all civil case referrals and complaints
- Effective and timely communication with cognizant agency officials, including suspension and debarment authorities, to enable agencies to pursue available remedies
- Early and regular communication between civil and criminal attorneys regarding *qui tam* and other civil referrals, especially when the civil case is developing ahead of the criminal prosecution, and
- Coordination, when appropriate, with state and local authorities

The policy encouraged the development of criminal cases through administrative means, rather than a grand jury, to facilitate information-sharing with civil components. DEP'T OF JUSTICE, UNITED STATES ATTORNEYS' MANUAL § 1-12.000 (2012).



Attorney General Holder reemphasized the use of parallel proceedings in his January 30, 2012 memorandum:

Department policy is that criminal prosecutors and civil trial counsel should timely communicate, coordinate, and cooperate with one another and agency attorneys to the fullest extent appropriate to the case and permissible by law, whenever an alleged offense or violation of federal law gives rise to the potential for criminal, civil, regulatory, and/or agency administrative parallel (simultaneous or successive) proceedings. By working together in this way, the Department can better protect the government's interests (including deterrence of future misconduct and restoration of program integrity) and secure the full range of the government's remedies (including incarceration, fines, penalties, damages, restitution to victims, asset seizure, civil and criminal forfeiture, and exclusion and debarment).

DEP'T OF JUSTICE, UNITED STATES ATTORNEYS' MANUAL, ORGANIZATIONS AND FUNCTIONS MANUAL 27 (2012).

In accordance with this Department of Justice (DOJ) policy, Tax Division attorneys and AUSAs should evaluate each incoming case for parallel potential and keep in mind, among many things, grand jury secrecy, agent and witness safety, discovery issues, effective use of resources, and taxpayer privacy and the disclosure restrictions of 26 U.S.C. § 6103.

The Internal Revenue Service has been coordinating civil and criminal enforcement for years. Its current Policy Statement P-4-26, in Part 1, Chapter 2, Section 13 of the Internal Revenue Manual, encourages the use of parallel proceedings, where appropriate, to combat promoters of abusive tax schemes and unscrupulous tax return preparers. *See* INTERNAL REVENUE SERVICE, INTERNAL REVENUE MANUAL P-4-26 (2005). The policy emphasizes the need for civil and criminal investigators to meet at least quarterly. These "six-way" meetings involve IRS personnel from both the civil and criminal divisions, IRS counsel, and the civil and/or criminal attorneys at the DOJ after a referral is made to DOJ. These meetings are an opportunity to share appropriate information about the status of each investigation and ensure that action contemplated in one proceeding does not imperil another. As will be discussed later, there are limitations on the involvement that each component can have with the other and on what information can be shared, but, at the very least, six-way conference calls help to avoid unpleasant surprises.

In the Tax Division, we have had a formal civil/criminal coordination program since 2004. Assistant Attorney General O'Connor formalized the Division's commitment to using "all available tools to combat the promotion of tax fraud schemes" and established a Special Counsel for Civil/Criminal Coordination to track parallel proceedings, provide resources and advice on issues that arise in parallel proceedings, work with the IRS on coordinated cases, and assist in resolving conflicts between civil and criminal proceedings and between IRS and DOJ. *See* DEP'T OF JUSTICE, TAX RESOURCE MANUAL 22, available at [http://www.justice.gov/usao/eousa/foia\\_reading\\_room/usam/title6/tax00022.htm](http://www.justice.gov/usao/eousa/foia_reading_room/usam/title6/tax00022.htm).

A number of resources are available to Government attorneys regarding parallel proceedings, such as United States Attorneys' Manual Chapter 1-12.000 ([http://www.justice.gov/usao/eousa/foia\\_reading\\_room/usam/title1/12mdoj.htm](http://www.justice.gov/usao/eousa/foia_reading_room/usam/title1/12mdoj.htm)). The Criminal Tax Manual has additional guidance on how to maximize the effectiveness of plea agreements to address civil enforcement, at <http://www.justice.gov/tax/readingroom/2008ctm/TaxManual2012.pdf>. The DOJ's Professional Responsibility Advisory Office can provide guidance to DOJ attorneys concerning the overlap of parallel proceedings and ethical issues.

### III. Coordination of civil and criminal proceedings

#### A. Cases finding proper use of parallel proceedings: *Kordel*, *Dresser Industries*, *Stringer*

There is nothing improper about the Government undertaking simultaneous criminal and civil investigations, provided that the Government uses those proceedings and associated investigative tools for their proper purposes and in appropriate ways. *United States v. Stringer*, 535 F.3d 929, 933 (9th Cir. 2008), *vacating in part and reversing in part*, 408 F. Supp. 2d 1083 (D. Or. 2006); *see also United States v. LaSalle Nat'l Bank*, 437 U.S. 298, 310-12 (1978) (explaining that the IRS may use summons to gather evidence for civil and criminal purposes under 26 U.S.C. § 7602, provided it does so in good faith and prior to any recommendation of criminal prosecution to the DOJ); *Kordel*, 397 U.S. at 11 (“It would stultify enforcement of federal law to require a governmental agency . . . invariably to choose either to forgo recommendation of a criminal prosecution once it seeks civil relief, or to defer civil proceedings pending the ultimate outcome of a criminal trial.”); *Dresser Indus., Inc.*, 628 F.2d at 1374 (“In the absence of substantial prejudice to the rights of the parties involved, such parallel proceedings are unobjectionable under our jurisprudence.”).

The Supreme Court in *Kordel*, while approving the use of parallel proceedings, cautioned the Government to not use its civil case solely to obtain evidence for its criminal prosecution, to advise the civil defendant if a criminal prosecution is contemplated, and to use caution in pursuing parallel tracks if the defendant is unrepresented or if special circumstances suggested prosecution was improper or unconstitutional. *Kordel*, 397 U.S. at 11-12.

#### B. Cautionary tales: *Tweel*, criminal discovery, and joint witness interviews

***Tweel* issues:** While courts have approved parallel proceedings, they also have recognized that multiple actions against individuals have the potential for abuse. The most often cited example is *United States v. Tweel*, 550 F.2d 297 (5th Cir. 1977). In *Tweel*, the Fifth Circuit reversed a conviction, finding that evidence elicited from a defendant during a civil audit should be suppressed after the taxpayer’s consent was obtained by literally true, but “sneaky” and “shocking” assurance by an IRS revenue agent that no “special agent” was involved. *Id.* at 299-300. According to the court, this created the misimpression that the inquiry was for a civil, and not a criminal, matter. The Fifth Circuit held that a defendant’s consent to a search (during a civil audit or other proceeding) will be deemed invalid if it is induced by deceit, trickery, or misrepresentation about the nature of the inquiry.

In similar cases, claims of having been manipulated or misled by the Government have resulted in the dismissal of an indictment under circumstances where the Government made false promises to the detriment of the criminal defendants. *See, e.g., Bram v. United States*, 168 U.S. 532, 542-43 (1897); *United States v. Rutherford*, 39 F. App’x 574, 576 (9th Cir. 2002) (IRS agent was not required to provide *Miranda*-type warnings to individual under IRS investigation before questioning, therefore no Fifth Amendment violation); *United States v. Kontny*, 238 F.3d 815, 816-18 (7th Cir. 2001) (agent who stated that he was investigating allegations that taxpayer had failed to withhold payroll taxes, was conducting civil examination, and would refer matter for criminal investigation if fraud was discovered, did not obtain admissions through coercion or false promises); *United States v. Holloway*, 74 F.3d 249, 252-53 (11th Cir. 1996) (AUSA’s false promise in a civil deposition during civil forfeiture proceeding that witness would not be prosecuted required dismissal of later indictment of witness); *United States v. Rodman*, 519 F.2d 1058, 1059 (1st Cir. 1975) (indictment dismissed where subject of SEC investigation was induced to cooperate based on representation that SEC would make a strong recommendation against criminal prosecution and no such recommendation was made); *United States v. Carriles*, 486 F. Supp. 2d 599, 619, 620 (W.D. Tex. 2007) (indictment charging defendant with false statements in naturalization proceedings dismissed,

finding that naturalization interview was “a pretext for a criminal investigation” and the Government engaged in “fraud, deceit, and trickery” during the naturalization interview), *rev'd*, 541 F.3d 344 (5th Cir. 2008); *United States v. Rand*, 308 F. Supp. 1231, 1235 (N.D. Ohio 1970) (criminal case dismissed where it was based on testimony of subject at SEC trial induced by representation that there would be no criminal prosecution).

