



When the IRS Comes Knocking

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Your client - although you and he do not yet know of the relationship that is soon to be - is showered, dressed, and finishing his morning cup of coffee when the doorbell rings. It is 8:00AM, and he is running late. He opens the door, and a middle-aged woman and a younger man in business attire greet him with serious but disarming smiles. They flash what appear to be badges. The older individual says, "We are special agents with the Treasury Department, and we would like to talk with you about your tax returns" - a particular year or years will be specified. "Do you mind if we come in?" Before your soon-to-be-client can digest what is going on and react, the special agents are in the living room, where they inform him that they have "just a few" questions about the tax returns they are looking into. Often, the agents will give the taxpayer Miranda warnings, even in noncustodial settings like home interviews. If they don't, however, courts will not grant a motion to suppress the taxpayer's statements. See *United States v. Fitzgerald*, 545 F.2d 578 (7th Cir. 1976); *United States v. Mauser*, 723 F. Supp. 995 (S.D.N.Y. 1989).

The questioning then begins. How to respond? Should one say, "I'm late for work. I'll call you back." Should there be a demand to talk to a lawyer before replying, and a request that the agents leave? Should there be selective answering of questions, or will that highlight the unanswered questions and cause suspicion?

Every school child in this country is taught that the Fifth Amendment to the U.S. Constitution provides that we have the right to remain silent in response to official interrogations. What we don't learn in school about the Fifth Amendment is drummed into our heads by the movies, television, and news media. Many of us know of government officials and other witnesses who "plead the Fifth" when they have been called to testify before congressional committees. Yet, notwithstanding our formal education and our experience, I have found that many of my clients are referred to me after being interviewed by special agents from the Internal Revenue Service, often for extended periods of time. Despite telling me that they understood they had the right to remain silent, they nonetheless "spilled their guts" to the agents or made

misstatements that may later become the lie that supports the criminal intent necessary to prove guilt, before ever contemplating the import and the ramifications of their voluntary statements. And they have often done so without understanding the role of the IRS special agent.

As stressed in the Internal Revenue Manual, special agents are not collection officers whose goal is to collect taxes owed; nor are they auditors from the examination division, who determine that a taxpayer took too large a deduction for the purported business use of an automobile. IRM 313 (2002). The role of the special agent is to make a criminal tax case. Making a criminal tax case means marshaling the facts so that the evidence and the law mandate that an individual be indicted, convicted, and ultimately incarcerated.

Special agents are well-trained law enforcement officers whose low caseloads, generally a few active cases per year, give them the time to do such things as watch what cars are parked in a taxpayer's driveway, summon and read their credit card statements, and go through their garbage. Special agents know that garbage may yield a plethora of interesting information in which no one could claim a reasonable expectation of privacy. *California v. Greenwood*, 486 U.S. 35 (1988). A taxpayer with a soda-pop type of declared income may be found to have a champagne thirst. Also, the credit card receipts for the family trip to Tahiti might seem costly for someone on a Magic Kingdom-type salary. The luxury car in the driveway might have been paid in cash and registered in the name of a brother-in-law or a good friend. All of these curiosities will pique the interest of the savvy special agent.

Before they ask the amount of my retainer and whether they could go to prison, many new clients often ask, the "why me" question. After noting that they work hard to support their family, they usually ask several rhetorical questions. Why is the IRS not going after some bad rich person? Why are they picking on me? Following the taxpayer's expressions of righteous indignation and protestations regarding the propriety of the target selected by the IRS, the slow and sobering education process for the client must begin. Clients must be told that

IRS special agents do not only focus their investigations on "bad people." Philanthropists, physicians, and clergyman sometimes are the subjects of investigation. They need to be reassured that an investigation does not mean disaster.

The Informant

Informants often generate IRS criminal investigations. NM 332.22 (2002). An informant is not necessarily a foreigner with a raspy voice in a trench coat. Rather she may be - and often is- a fired secretary, a disgruntled colleague, an overworked bookkeeper, an ex-spouse, or a jilted lover. The informant's initial call to the IRS is often motivated by a desire for revenge or a desire to inflict hurt and pain upon someone. In tax cases, it is true that "hell hath no fury like a lover scorned."

My law firm represented a podiatrist who fired his assistant after a heated dispute. Shortly thereafter, special agents from the IRS and local law enforcement officers swooped down almost simultaneously on his office and his expensive waterfront home and seized his patient records as well as a mass of financial records and numerous other personal items. Patients came in for scheduled appointments, but their podiatrist had no records. The effect on our client's practice was devastating.