While agents and attorneys should be aware of and avoid potential *Tweel* problems, it is important to recognize that most courts have limited *Tweel* to situations involving an affirmative misrepresentation as to the scope or nature of the civil investigation. *See, e.g., United States v. Stringer*, 408 F. Supp. 2d 1083, 1092-93 (D. Ore. 2006), *vacated in part and rev'd in part*, 535 F.3d 929 (9th Cir. 2008); *United States v. Scrushy*, 366 F. Supp. 2d 1134, 1139 (N.D. Ala. 2005); *see also United States v. Carriles*, 541 F.3d 344, 355 (5th Cir. 2008). In cases finding a *Tweel* problem, the lower courts were convinced that the Government had improperly used civil process to develop evidence for the criminal cases and, in so doing, had violated the defendants’ constitutional rights and/or departed from the proper administration of justice. Courts have declined to extend *Tweel* to situations where the agent merely failed to apprise the subject of the possibility of criminal sanctions. In fact, no universal duty exists to advise a taxpayer that a related criminal investigation is taking place, and there are times when it would be detrimental to witnesses and the prosecution case to do so. *See, e.g., United States v. Rutherford*, 555 F.3d 190, 197-98 (6th Cir. 2009). That being said, it is wise to not be, and to caution your agents against being, too cute about the nature of the investigation or litigation, and to be forthcoming where appropriate when discussing the nature of an investigation with the person under investigation.

*Tweel* and later decisions on this issue stand for three propositions. First, during an audit or interview which is being conducted as part of a civil or criminal investigation, an agent or attorney should not engage in fraud, deceit, or trickery. Second, for fraud, deceit, or trickery to exist in this context, the agent or attorney would have to make an “affirmative representation,” or fail to answer an inquiry when there is a duty to speak, or where an inquiry left unanswered would be intentionally misleading. Third, the mere failure to warn a person that the investigation may result in criminal charges does not constitute fraud, deceit, or trickery.

As a practical matter, to avoid allegations of affirmative misrepresentations, an attorney or agent handling a parallel civil case may wish to begin interviews and depositions with introductory remarks or use the following responses to any inquiries about potential criminal investigations or charges:

- The questions I am asking you today are in connection with XYZ matter.
- A criminal investigation may or may not be underway. If I knew of the existence of a criminal investigation, I would not be at liberty to tell you about it.
- Were a criminal investigation underway now or opened later, any information I gather in connection with this civil matter can be shared with and used by a criminal investigator or prosecutor in a criminal investigation or prosecution.

Again, it is good practice to discuss with the prosecutor and the Civil/Criminal Coordinator how to address this issue, and whether the existence of a criminal investigation has been publically disclosed, prior to conducting an interview or deposition.

**Criminal discovery obligations:** Civil investigators and litigators must be mindful of prosecutors’ disclosure and discovery obligations. Witness interview notes, emails analyzing evidence including witness testimony, and the results of even casual Internet searches—while often considered non-disclosable attorney work-product in the civil context—may very well be disclosable in the parallel criminal proceeding under *Brady v. Maryland*, 373 U.S. 83, 89-90 (1963) (exculpatory information),

*Giglio v. United States*, 405 U.S. 150, 154-55 (1972) (to show bias or for impeachment), the Jencks Act, 18 U.S.C. § 3500 (witness statements), or Federal Rule of Criminal Procedure 16. Civil attorneys handling a parallel matter are advised to review DOJ policies on criminal discovery, compiled in the Attorney General’s March 27, 2012 memorandum titled, “Criminal Discovery Training & Resources.”

**Joint witness interviews:** Under appropriate circumstances, much may be gained if civil and criminal investigators conduct joint interviews of witnesses. The potential for *Tweel* violations is greatly reduced, there is less chance a witness interviewed multiple times will even inadvertently make inconsistent statements or be fatigued, and government resources are conserved. But the government participants must ensure that, if applicable, grand jury secrecy rules are followed, which may prevent a joint interview from occurring. If the interview proceeds, all notes of the interview should be preserved for production in criminal proceedings or in civil discovery. It may be good practice to agree beforehand that one agent will take notes and prepare a memorandum of the interview, for review by all participants.

This careful practice could avoid the problem highlighted in *United States v. Gupta*, 848 F. Supp. 2d 491, 497 (S.D.N.Y. 2012). In *Gupta*, the district court ruled that the prosecutor in an insider trading case had a *Brady* obligation to disclose memoranda that were prepared by the SEC attorney in a civil enforcement proceeding from notes taken during joint interviews of 44 witnesses conducted by both the SEC and United States Attorney’s office. During the joint interviews, questions were asked of the witnesses by both the SEC attorneys and the prosecutors, and the AUSA was consulted by SEC counsel during preparation of the memoranda. The court allowed that attorney work-product might be segregated and protected from disclosure, but litigation over such a disclosure issue is a preventable problem.

Similarly, the Second Circuit found an SEC misstep to have been preventable, and vacated a portion of a conviction for property fraud where prosecutors were aware of but failed to disclose transcripts of depositions that were taken pre-indictment in administrative proceedings before the SEC. *United States v. Mahaffy*, 693 F.3d 113, 130-33 (2d Cir. 2012). The failure to disclose violated *Brady* and warranted vacatur of defendants’ convictions for conspiracy to commit securities fraud. Although portions of the transcripts were consistent with the Government’s theory that “squawked” information was confidential, the testimony also harmonized with defendants’ theory that it was not, and should have been disclosed.

### C. Other concerns unique to parallel proceedings

Successful parallel proceedings require a bit more effort than litigation on one front, but they are a powerful law enforcement tool. Among other issues addressed here, Government counsel should:

- Appropriately coordinate investigative strategies and case theories, such as discussing what actions in a civil investigation might harm the criminal case, and discuss theories and alternative theories of liability or culpability. This practice is particularly important when entering into factual or legal stipulations and when crafting civil settlements, especially those based on alternative theories of liability.
- Ensure that each proceeding is used for its proper purpose. Prosecutors should not attempt to direct the civil case or “suggest” areas of inquiry in civil discovery, at the risk of having an indictment dismissed. See *United States v. Scrushy*, 366 F. Supp. 2d 1134, 1140 (N.D. Ala. 2005) (suppressing use of deposition testimony from SEC civil case in criminal prosecution where prosecutors were too involved with civil case). Civil investigators and litigators cannot act solely to develop a criminal case, but must have an independent basis for their discovery. See *United States v. Baisden*, 2010 WL 5606727, at \*9-11 (D. Neb. Dec. 17, 2010).

- Observe grand jury secrecy, tax confidentiality rules, protective orders, and orders sealing proceedings (see the discussion of information sharing, below).
- Comply with *Brady*, *Giglio*, Jencks Act, and Federal Rule of Criminal Procedure 16 obligations to disclose exculpatory evidence, evidence showing bias/motive of a witness, and witness statements.
- Properly communicate with parties/witnesses under criminal investigation. Properly identify yourself and your role in the proceeding and, if the Government has confirmed to the individual that he or she is under criminal investigation, you may wish to provide the individual with the warning about the use of testimony noted above in the civil case, to avoid problems highlighted by *Tweel*.
- Evaluate and minimize any adverse impact that civil discovery may have on the criminal case— that is, consider whether the civil case should be delayed or stayed pending completion of the criminal case, or whether you may need a protective order limiting the scope of discovery.
- Consider the ramifications of the civil defendant’s most common dilemma: asserting the Fifth Amendment privilege against self-incrimination and being forced to live with an adverse inference in the civil case, or waiving the privilege to protect interests in the civil case but risking self-incrimination.

Courts are sensitive to the dilemma faced when an individual is a defendant in a civil action but is also a target of a criminal investigation. They may go to great lengths to protect the defendant’s Fifth Amendment rights, even going so far as to purportedly grant the defendant use immunity in the civil action. For this reason, civil litigators should consider whether to forego discovery of the defendant (but not third parties). Although a court can manage discovery in its own cases, it is the exclusive province of the executive branch to grant use immunity. *United States v. Certain Real Property and Premises Known as 4003-4005 5th Ave., Brooklyn, N.Y.*, 55 F.3d 78, 83 (2d Cir. 1995); *Andover Data Services v. Statistical Tabulating Corp.*, 876 F.2d 1080, 1084 (2d Cir. 1989); *United States v. Payment Processing Ctr., LLC*, 443 F. Supp. 2d 728, 734 (E.D. Pa. 2006). If such immunity purportedly is granted, the civil litigator should consult his or her supervisor and the Civil/Criminal Coordinator to discuss how best to proceed. We may seek to modify or vacate such an order, or forgo discovery of the “immunized” witness altogether, to avoid complications to the criminal prosecution.

Attorneys litigating parallel civil and criminal cases should be mindful that there are risks for both the criminal prosecution and the civil action. Those risks include, but are not limited to the following:

- The risk that criminal targets will use civil discovery tools to obtain information not otherwise available in a criminal case (including information regarding the Government’s investigation, particularly if the investigation is not yet overt)
- The risk that the identities of confidential informants and cooperating witnesses will be revealed
- The risk that the prosecution team may be exposed to information that it should not receive under the applicable rules of professional conduct or other laws
- The risk of disclosure of information protected by governmental privileges, including the law enforcement privilege and deliberative process privilege, and

- The risks that civil litigation files may contain exculpatory or impeachment evidence that criminal prosecutors could be required to turn over, or may contain information obtained through administrative or disciplinary proceedings to which criminal prosecutors should not be exposed under *Garrity v. New Jersey*, 385 U.S. 493, 509-10 (1967).