The assistant had reported our client to whichever government agency would listen. The Equal Employment Opportunity Commission, the United States Attorney's Office, and the IRS were all recipients of the assistant's complaints. Among the complaints, the assistant claimed that our client was not reporting all of his cash receipts.

Eventually, the IRS began to return to us copies of the records, which made it clear that he received very little cash. The client told us that his revenue was primarily derived from insurance companies. But the IRS investigation continued. Third-party records were summonsed, and we shadowed the IRS investigation. More than a year went by and still the investigation continued. The special agent went so far as to interview the owner of a dress shop where the client's wife

shopped. The store owner was asked what dresses the wife bought and if she paid in cash. At that point, our client said, "enough is enough."

We met with the special agent's group manager and showed him affidavits from people who had worked with the assistant and knew the assistant to be a liar. We explained how all the other government investigations that were based on the assistant's lies had now been closed. None of the informant's allegations had been found to be truthful by the other investigating government agencies. Only the IRS had taken the bait from the liar, and the government was wasting its time. The group manager was told that the special agent was going as far as interviewing a dress store owner and asking about the wife's dresses, and that our client and his wife were emotionally devastated and financially wounded. The IRS soon thereafter ended the criminal investigation.

Investigating the Facts

To be an effective advocate and properly counsel the client, a thorough understanding of the client's business practices, and current and prior financial statements, coupled with a review of any previously filed tax returns, among other things, is essential. Because of a low caseload, the special agent has the luxury of trying to learn everything about the life of his target. Documents known as third-party records are almost always summonsed pursuant to I.R.C. §7609 (West 2002). The special agent's broad powers include the right to summons bank records and other such materials that are kept by third parties. I.R.C. §7602 (West 2002); IRM 25.5.1.3.2 (2002). The special agent has access to and will utilize various sources to learn about the client's assets, including ownership of real estate and corporate directorship or officer positions. A search of public records will include a review of court files in which the target was a party in civil lawsuits, as well as an inspection of criminal and traffic court records.

The record searches will ultimately lead the special agent to interview witnesses. If you know that the special agent will be interviewing certain individuals, it is generally prudent to interview those witnesses before the government approaches them. Even if you think the witnesses will bury your client, it is better to hear it earlier rather than later. By interviewing such witnesses, you can often avoid the witnesses later identifying only with the government. Additionally, informed witnesses may also invite defense counsel to be present if the special agent later interviews them. The presence of defense counsel at the interview may soften the special agent's demeanor and keep him from potentially twisting the witnesses' responses to the questions.

An investigation by a special agent is called an administrative tax case. A special agent may investigate a target for several years because of the long six-year criminal tax statute of limitations. I.R.C. §6531 (West 2002). Investigations by a federal prosecutor, however, are conducted through a grand jury and usually are limited to terms of 18 months. Fed. R. Crim. P. 6. To bring criminal tax charges, a grand jury must ultimately indict the taxpayer in accordance with the Fifth Amendment to the United States Constitution.

The Shadow Investigation

I often want to shadow the special agent's investigation. After my submission of the requisite power of attorney form, 26 C.F.R. §601.502 (West 2002), the special agent is required to send me copies of certain third-party summonses. I.R.C. §7602 (West 2002). I advise the special agent that my client will not submit to any further interviews until I am given assurances that the criminal tax case has been terminated or that any statement my client makes will not be used against him or her. The special agent will not make any such promise. So, the client will not make any more statements to the special agent. As I often explain to the client, my role is not only to protect the client from the government, but also to protect the client from herself. This includes reminding the client that while her rights

are to be protected, she must not do anything to legally obstruct or criminally tamper with the government's investigation.

Philosophically, with some exceptions in extraordinary circumstances, I take a position of courteous but firm non-cooperation. I utilize and enjoy the full statutory and constitutional arsenal that is available on behalf of the client. So, if a third-party summons issued by the special agent is overbroad, ambiguous, or facially defective, I may litigate the issue by filing a petition to quash in the United States District Court. I.R.C. §7609. Such a filing will result in the special agent, through the local IRS criminal investigation attorney, notifying the United States Department of Justice. Tax Division in Washington. D.C. If I am unsuccessful at the district court, then, if legally appropriate, I will suggest to the client that the matter be appealed. Such non-cooperation does not include any action that may be legitimately construed as tampering or obstruction.

Why do I suggest this strategy of non-cooperation? Because a special agent has a choice of whom to target. If I can make it legally uncomfortable, onerous, and tiring for the government to pursue my client, then the special agent may get distracted and pursue someone else.