One way to mitigate these risks is to delay filing, or seek a stay in a filed civil action. Either course will require communication with the criminal investigators or, if the matter has been referred to DOJ, the prosecutor. The litigators should have a frank and open discussion about the timeline of each proceeding, the risks presented with both going forward on parallel tracks and staying one proceeding, and ideas for balancing the Government's interests, within the constraints of § 6103 and the prohibitions on disclosure of grand jury information.

#### **D. Stay of civil proceedings**

As noted in the section above, one of the most common questions in parallel proceedings is whether to seek a stay of the civil proceeding in deference to the criminal proceeding. Courts possess inherent power to manage their cases, and have discretion to impose a stay. In general, while denial of a stay may be reviewable on appeal for abuse of discretion, granting a stay is not reviewable. *Microfinancial, Inc. v. Premier Holidays Int'l Inc.*, 385 F.3d 72, 77 (1st Cir. 2004); *Acton Corp. v. Borden, Inc.*, 670 F.2d 377, 380 (1st Cir. 1982). A good discussion of the facts to consider in seeking a stay is found in the Second Circuit's decision in *Louis Vuitton Malletier S.A. v. LY USA, Inc.*, 676 F.3d 83, 99 (2d Cir. 2012); *see also, e.g., Sec. and Exch. Comm'n v. Trujillo*, 2010 WL 2232388, at \*1 (D. Colo. June 1, 2010); *In re WorldCom, Inc.*, 2002 WL 31729501, at \*3-5 (S.D.N.Y. Dec. 5, 2002). In general, courts consider:

- The extent of the overlap between the two cases
- The status—Has there been an indictment? Is civil trial imminent?
- The public's and the court's interest in expeditious resolution of the civil case versus the potential for prejudice to, and the burden on, the criminal defendant
- Interests of non-parties, and
- Whether the Government is a party and, if so, potential harm to the enforcement, undercover operatives, agents, and witnesses.

Many of these same factors need to be evaluated in determining whether to seek entry of a protective order limiting the scope or use of discovery in the civil case. *See Martindell v. Int'l Tel. & Tel. Corp.*, 594 F.2d 291, 295-97 (2d Cir. 1979). Ask yourself, would the defendant gain an improper preview of his criminal case through civil discovery? Would witnesses be harmed or intimidated? Would the plea negotiation process be impaired? Does the public's interest or the court's need for expeditious resolution outweigh prejudice to the taxpayer? The Government plaintiff seeking a stay or protective order in a civil case needs to demonstrate how continued discovery will harm the criminal case, perhaps with a declaration filed by the prosecution under seal that shows the potential for witness intimidation, manufacture of evidence, or danger to a confidential informant.

Criminal defendants sometimes seek a stay or protective order in a parallel civil enforcement action against them in order to avoid a common dilemma: assert their Fifth Amendment privilege against self-incrimination to protect them in the criminal prosecution, but risk an adverse inference in the civil case, or testify to protect their interest in a civil case and risk self-incrimination. This concern arguably is higher where the criminal defendant bears the burden of proof in the civil case, such as a claimant in a

civil forfeiture action. Still, the stay or protective order may be denied if, for example, the public interest in preserving the public treasury by halting an abusive tax avoidance scheme is deemed to outweigh a potential risk of incrimination when there has been no indictment, or where the defendant has used the privilege to avoid discovery, but desires to waive the privilege at the eleventh hour to testify at trial. *See, e.g., United States v. Certain Real Property and Premises Known as 4003-4005 5th Ave., Brooklyn, N.Y.*, 55 F.3d 78, 84-85 (2d Cir. 1995). In a recent case, the Second Circuit found that a defendant's request for a stay of a civil action was properly denied, despite invocation of the Fifth Amendment, where the civil defendants' rights, pre-indictment, were not unduly prejudiced. *Louis Vuitton*, 676 F.3d at 101-02.

Two items are important to note. First, a civil protective order may not prevent issuance of, and compliance with, a later grand jury subpoena. *E.g., In re Grand Jury*, 286 F.3d 153, 160 (3d Cir. 2002); *In re Grand Jury Subpoena*, 945 F.2d 1221, 1224-25 (2d Cir. 1991) (Government must move for order allowing grand jury subpoena in face of civil protective order, showing extraordinary circumstances justifying need). Defendants' counsel may well want to advise their clients of this twist. Second, the court seeking to preserve a defendant's Fifth Amendment privilege cannot go so far as to essentially order the Government to grant the defendant immunity from prosecution. Such an order invades the province of the executive branch and flies in the face of effective parallel proceedings. *See, e.g., Andover Data Services v. Statistical Tabulating Corp.*, 876 F.2d 1080, 1084 (2d Cir. 1989).

Be mindful of the fact that the IRS typically halts a civil examination of a taxpayer once a revenue agent finds firm indicia of fraud and refers the matter for criminal investigation. Accordingly, if the criminal investigation is expected to be lengthy, the IRS civil examiner may need to seek the taxpayer's consent to extend the statute of limitations for assessment of the tax unless the applicable limitations period remains open due to an attempt to evade tax. *E.g.*, 26 U.S.C. § 6501(c)(2) (2012). This situation could tip off the taxpayer to the existence of a criminal investigation, so if the Government prefers to keep the criminal investigation covert, civil/criminal coordination is needed to ensure both matters are proceeding in a timely fashion.

Suspending a civil investigation is not the general rule where the IRS is investigating ongoing promoters of tax-avoidance schemes or unscrupulous tax return preparers for a referral for possible civil injunction, where there is a significant risk of harm. Rather, under IRS Policy Statement P-4-26, the general rule is that the civil and criminal investigations of promoters and preparers will continue on parallel tracks. *See* INTERNAL REVENUE SERVICE, INTERNAL REVENUE MANUAL P-4-26 (2005).

## **E. Effective use of parallel proceedings in tax cases**

The Tax Division strongly encourages using both civil injunctions and criminal proceedings against fraudulent tax return preparers and promoters of abusive tax avoidance schemes, where it is in the best interest of overall law enforcement. DEP'T OF JUSTICE, CRIMINAL TAX MANUAL 13.11 (2013), available at <http://www.justice.gov/tax/readingroom/2008ctm/CTM%20Chapter%2013.pdf>. To the extent that the civil injunction case is ready to proceed, generally it should go first (as long as that process would not impair the criminal investigation). Civil injunctions enable the DOJ to put fraudulent return preparers and scheme promoters out of business as fast as it can develop the cases to do so. These injunctions are no bar to a subsequent criminal prosecution.

In cases involving charges against fraudulent tax return preparers who are actively preparing returns, attorneys are advised to seek a preliminary injunction, under 26 U.S.C. §§ 7402 and 7407, upon the filing of the complaint, or very soon thereafter. Under § 7407(b), if the district court finds that a tax return preparer has:

- Engaged in any conduct subject to penalty under § 6694 or § 6695, or subject to any

criminal penalty provided by the Code

- Misrepresented his or her eligibility to practice before the Internal Revenue Service, or otherwise misrepresented his or her experience or education as a tax return preparer
- Guaranteed the payment of any tax refund or the allowance of any tax credit, or
- Engaged in any other fraudulent or deceptive conduct which substantially interferes with the proper administration of the Internal Revenue laws

and that injunctive relief is appropriate to prevent the recurrence of such conduct, the court may enjoin such person from further engaging in such conduct (a “specified conduct” injunction). If the court finds that a tax return preparer has continually or repeatedly engaged in any such offensive conduct and a specified conduct injunction would not be sufficient to stop the behavior, the court may enjoin the preparer from acting as a tax return preparer altogether. Injunctive relief also may be obtained under 26 U.S.C. § 7408 against those who promote unlawful tax shelters and other abusive tax-avoidance schemes.

Courts consider the following factors to determine whether a permanent injunction is needed: (1) the gravity of the harm caused by the offense, (2) the extent of the defendant’s participation, (3) the defendant’s degree of scienter, (4) the isolated or recurrent nature of the infraction, (5) the defendant’s own recognition or non-recognition of his or her own culpability, and (6) the likelihood that the defendant’s occupation would place him or her in a position where future violations could be anticipated. *See, e.g., United States v. Benson*, 561 F.3d 718, 724 (7th Cir. 2009); *United States v. Gleason*, 432 F.3d 678, 683 (6th Cir. 2005).

If a fraudulent tax return preparer or promoter already is out of business and there is little or no likelihood of recurrence, then the Government’s goals are to punish the individual and deter others, so an injunction may not be necessary. This situation may result when, for example, the criminal sentence is lengthy and conditions of supervised release include a prohibition on return preparation or scheme promotion. But where there is a substantial likelihood that the preparer or promoter will resume his misconduct after completion of his criminal sentence, or an indication that the individual will continue to encourage or have some “supervisory” role in the unlawful business, it may be appropriate to seek a civil injunction, even post-conviction.

Because a primary purpose of law enforcement is deterrence, civil attorneys and prosecutors are encouraged to publicize our civil and criminal efforts to combat tax fraud, either through the public affairs offices of United States Attorneys’ offices or the Office of Public Affairs at the Department of Justice.