But, merely because a client might be able to afford such litigation in the courts is not sufficient enough reason to throw up such legal roadblocks. A lawyer's credibility with the special agent, the agent's IRS superiors, and the court is critical. Lawyers and judges do remember. And they enjoy gossiping about other lawyers. See M. Kennelly. *From Lawyer to Judge*. LITIGATION. Summer 2001. at 3. A zealous and honest lawyer is respected and will be trusted by adversaries and by the court. So, though my philosophy is one of thoughtful noncooperation, it is always tempered by what actions may be legitimately maintained.

Clients will often suggest that if we tell the special agent the weak points in the investigation, the government will cease the criminal investigation and end the administrative tax case. This may be an

extremely dangerous and naive strategy. In many ways, this client-propelled strategy is one premised on the client's self-perception: "Because I am a good person, the special agent will leave me alone if only I tell the agent about myself and about the weak points of the investigation." The unfortunate reality is that if the client and the attorney tell the special agent about the weak points in the case, the special agent will probably work around them, rather than closing the investigation. Disclosure of trial defenses merely neutralizes any advantage of surprise at trial.

This does not mean that there are not times when such a strategy is in the client's interest. Because law is not a science, numerous factors must be thought about before contemplating such an approach. In the appropriate circumstance, however, this can be a winning strategy, and could result in closure of the case. It all depends.

During the investigation, there may be months when the client and counsel never hear directly or indirectly from the special agent. He may be reviewing records, interviewing witnesses, or simply working on other things. Ultimately, she will conclude the investigation with what is called a special agent's report (SAR). IRM 9.5.12.3.1 (2002). The SAR is the special agent's treatise regarding a particular target; it lists the evidence, the documents, the witnesses, the applicable tax loss, the federal statutes (often Title 26 of the United States Code) that have been violated, and what charges should be brought against the client. If it suggests that the case be terminated, then no further discussion is needed. The defense rarely, if ever gets to see the SAR because it is the special agent's work product.

Defense counsel, in accordance with IRS policy and procedure as well as the United States Attorneys' Manual (USAM), is generally granted two formal meetings with representatives of the government. IRM 9.5.12.2.1 (2002); USAM Title 6-4.2.1.4 (2002). At the first, defense counsel meets with the lawyer for criminal investigations of the IRS - in other words, the lawyer for the special agent. At that meeting, IRS counsel will inform defense counsel of the contemplated criminal tax

charges, including the number of counts and the amount of the alleged tax loss. Remember, not all tax charges require an actual loss.

You must not forget that the vicarious admission policy applies at the meeting, and anything *you* say can be used against the *client*. IRM 31.4.2.3(2002). IRS counsel is always there with an IRS attorney or a special agent manager from a different group than that of the investigating special agent. In addition, the IRS representatives always take notes of what the defense attorney says. Based on that meeting and other factors, including what are the perceived weaknesses or strengths of the investigation, IRS counsel will recommend that either a target be referred to the Department of Justice with a recommendation of criminal prosecution or that the case be terminated. The standard of proof is high: whether IRS counsel believes the target is guilty and whether there is a substantial likelihood of obtaining a conviction. IRM 31.1.3 .4 (2002).

My law firm represented an accountant who would often put down a number on the returns without any logic other than that it got his clients big tax refunds. He also created new deductions that were unsupported in fact or law. And he did this dozens and dozens of times for many clients. In essence, he lied on the tax returns. His clients presumably thought he was brilliant. He was ultimately diagnosed with bipolar disorder. He resigned his state CPA license and, after extreme scrutiny by his disability insurance carrier, he began receiving proceeds from his disability insurance. His treating psychiatrist prescribed anti-psychotic medication, which helped him cope with this debilitating mental illness.

Notwithstanding all this psychiatric history, the investigating special agent concluded in his S.A.R. that this target should be prosecuted. At our requested meeting, IRS counsel informed me of the criminal tax charges that the IRS would recommend. I did not take the client to that meeting. In fact, I have never taken a client to such a meeting. But I did take my client's treating psychiatrist and a forensic psychologist, who each had examined him. They explained to IRS counsel that the client could not have had the requisite intent to commit a crime

because of his mental illness. Because investigators and government attorneys are generally skeptical of any insanity defense, I suggested that the best proof of our client's lack of *mens rea* was the fact that an insurance company, by nature a fiscally conservative institution, was making disability insurance payments to him even month. I also suggested that the special agent had been incomplete in his investigation because the treating psychiatrist had never been consulted. Soon after this meeting, the criminal case was closed.