Where criminal tax charges against a fraudulent tax return preparer are resolved by guilty plea *before* entry of a civil injunction, it is good practice to include a provision in the plea agreement by which the defendant agrees to be permanently enjoined from preparing or filing federal tax returns on behalf of third parties. (The injunction must be obtained by initiating a separate civil action against the defendant.) A criminal defendant can promise as part of a plea agreement never to prepare returns for third parties again, but that creates only a contract. Once the defendant’s period of incarceration, supervised release, and/or probation have ended, the contract, if violated, is enforceable only by bringing a civil suit against the defendant. An injunction, on the other hand, is permanent. If it is violated, the Government does not have to sue to enforce a contract. Rather, the Government can go straight to civil contempt proceedings to force compliance with the injunction or to a criminal contempt prosecution to punish the violation.

The IRS and the Tax Division have worked together for many years to obtain similar injunctions against preparers pleading guilty to crimes. Language in a plea agreement indicating the defendant’s consent to the injunction facilitates the Government’s ability to obtain a permanent injunction and, in



most cases, requires minimal additional effort on behalf of the prosecutor. As explained in the Criminal Tax Manual, it is good practice to include such language in every plea agreement, unless there is a very compelling reason not to pursue this parallel civil relief. We suggest that the following language be included in the plea agreement:

Defendant agrees, as part of this plea agreement, to be permanently enjoined under Sections 7402 and 7407 of the Internal Revenue Code (26 U.S.C.), from preparing or filing federal tax returns for anyone other than himself/herself. Defendant understands that the United States will file a civil complaint against him/her seeking this relief, and agrees not to oppose such relief.

Ideally, the prosecutor will incorporate a sample injunction into the plea agreement. To use such a provision, the prosecutor must coordinate with the Small Business, Self-Employed (SBSE) Group, or other applicable group within the IRS Examination Division, and the appropriate Tax Division civil trial section. Coordination with these entities will allow SBSE to make a quick injunction referral and the Tax Division to draft the complaint and the consent injunction, which will serve as an exhibit to the plea agreement. Similar language can be crafted for plea agreements with promoters of abusive tax shelters. Although using a plea agreement to lay the groundwork for prompt resolution of an injunction case is encouraged, prosecutors are cautioned that the DOJ generally prefers that full settlement of the merits of a criminal defendant's civil tax liability be postponed until after sentence has been imposed. DEP'T OF JUSTICE, CRIMINAL TAX MANUAL 5.01 (2012), *available at* <http://www.justice.gov/tax/readingroom/2008ctm/TaxManual2012.pdf>. The prosecutor or Special Agent should notify the IRS that it may resume the civil examination after sentencing, and should highlight whether restitution has been imposed, so that assessment and collection of the restitution properly may be coordinated.

Except in the most extraordinary circumstances, the Tax Division will not approve a plea agreement that includes a global settlement of a defendant's criminal and civil tax liabilities. The Tax Division also will not authorize any plea agreement that purports to bar the IRS from a further examination of the defendant's civil tax liabilities. But as explained more fully in the Criminal Tax Manual, the Tax Division strongly encourages prosecutors to include in plea agreements admissions by the defendant regarding civil tax issues, such as:

- An admission of either the receipt of enumerated amounts of unreported income or enumerated amounts of claimed illegal deductions or improper credits for specified years in issue
- A stipulation that the defendant is liable for the civil fraud penalty imposed by 26 U.S.C. § 6663 on the understatements of tax for the years involved (This situation may be a crucial admission. Without it, the defendant may be able to avoid the payment of not only the civil fraud penalty, but the underlying tax liability as well, if the Tax Court or district court having jurisdiction over the civil trial ultimately determines that the statute of limitations for civil tax liability has lapsed.)
- An agreement by the defendant to file, prior to sentencing, complete and correct initial or amended tax returns for the years in issue and, if requested, to provide the IRS with information regarding these years, and pay all additional taxes, penalties, and interest due and owing at sentencing
- An agreement by the defendant not to file thereafter any claims for a refund of taxes, penalties, or interest for amounts attributable to the returns filed incident to the plea, and
- An agreement by the defendant to sign a closing agreement with the IRS

contemporaneously with the signing of the plea agreement, allowing the IRS to assess and collect enumerated amounts of tax due and owing for specified years in issue. (Before this term is included in a plea agreement, the prosecutor must confirm that the IRS is agreeable to signing a closing agreement with the defendant.)

#### **IV. Sharing information**

Taking into account the overriding requirement that civil and criminal processes be used for proper purposes, and mindful of other disclosure constraints, information obtained as the result of legitimate civil or criminal investigations or proceedings may be shared between criminal and civil agents and attorneys. To maximize appropriate sharing, criminal investigators and prosecutors should consider developing as much evidence as possible before the grand jury is used, where appropriate. For example, witness interviews, undercover operations, surveillance, trash runs, administrative summonses, search warrants, and publicly available information generally may be used to develop evidence prior to the use of the grand jury, and thus may be shared with civil counterparts. Specific limitations on and requirements for developing and sharing evidence are discussed below.

##### **A. Grand jury information**

Federal Rule of Criminal Procedure 6(e) prohibits the disclosure of “matters occurring before the grand jury” to civil agents and attorneys, unless a court order is obtained. Information which is *not* deemed to be “matters occurring before the grand jury” may be disclosed. *There is uncertainty in this area of the law, and the law differs from circuit to circuit. Care should be taken to review the law of the jurisdiction and act in accordance therewith.*

The phrase “matters occurring before the grand jury” is not defined in the rule. Courts have interpreted Rule 6(e) as including information revealing: that a person is the target of a grand jury investigation, the strategy or direction of the investigation, the nature of the evidence produced to the grand jury, the views expressed by members of the grand jury, transcripts of grand jury testimony, and things that actually occurred before the grand jury.

Practically speaking, although the identities of witnesses subpoenaed by or appearing before the grand jury are grand jury matters, the majority view is that Government memoranda of witness interviews conducted prior to serving the witness with a grand jury subpoena are not grand jury matters, even if the statements contained in such memoranda are later reported to the grand jury by the Government attorney, or are repeated to the grand jury by the witness. Similarly, although an affidavit or declaration in support of a search warrant may contain grand jury information, and thus may not be disclosed to civil counsel, in many cases the documents and information obtained through the search warrant may be shared. In many jurisdictions, documents produced pursuant to a grand jury subpoena are not considered matters occurring before the grand jury if they are sought only for the information they contain and do not reveal the direction or strategy of the grand jury investigation. Thus, prosecutors may be able to disclose the general nature of their investigation and documents obtained during the pendency of a grand jury investigation, but they cannot disclose the identities of witnesses appearing before the grand jury or their grand jury testimony.

Prosecutors are advised to review the law on grand jury secrecy in their judicial circuit, and discuss any concerns with their supervisor. United States Attorneys’ Manual § 9-11.250, and Criminal Resource Manual § 156 (*available at* [http://www.justice.gov/usao/eousa/foia\\_reading\\_room/usam/title9/crm00156.htm](http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/crm00156.htm)) also provide useful resources, as does Tax Resource Manual 22 (*available at* [http://www.justice.gov/usao/eousa/foia\\_reading\\_room/usam/title6/tax00022.htm](http://www.justice.gov/usao/eousa/foia_reading_room/usam/title6/tax00022.htm)). The limitation on

disclosure of matters occurring before a grand jury will likely mean that, in coordinating parallel proceedings, civil attorneys and agents will provide most of the information about their case. Separate discussions with the Civil/Criminal Coordinator outside the presence of the civil attorneys may be useful in determining whether and what disclosures are appropriate in a given case.

When disclosure of grand jury matters is sought for purposes of *using* the information in the civil matter, a court order permitting such disclosure must be obtained beforehand. A court will permit disclosure under these circumstances only if the Government meets the exception requirements set forth in Rule 6(e)(3)(E), that the disclosure is “preliminarily to or in connection with a judicial proceeding” and a particularized need for the requested material has been shown. *See United States v. Sells Eng’g Inc.*, 463 U.S. 418, 443 (1983). It is advisable to coordinate with the prosecutor, who can file an appropriate memorandum under seal describing the grand jury investigation and supporting the limited disclosure.

## **B. Search warrant materials**

Search warrants are one method of obtaining evidence necessary for the criminal case. The search warrant must be “conceived and initiated” for appropriate purposes. Its scope must pertain to information necessary for the criminal case. If the scope of a warrant is broadened to obtain evidence needed only for the civil case, it is likely that defendants will argue, and courts may find that the Government has abused the search warrant process by gathering evidence needed for the civil, but not the criminal, case. A few courts have acknowledged the propriety of sharing search warrant information absent a showing of bad faith, an abuse of process, or grand jury disclosure limitations. As noted above, be mindful that, although the materials gathered pursuant to a search warrant generally may be shared with civil attorneys, often the affidavit or declaration submitted in support of the request for a search warrant contains information that would reveal matters occurring before a grand jury and should not be shared.

## **C. Section 6103 disclosures**

Section 6103 of the Internal Revenue Code protects all returns and return information collected or gathered by the IRS from unauthorized disclosure. Under 26 U.S.C. § 6103(h)(3), the IRS is permitted to disclose returns and return information to DOJ if the IRS has referred a matter of tax administration to DOJ under § 6103(h)(2). Additionally, the Assistant Attorney General can make a written request for the information for a tax administration purpose.

As our guidance on parallel proceedings explains, the disclosure provisions are not intended to be an impediment to the Government’s ability to use all tools available for effective law enforcement. But disclosures within the DOJ must be made in accordance with § 6103(h) and Treasury Regulation 26 C.F.R. § 6103(h)(2)-1(a) and (b). *See* DEP’T OF JUSTICE, TAX RESOURCE MANUAL 22 (2007), *available at* [http://www.justice.gov/usao/eousa/foia\\_reading\\_room/usam/title6/tax00022.htm](http://www.justice.gov/usao/eousa/foia_reading_room/usam/title6/tax00022.htm). This means, for example, that prosecutors may disclose returns and return information to seek information from, or confer with, DOJ civil attorneys and employees in connection with handling the criminal case or coordinating the civil and criminal matters. Similarly, DOJ attorneys and employees who are assigned to handle a civil injunction matter referred by the IRS may disclose returns and return information to seek information from, or confer with, DOJ criminal section attorneys and employees in connection with handling the civil injunction case or coordinating the civil and criminal matters. Typically, broad disclosure of returns and return information obtained from the IRS should be made in consultation with IRS Counsel. *See id.*

## **D. Case strategy and theories**

When pursuing parallel proceedings, it is important to consider the best overall law enforcement strategy for the case and to make sure that the Government's theories in the civil and criminal cases are consistent. It may be useful for attorneys to discuss and coordinate, where appropriate, the timing of actions so as to maximize the Government's effectiveness and avoid or minimize harm to any of the proceedings. For instance, overt actions in a civil case should be delayed until undercover operations and/or surveillance are completed and search warrants are executed. Attorneys also may find it useful to review drafts of pleadings to be filed (complaints, motions for summary judgment, discovery responses, and indictments/information) and proposed settlements (particularly if based on alternative legal theories), subject to any limitations on disclosure.

## **E. Use of process for proper purposes**

An overarching principle that must be followed in parallel proceedings is the use of each process for proper purposes. Agents and attorneys may conduct investigative and litigation-related tasks when justified by genuine case purposes. Civil processes may not be used as a pretext to obtain information for a criminal investigation and criminal processes may not be used as a pretext to obtain information for a civil investigation. A defendant may attack the Government's pursuit of parallel proceedings by arguing that civil and criminal agents and/or attorneys have misused their processes. To meet allegations of improper use of process, civil and criminal agents and attorneys should keep adequate records of the decisions made and their independent reasons for those decisions. Agents and attorneys should carefully document the source and timing of evidence gathered (search warrant, grand jury subpoena, inspector general subpoena, foreign treaties, etc.).

## **F. Criminal discovery and disclosure obligations**

Civil *and* criminal agents and attorneys must be aware of potential *Brady*, *Giglio*, Jencks Act, and Federal Rule of Criminal Procedure 16 discovery obligations in criminal proceedings. Among other things, at the request of the defendant, the Government must disclose and make available various statements made by the defendant at different times, a copy of the defendant's prior record, certain documents and tangible objects that are material to the preparation of the defendant's defense or that the Government intends to use at trial as evidence in its case in chief, reports of various examinations and tests, and a summary of expert witness testimony, opinion, bases and reasons for the opinion, and qualifications.

*Brady*, *Giglio*, and DOJ policy require that the Government disclose exculpatory and impeachment evidence to the defendant when such evidence is material to guilt or punishment, regardless of whether a request is made. For *Brady* and *Giglio* purposes, the definition of "prosecutor" or "government" encompasses agents as well as the attorneys on the prosecution team. Thus, even if a prosecutor does not have actual knowledge, the Government most likely will be required to disclose information known to an agent. Under these cases, therefore, attorneys and agents should assume that criminal prosecutors are obligated to disclose information known to agents and attorneys who are working on a parallel civil case, particularly if they are communicating frequently and sharing information. Additionally, under the Jencks Act, criminal attorneys are obligated to disclose statements of witnesses that are in the Government's possession, after the Government has called those witnesses to testify in the criminal trial. This requirement would include statements contained in both criminal and civil case files.

## G. Civil discovery and trial disclosures

A civil injunction proceeding often goes forward before the criminal investigation is completed and an indictment sought. In such circumstances, attorneys and agents should consider the impact of civil discovery on the criminal investigation and prosecution. Discovery under the Federal Rules of Civil Procedure is permitted earlier in the proceedings and is broader than the discovery permitted under the Federal Rules of Criminal Procedure. Initial disclosures of documents that a party “may use to support its claims or defenses” are required under Federal Rule of Civil Procedure 26(a)(1). Criminal defendants may attempt to use the liberal civil discovery rules to learn information about the Government’s criminal case that they would not otherwise obtain or that they would ordinarily not obtain until closer to trial.

Civil attorneys should engage in civil discovery in a way that minimizes harm to the criminal case. There are several ways to meet civil discovery obligations when parallel proceedings are pending. First, if the Government does not plan to use information in criminal investigative files, that information need not be provided in the Rule 26(a)(1) initial disclosures. Second, if necessary, the Government can move the civil court for a Rule 26(c) protective order limiting the defendant’s discovery in the civil case in order to prevent a criminal defendant from circumventing limitations on discovery in criminal cases. Third, if the court is unwilling to enter a protective order, the Government could seek a stay of the civil action pending resolution of the criminal case. Finally, as a last recourse, and assuming there is no issue with a civil statute of limitations expiring, the Government can seek to dismiss the civil case without prejudice. This latter course is appropriate only where it is clear that turning over information from the criminal investigation in civil discovery will substantially prejudice the criminal case and the criminal prosecution is more important than stopping the offensive conduct quickly through an injunction.

In addition to the issues raised by discovery in the civil proceeding, the Government will be disclosing witnesses, exhibits, and other evidence in connection with filing dispositive motions or preparation for hearings or trial. Disclosure of the Government’s evidence may result in the defendant’s attempting to contact or intimidate witnesses, or attempting to destroy or manufacture evidence. Assuming the civil case proceeds first, the defendant will have an opportunity to preview and counter at least some of the Government’s theories and evidence before he or she proceeds to the criminal trial. These concerns merely highlight the need for coordination and discussion about how best to proceed—or not—with parallel proceedings.

## V. Conclusion

Parallel proceedings present additional challenges, but the benefits gained by coordinated efforts to punish and deter wrongdoers through effective criminal prosecutions, civil monetary recoveries, and injunctions can be worth the extra effort when the risks are properly considered. The Tax Division continues to examine when and how to conduct parallel proceedings. Please consult the Tax Division’s Web page for the latest guidance on this powerful tool for comprehensive tax enforcement. ❖

### ABOUT THE AUTHOR

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# Restitution-Based Assessments Pursuant to 26 U.S.C. § 6201(a)(4)

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## I. Introduction

On August 16, 2010, 26 U.S.C. § 6201(a)(4) was enacted. This provision gives the IRS a statutory mandate to administratively assess and collect restitution ordered in criminal tax cases. The statute provides that (1) the IRS “shall assess and collect the amount of restitution” imposed for failure to pay any tax imposed by Title 26 “in the same manner as if such amount were such tax,” (2) the assessment and collection shall be made after the criminal case is final, and (3) the amount of the restitution-based assessment may not be challenged in any proceeding authorized by Title 26.

We will begin with a general overview of restitution in criminal tax cases before turning to the effects of 26 U.S.C. § 6201(a)(4) and the steps that prosecutors and Financial Litigation Unit (FLU) attorneys can take to facilitate the collection of restitution in criminal tax cases.

## II. Overview of restitution in criminal tax cases

The authority to impose restitution in a criminal case is statutory. Courts have no inherent power to order restitution. *See, e.g., United States v. Hensley*, 91 F.3d 274, 276 (1st Cir. 1996); *United States v. Helmsley*, 941 F.2d 71, 101 (2d Cir. 1991). The source of a court’s authority to order restitution in a criminal tax case varies depending on the circumstances of the case.

The simplest case arises when a defendant agrees to pay restitution as part of a plea agreement. District courts may order restitution in criminal tax cases “to the extent agreed to by the parties in a plea agreement.” 18 U.S.C. § 3663(a)(3) (2012). Accordingly, a defendant can agree to pay restitution to any victim in an amount exceeding the counts of conviction, and the sentencing court can order the restitution as part of the sentence.

Restitution is mandatory in criminal tax cases involving violations of Title 18, such as a conspiracy to defraud the United States, in violation of 18 U.S.C. § 371, or filing a false claim, in violation of 18 U.S.C. § 287. *See* 18 U.S.C. § 3663A(c)(1)(A)(ii) (2012). In such cases, the court must order restitution as part of the sentence, but the amount of restitution is limited to the loss resulting from the count(s) of conviction. *See, e.g., United States v. Gray*, 337 F. App’x 365, 368 (4th Cir. 2009) (vacating restitution order that included loss from relevant conduct); *United States v. Inman*, 411 F.3d 591, 595 (5th Cir. 2005) (vacating restitution order when it included loss resulting from conduct that was beyond the scope of the count of conviction).

In cases involving criminal violations of Title 26, the sentencing court may not order restitution as part of the sentence, but may order restitution as a condition of supervised release or probation. 18 U.S.C. §§ 3556, 3563(b), 3583(d) (2012). Restitution in Title 26 cases is discretionary. Again, unless the defendant has agreed to pay more as part of a plea agreement, restitution is limited to the loss resulting from the counts of conviction. *See, e.g., United States v. Amason*, 318 F. App’x 442, 443-44 (8th Cir.

2009) (vacating restitution order when it included relevant conduct); *United States v. Nolen*, 523 F.3d 331, 332-33 (5th Cir. 2008) (restitution that exceeded the loss resulting from the count of conviction was plain error); *Gall v. United States*, 21 F.3d 107, 110-11 (6th Cir. 1994) (restitution ordered as a condition of supervised release is limited to loss resulting from count of conviction).

The IRS is the victim in all criminal tax cases and thus is the recipient of restitution payments. Before the enactment of 26 U.S.C. § 6201(a)(4), the IRS had no independent ability to collect restitution payments from defendants. The Department of Justice, specifically the Financial Litigation Units (FLUs) in United States Attorneys' offices, is responsible for enforcing restitution orders. *See* 18 U.S.C. §§ 3613, 3664(m) (2012).

Restitution compensates victims for the actual loss resulting from the offense conduct. 18 U.S.C. § 3663(a)(1)(A) (2012). Accordingly, in criminal tax cases, the government must prove the loss suffered by the IRS as a result of the defendant's crimes. But restitution does not allow for double recovery. *See United States v. Ruff*, 420 F.3d 772, 773-76 (8th Cir. 2005); *United States v. Nucci*, 364 F.3d 419, 423-24 (2d Cir. 2004). Thus, the IRS must give the defendant credit on the civil tax debt for any restitution payments and may not attempt to collect civilly on debts that the defendant fully paid as part of a restitution order. *Helmsley*, 941 F.2d at 102.

For more information about restitution in criminal tax cases, see Chapter 44 of the [Criminal Tax Manual](http://www.justice.gov/tax/readingroom/2008ctm/CTM%20Chapter%2044%20Restitution.pdf), available at <http://www.justice.gov/tax/readingroom/2008ctm/CTM%20Chapter%2044%20Restitution.pdf>. For more information about restitution generally, see EOUSA's Prosecutor's Guide to Criminal Monetary Penalties.

### **III. The impact of 26 U.S.C. § 6201(a)(4)**

The statute authorizing restitution-based assessments gives the IRS a powerful new tool to collect restitution ordered in a criminal tax case after August 16, 2010. The statute applies both when restitution is ordered as part of the sentence (in Title 18 and plea agreement cases) and when restitution is ordered as a condition of supervised release or probation (in Title 26 cases). *See* IRS Chief Counsel Notice, CC-2011-018 (Aug. 26, 2011) at 2-3, available at 2011 WL 3860658. The statutory language makes clear that the IRS *must* both assess and collect restitution: "The Secretary *shall* assess and collect the amount of restitution . . . for failure to pay any tax imposed under this title in the same manner as if such amount were such tax." 26 U.S.C. § 6201(a)(4)(A) (2012) (emphasis added). Thus, the IRS lacks the discretion to assess or collect less than the amount of restitution ordered in the criminal case. In addition, the defendant may not challenge the amount of the restitution-based assessment in any proceeding authorized by Title 26. *Id.* § 6201(a)(4)(C). In order to provide notice to defendants and district judges of the IRS's ability to assess and collect restitution, we recommend including language describing 26 U.S.C. § 6201(a)(4) in all plea agreements and sentencing memoranda. Our recommended language is included at the end of this article (*see* "Important Steps for Prosecutors to Take When Seeking Restitution in Criminal Tax Cases") and in the sample plea available in the [Tax Resource Manual](http://www.justice.gov/usao/eousa/foia_reading_room/usam/title6/tax00019.htm), available at [http://www.justice.gov/usao/eousa/foia\\_reading\\_room/usam/title6/tax00019.htm](http://www.justice.gov/usao/eousa/foia_reading_room/usam/title6/tax00019.htm).

### **IV. The importance of accurate, detailed restitution orders in criminal tax cases**

Because the IRS cannot alter, and the defendant cannot subsequently challenge, the amount of a restitution-based assessment, it is vital that the restitution order reflect the most accurate possible calculation of the loss to the IRS caused by the count(s) of conviction. If the calculations are particularly difficult or complex, 18 U.S.C. § 3664(d)(5) provides that the court may determine the amount of restitution up to 90 days after the sentencing hearing. After the district court enters its restitution order,



there are very limited circumstances in which the restitution order can be modified. *See* 18 U.S.C. § 3664(o) (2012). Accordingly, prosecutors should work closely with IRS special agents to determine the correct restitution amount. Note that the restitution amount will often differ from the tax loss amount under the United States Sentencing Guidelines. Tax loss under the Guidelines includes a defendant's relevant conduct and encompasses the total intended loss. *See* U.S. SENTENCING GUIDELINES §§ 1B1.3, 2T1.1 (2012). In contrast, restitution is limited to the actual loss resulting from the count(s) of conviction, unless the defendant agrees otherwise in a plea agreement. Courts have refused to order restitution in cases in which the government has only provided a rough estimate of the loss for restitution purposes, so prosecutors should strive to present as precise a figure as possible when seeking restitution. *See, e.g., United States v. Beydoun*, 469 F.3d 102, 107-08 (5th Cir. 2006) (vacating restitution order when district court used restitution figure that amounted to a "goal or a target" rather than actual loss); *United States v. Hirmer*, 767 F. Supp. 2d 1305, 1312-14 (N.D. Fla. 2011) (refusing to order restitution when government argued that IRS was entitled to 20 percent of defendants' gross receipts rather than providing a calculation of the actual loss caused by the scheme).

Because the IRS must give defendants credit for restitution payments, restitution orders should include a detailed breakdown of the loss amount that includes the loss attributable to each tax year at issue, the type of tax involved, and the names of any relevant entities or third parties. A sample restitution order is available in Section 21 of the Tax Resource Manual ([http://www.justice.gov/usao/eousa/foia\\_reading\\_room/usam/title6/tax00021.htm](http://www.justice.gov/usao/eousa/foia_reading_room/usam/title6/tax00021.htm)).

## **V. Collecting restitution in criminal tax cases**

For restitution orders entered after August 16, 2010, both the IRS and the FLUs have the ability to collect restitution: the FLUs can collect on the restitution order itself, *see* 18 U.S.C. §§ 3613, 3664(m) (2012), while the IRS can collect on the restitution-based assessment. The IRS cannot assess restitution "before all appeals of such order are concluded and the right to make all such appeals has expired." 26 U.S.C. § 6201(a)(4)(B) (2012). But 26 U.S.C. § 6501(c)(11) provides that the IRS may begin efforts to collect the restitution amount before an assessment is made. The FLUs may begin collection efforts as soon as the restitution order takes effect, and the FLUs retain the ability to collect restitution after the IRS has assessed. In order to avoid duplicative efforts, FLU attorneys should coordinate with the IRS before beginning collection in a criminal tax case.

Courts often impose a restitution payment schedule on defendants. The government's position is that if a defendant can afford to pay more than the payment schedule requires, then a defendant's compliance with such a schedule does not prevent either the FLU or the IRS from undertaking additional collection efforts. It nonetheless may be wise to seek a modification of the payment schedule from the court, pursuant to 18 U.S.C. § 3664(k), before attempting to collect more than the payment schedule requires.

## **VI. Important steps for prosecutors to take when seeking restitution in criminal tax cases**

- Ensure that the restitution amount is based on actual loss to the IRS caused by the count(s) of conviction.
- Provide the court with a detailed breakdown of the restitution loss figure that includes the tax years at issue, the type of tax involved, and the names of any relevant entities or third parties. Ensure that the court includes as much detail as possible in the restitution order itself.

- In order to provide notice of the IRS's ability to collect the amount of restitution both to defendants and to district courts, please add the following language to all sentencing memoranda and plea agreements:

If the Court orders the defendant to pay restitution to the IRS for the failure to pay tax, either directly as part of the sentence or as a condition of supervised release, the IRS will use the restitution order as the basis for a civil assessment. *See* 26 U.S.C. § 6201(a)(4). The defendant does not have the right to challenge the amount of this assessment. *See* 26 U.S.C. § 6201(a)(4)(C). Neither the existence of a restitution payment schedule nor the defendant's timely payment of restitution according to that schedule will preclude the IRS from administrative collection of the restitution-based assessment, including levy and distraint under 26 U.S.C. § 6331.

- Provide the court with the correct address for IRS restitution payments:

IRS – RACS  
Attn: Mail Stop 6261, Restitution  
333 W. Pershing Ave.  
Kansas City, MO 64108

- Remember that for Title 26 offenses restitution is discretionary and can only be ordered as a condition of supervised release or probation. For Title 18 offenses, restitution is mandatory. The defendant can agree to pay any amount as restitution as part of a plea agreement.
- Make use of the sample plea agreement and sample restitution orders available in the Tax Resource Manual at Sections 19, 20, and 21, *available at* [http://www.justice.gov/usao/eousa/foia\\_reading\\_room/usam/title6/tax00018.htm](http://www.justice.gov/usao/eousa/foia_reading_room/usam/title6/tax00018.htm). ❖

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# Terrorism Tax Evasion: Using Criminal Tax Charges to Combat the Use of Charities in Terrorism Financing

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In the Final Report of the National Commission on Terrorist Attacks Upon the United States (9/11 Commission Report), the Commission noted that, contrary to widespread belief, Usama Bin Laden funded al-Qaeda not from his personal wealth, but rather from funds he received from like-minded Persian Gulf charities. Even prior to 9/11, the Department of Justice recognized that charities—including those within the United States that are recognized by the IRS as tax-exempt under 26 U.S.C. § 501(c)(3)—were logical fund-raising fronts for international terrorist organizations that were legally prohibited from operating openly in the United States. *National Report on Terrorist Financing*, United States Treasury Dep’t, pp. 12-13 (Nov. 2007). Once an organization is approved under 26 U.S.C. § 501(c)(3), it may offer its donors the benefit of tax deductions for their charitable contributions. As a practical matter, because American donors prefer to deduct their contributions on their individual federal and state income tax returns, charities that seek to raise funds from the American public must be recognized under § 501(c)(3). As of September 30, 2006, there were approximately 1,800,000 organizations in the United States, and 55,000 of these tax-exempt entities had nearly \$1 billion in unpaid federal taxes. *Tax Compliance: Thousands of Organizations Exempt from Federal Income Tax Owe Nearly \$1 Billion in Payroll and Other Taxes: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means*, 110th Cong. (July 24, 2007) (Statement of Gregory D. Kutz, Managing Director Forensic Audits and Special Investigations).

Historically, most terrorism prosecutions have been reactive. Preventing terrorism before it occurs involves the ability to disrupt terrorist planning at an earlier stage. This disruption can be achieved, in part, by disrupting financing networks—including the use or abuse of tax exempt charities. By definition, an organization designated under the International Emergency Economic Powers Act (IEEPA), 50 U.S.C. §§ 1701–1707 (2012), as a Specially Designated Global Terrorist (SDGT), or as a Foreign Terrorist Organization (FTO), cannot legally operate in the United States. If such a charity uses a tax-exempt charity for fund-raising purposes, the charity in question must accordingly conceal its activities and affiliations with the parent terrorist organization. This subterfuge includes concealment from the United States government agency charged with the policing and monitoring of tax exempt entities—the IRS. This need for concealment can be a valuable law enforcement tool for proactive disruption efforts.

## I. The tax-exempt reporting requirement

The standard annual filing form for a § 501(c)(3) entity is Form 990, the “Return of Organization Exempt From Income Tax,” available at <http://www.irs.gov/pub/irs-pdf/f990.pdf>. This filing requirement

is codified at 26 U.S.C. § 6033. Public availability of these returns (partially redacted) is mandated under 26 U.S.C. § 6104. The legislative history indicates that the Congressional intent behind these informational returns was the desire to institute transparency for organizations that are effectively quasi-public institutions. Revenue Act of 1950, 81st Cong. 2d Sess., HR 8920 Aug. 22, 1950, pp. 34-35. *See also* Message from President of the United States, 81st Cong. 2d Sess., Jan 23, 1950; Pub. L. No. 91-172, § 201, 83 Stat 523, Dec. 30, 1969. Recognizing that tax-exempt organizations could be subject to abuse, Congress required public availability of informational returns for tax-exempt entities. When an organization applies for tax-exempt status under 26 U.S.C. § 501(c)(3), its principal(s) must fill out and file an Application for Recognition of Exemption (Form 1023). Form 1023 and the annual Form 990 both contain extensive lists of questions intended to disclose tax-exempt entities' organizational structure, operational leadership, history, and affiliations. False responses to these inquires not only constitute documentary perjury, but also thwart and obstruct the ability of the IRS to effectively police and monitor tax-exempt organizations in general. As such, these misrepresentations may be "material" for purposes of an 18 U.S.C. § 1001(a)(1) or a 26 U.S.C. § 7206(1) criminal violation. The misrepresentations also may constitute obstruction of a function of the IRS, in violation of 26 U.S.C. § 7212(a). In this context, materiality is defined as a statement that has the effect of impeding or obstructing an agency of the United States government in the performance of its official duties. *United States v. King*, 660 F.3d 1071, 1081 (9th Cir. 2011), *citing United States v. Green*, 745 F.2d 1205 (9th Cir. 1985) (for purpose of 18 U.S.C. § 1001(a)(2), "materiality" is defined as a deceptive statement that "might result in the frustration of authorized government functions"). *See also United States v. Peters*, 153 F.3d 445, 461 (7th Cir. 1998), *citing United States v. Greenberg*, 735 F.2d 29, 32 (2d Cir. 1984) (materiality defined for purposes of Title 26 as a statement that "has 'the potential for hindering the IRS's efforts to monitor and verify the tax liability' of the corporation and the taxpayer").

In order for the IRS to ensure that entities granted tax-exempt status remain entitled to this status, the IRS must rely upon accurate and truthful responses to the information requested on the charity's annual Form 990 filings. When an organization makes fraudulent representations on its Form 1023 application for tax-exempt status, it receives an undeserved subsidy from American taxpayers. This fraud is perpetuated if the organization continues to conceal these affiliations and activities in its annual Form 990 filings. Where the organization is covertly controlled by, or affiliated with, a terrorist organization, the fraud is against both the United States government and individual taxpayers who may not be willing to direct their generosity to organizations involved in violent activities. Permitting the generosity of American taxpayers to fund groups antagonistic to the interest of the United States undermines taxpayers' faith in the revenue system and their reliance on the integrity of the charity industry.

## II. The Illegality Doctrine

The Illegality Doctrine has long recognized that tax-exempt entities that engage in *substantial illegal activities*, or activities that are contrary to public policy, place their tax-exempt status in jeopardy and warrant additional scrutiny. The Illegality Doctrine has been a part of IRS policy since 1971 and was ratified by the United States Supreme Court in *Bob Jones University v. United States*, 461 U.S. 574 (1983). In short, the Illegality Doctrine states: "[W]here an exempt organization has been found to violate a statute that reflects an important public policy, it should be aware that the violation is inconsistent with exempt status and may jeopardize exemption for the period in which the violation occurred." Jean Wright and Jay H. Rotz, *Illegality and Public Policy Considerations* 8 (1994), available at <http://www.irs.gov/pub/irs-tege/eotopic194.pdf>. *See also* Rev. Rul. 71-447, 1971-2 C.B. 230, at \*2 ("All charitable trusts, educational or otherwise, are subject to the requirement that the purpose of the trust may not be illegal or contrary to public policy."). IRS General Counsel has defined "terrorist" or "violent activity" as per se "substantial illegal activity" for purposes of application of the Illegality Doctrine. *See* I.R.S. Gen. Couns.

Mem. 34631, at \*5 (Oct. 4, 1971); I.R.S. Gen. Couns. Mem. 39862 (Nov. 21, 1991). *See also* Treas. Reg. 1.501(c)(3)-1(c) (2008).

Accordingly, tax exempt entities that affirmatively attempt to conceal their affiliation with a terrorist organization, either an FTO or SDGT, by filing false Forms 990 or 1023 with the IRS, violate the Illegality Doctrine and by definition are impeding and obstructing a function of the IRS (i.e., the policing and monitoring of tax exempt entities). An effective method of disrupting the terrorist financing purpose of such a charity is prosecution for the *deceptive* concealment of its illegal affiliation with a terrorist organization. Such a case takes on the character of an “obstruction of justice” prosecution (in this case, an obstruction of the function of the IRS) as opposed to a “material support of terrorism” case. Often what appear to be innocuous misrepresentations may actually foretell more devious motivations. In 2010, Marcus S. Owens, former Director of IRS Tax Exempt and Government Entities, testified for the defense in the *Sedaghaty* trial in the District of Oregon on this issue. On cross examination, Mr. Owens affirmed the validity of a statement he made in 1999: “[f]alse statements are made deliberately, and we’re talking about a 990, the IRS will often pursue the broader investigation because there is probably a heck of a lot more under the rock.” *United States v. Sedaghaty*, Crim. No. 05-60008-2 HO (D.O. Sept. 2, 2010). In other words, where individuals make false representations that conceal requested information regarding the operation of their tax exempt charity from the IRS, it is likely that this deceptive behavior is intended to conceal much more extensive illegal activity.

Charges that may be used to prosecute individuals engaged in such deceptions include 18 U.S.C. § 1001(a)(1) (scheme to conceal a material matter); 26 U.S.C. § 7206(1) (filing a materially false tax return); and/or 26 U.S.C. § 7212(a) (a corrupt endeavor to impair and impede the due administration of the Internal Revenue Code). These charges can be used in conjunction with more typical counter-terrorism charges, such as providing material support to a FTO, in violation of 18 U.S.C. § 2339B, or charges under IEEPA, alleging a violation of 50 U.S.C. §§ 1701-1707. Of course, the appropriate charges depend on the facts presented, and every investigation is unique. However, one advantage of the “obstruction” methodology is that the quantum of evidence needed to prove a tax-exempt entity deceptively misled the IRS regarding its activities and affiliations may be much less than the evidence required to prove material support or IEEPA charges (in violation of 18 U.S.C. § 2339B and 50 U.S.C. § 1705, respectively). The need for a lesser quantum of evidence may be determinative, depending on the sensitivity of the evidence in question. Nevertheless, a successful prosecution of a tax-exempt charity and its principals under Title 26 for filing false Forms 1023 and 990 with the IRS will disrupt the terrorism financing network to which the charity in question is a part. The charity is likely to lose its coveted tax-exempt status and its financial affiliations will be exposed. This loss and exposure is sure to cause its donor base to shrink, depriving the parent terrorist organization of a source of funding. *See United States v. Arnaout*, 323 F. App’x 458 (7th Cir. 2009) (Benevolence International Foundation, Inc. went out of business after its connections to al-Qaeda were exposed and principal pled guilty). *See also United States v. El-Mezain*, 664 F.3d 467 (5th Cir. 2011) (Holy Land Foundation for Relief and Development and principals convicted on charges, including 26 U.S.C. § 7206(1), arising out charity’s financial support for terrorist organizations in the Gaza Strip, and then went out of business after affiliations revealed in prosecution and subsequent convictions).

### **III. The First Circuit: *United States v. Mubayyid***

In September 2011, the First Circuit ratified the use of Title 26 charges in prosecutions of charitable organizations and their officers that conceal their true affiliations from the IRS by filing false Forms 1023 and 990. *United States v. Mubayyid*, 658 F.3d 35 (1st Cir. 2011). On March 8, 2007, a grand jury in Boston, Massachusetts, charged Muhamed Mubayyid, Emadeddin Muntasser, and Samir al-Monla

with a variety of charges related to their operation of the tax exempt charity called Care International (Care) (not affiliated with the tax exempt charities CAIR and CAIR Foundation). Specifically, Count 1 charged all three defendants with 18 U.S.C. §1001(a)(1), a scheme to conceal from the United States government the fact that Care was actually the successor to the Boston Chapter of Al-Kifah, and that it was engaged in substantial non-charitable activities. After the 1993 World Trade Center bombing, Al-Kifah, a Pakistani-based charity, was reputed in press reports to be affiliated with al-Qaeda. *See* Allison Mitchell, *After Blast, New Interest in Holy War Recruits in Brooklyn*, N.Y. TIMES, Apr. 11, 1993, at Sec. 1. Count 2 charged the defendants with conspiracy to defraud the United States government with regard to the tax filings for Care, in violation of 18 U.S.C. § 371; Counts 3–5 charged Mubayyid with willfully filing false Forms 990 for Care for the tax years 1997, 1999, and 2000, in violation of 26 U.S.C. § 7206(1); and Count 8 charged Mubayyid with a corrupt endeavor to obstruct and impede the due administration of the Internal Revenue Code, in violation of 26 U.S.C. § 7212(a). The charges, in part, focused on the defendants’ answer to question 76 on Care’s annual Form 990 filing. Question 76 asks, in pertinent part: “Did the organization engage in any activity not previously reported to the IRS?” The defendants answered “No” to question 76 in each of its Forms 990. The defendants were also charged with making additional oral false statements to the FBI and the IRS.

On January 11, 2008, Muhamed Mubayyid and his co-defendants were found guilty by the jury of nearly all charges. Subsequently, the District Court vacated a number of the jury’s verdicts, including the conspiracy charge contained in Count 2. The convictions of Mubayyid regarding his preparation and filing of Forms 990 for Care International, as well as Counts 1, 3, 4, and 8, were left intact. Both parties appealed.

On September 1, 2011 the First Circuit rejected the defendants’ appeals and reinstated all three defendants’ convictions under Count 2 (conspiracy to defraud the United States government). In affirming Mubayyid’s convictions of Counts 3–5 and 8 (filing false tax returns and corrupt endeavor to obstruct and impede the due administration of the IRC), the First Circuit stated: “The filing of false tax documents to mask an organization’s non-charitable purposes falls within the purview of § 7212.” *Mubayyid*, 658 F.3d at 61. The Court rejected the defendants’ claim that question 76 was vague and ambiguous. Instead, the Court held:

A straightforward reading of Form 990 and its instructions makes plain that Question 76 seeks the disclosure of information about activities not accurately depicted in the organization’s application for recognition of exemption, Form 1023 . . . .

. . . .

[T]he IRS sought through Question 76 to determine whether the organization remained entitled to its charitable tax status. To that end, the IRS plainly needed to know what the organization was currently doing.

*Id.* at 62-63.

The First Circuit found that the defendants’ failure to disclose (1) Care’s publication of the jihadist newsletter, “Al-Hussam,” and (2) that its financial support of “orphans,” which was actually in support of the children of terrorist martyrs, was sufficient to support the jury’s finding that the defendants had *intentionally* concealed these activities by answering “No” to question 76, and thus were guilty of the charges presented. These activities had not been previously reported on Care’s initial application for tax exempt status (Form 1023), and, accordingly, “Mubayyid was required to report Care’s actual orphan sponsorship program in response to Question 76 as an ongoing activity that had never been accurately disclosed.” *Id.* at 67.

#### IV. Proposal: Post-*Mubayyid*

The First Circuit's opinion in *Mubayyid* makes clear that a defendant's filing of a false Form 1023 and subsequent annual Forms 990, in an attempt to conceal a tax exempt charity's "non-charitable" or illegal activities, constitutes criminal tax violations, thereby providing federal law enforcement with an additional useful tool in prosecuting terrorism financing. While more typical counterterrorism charges remain available to prosecute individuals and entities financing international terrorist organizations, in some instances these charges are not viable. In such cases, the *Mubayyid* palette of charges may be a more attractive disruption tool. Specifically, material support, in violation of 18 U.S.C. § 2339B, and in violation of IEEPA, 50 U.S.C. §§ 1701-1707, require proof that the "questioned funding" was received by an FTO and/or SDGT, and that the defendants *knew* that this was the intended destination of the funding—although the Government is not required to establish that the defendant knew the funding was to be used to support a violent activity. Since by definition these "funding recipients" are domiciled overseas, evidence of this "knowledge" is often difficult to obtain.

On the other hand, as discussed by the First Circuit in *Mubayyid*, false statements that constitute intentional concealment of these affiliations and activities may be sufficient to obtain a conviction under the *Mubayyid* set of charges, and to disrupt the illegal funding stream. Moreover, in addition to the national security threat posed by the domestic financing of international terrorism, the abuse of tax-exempt status demonstrated by the defendants in the *Mubayyid* case poses a tax compliance and enforcement challenge. Because every dollar donated to tax-exempt charities results in a tax deduction on a donor's individual income tax return (Form 1040), under I.R.C. § 170, if these donated funds are being diverted to support terrorist activities, they constitute a *de facto* taxpayer subsidiary to the international terrorist organization that received these funds. If the public recognizes that federal law enforcement is addressing this abuse on a case-by-case basis, it is likely that others inclined to employ a *Mubayyid*-type scheme may be discouraged from doing so, thus multiplying the disruption impact of each prosecution.

In short, a tax-exempt charity that maintains an affiliation with an international terrorist organization, or a foreign charity so affiliated, listed as an FTO or SDGT, is engaging in conduct inconsistent with its tax-exempt status. Prohibited affiliations may include direct financial support, or may constitute a more subtle form of support as existed in *Mubayyid*. At a minimum, such affiliations are contrary to public policy and may constitute direct violations of existing federal law. In such a circumstance, the charity is in violation of the Illegality Doctrine. Under this doctrine, the charity's conduct places into question the validity of its tax-exempt status. The failure of the charity to accurately and truthfully report these activities to the IRS, if intentionally deceptive, obstructs and impedes the ability of the IRS to perform its lawful official function of policing the tax-exempt status of charities and other entities. Specifically, this intentional deception impedes the IRS in evaluating whether or not the charity in question is entitled to remain tax-exempt in light of its affiliations and activities. If sufficient evidence of the underlying affiliation of the tax-exempt charity with the FTO or SDGT cannot be acquired to prove material support, an IEEPA violation, or some other criminal charge beyond a reasonable doubt, the entity's failure to be candid and truthful with the IRS may provide a secondary method by which to disrupt the illegal activity. Title 26 charges proposed under this theory can be styled under either §§ 7206(1) or 7212(a), but in either event, the proposed charges must come through the Tax Division for review and approval. DEP'T OF JUSTICE, UNITED STATES ATTORNEYS' MANUAL § 6-4.200 (2012). ❖

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