My client, a very successful insurance agent, was approached by an officer of a large national chain of restaurants and requested to put together a program of insurance through various insurance companies for the restaurants. Soon after doing so, it was discovered that the square footage and the annual gross receipts of the restaurants were understated, which resulted in the cost of the insurance being underquoted and underpaid. The insurance companies in three states sued my client and the restaurant chain in both state and federal court. The insurance companies alleged that had they been given the correct square footage and receipts, the price for the insurance would have been much higher. They also claimed that they were underpaid and that my client was overpaid. Finally, they alleged that the insurance agent should have remitted to the insurance companies what he alleged were his commissions and the companies alleged were premiums due to them.

As a result of acrimonious civil litigation, which involved dozens of litigants and millions of dollars in alleged damages, an informant contacted the IRS regarding my client, the insurance agent. Though my client had received close to \$1 million for putting together the insurance program, he did not report it as income on his tax return. In addition, my client had prepared his own tax return. After an investigation lasting more than three years, the special agent recommended that my client be prosecuted for tax evasion. I took three witnesses to our first meeting with IRS counsel. The investigative accountant proffered that, because of the extensive litigation, it was unclear whether the particular sum was income

because it was an "open transaction" based upon the legal principles established in *Burner v. Logan*. 283 U.S. 404 (1931). The expert stated, and we argued, that because the disputed item of income was the subject of multiple arid continuing lawsuits in different courts and jurisdictions, the ultimate right to its possession was highly speculative. My client believed that he did not have a fixed right to keep these funds, and, even if he did, the amount thereof could not be determined with reasonable accuracy.

I explained that if the case were tried, we would have a solid winning defense and that my client was innocent. My two other witnesses were the insurance agent's lawyers in the civil litigation. They explained how it was still unclear based on the ongoing civil litigation whether the \$1 million was ultimately going to be classified as premiums or commissions. We argued that if it were found to be premiums, then my client would be obligated to remit those monies to the insurance companies. But, if it were found to be commissions, then it would be income to the insurance agent, and it would be duly reported on my client's tax return for the year in which it was no longer an "open transaction."

We were unsuccessful, and counsel for criminal investigations made a recommendation to the Department of Justice Tax Division in Washington, D.C., that the insurance agent be prosecuted. Because the administrative criminal tax case was not terminated, the criminal investigations from the local IRS office forwarded the case in accordance with standard procedure to the Department of Justice Tax Division for further review. IRM 9,5.12.3.1.5.1 (2002). A target is entitled to a second meeting through counsel at this level. I took two investigative accountants to the meeting in Washington, D.C., with a Department of Justice lawyer. I made the same argument and again submitted numerous exhibits and a memorandum of law. At this level, the vicarious admission policy does not apply. IRM 31.4.2.3 (2002). Accordingly, anything the witnesses and I said could not be used against my client. We were unsuccessful, and the Tax Division lawyer eventually sent me a letter informing me that the Department of

Justice was sending the case to our local United States Attorney's office with instructions to prosecute my client for tax evasion.

It is generally understood that, once the Department of Justice has instructed the local federal prosecutor's office to indict a target, the target will be indicted. Unless it is a politically sensitive case, a local Assistant United States Attorney does not refuse instructions from headquarters in Washington. D.C. Yet, I believed that my client was innocent and that he should not be indicted. Thus, after consultation with my client, we opted for the risky strategy of forsaking the element of surprise at trial and divulging the defense in an attempt to avoid an indictment.

I contacted the Assistant assigned to the case, and we had a series of meetings. Once again, I called my investigative accountant experts and the civil lawyers to make a presentation to the prosecutor. At a subsequent meeting, the local Assistant United States Attorney brought down a different Department of Justice attorney to review the case. After more than four years, the criminal tax case against my client was terminated.

Sentencing

It used to be that a United States district judge had complete discretion in criminal cases when imposing a sentence. *United States v. Frank*, 864 F.2d 992, 1008 (3rd Cir. 1989). The judge's sentencing decision was often predicated on a defendant's prior good deeds, remorse, crying spouse, helpless children, and myriad other factors that a criminal defense attorney was trained to point out to the trial court. A judge had the right to sentence a convicted tax evader to probation or to the maximum statutory sentence or anything in between. The sentencing philosophy of a judge was an important component in the ultimate fate of a convicted criminal defendant.

Everything changed on November 1, 1987. A judge sentencing a defendant for all crimes committed subsequent to that date was required to follow the federal sentencing guidelines promulgated by

the United States Sentencing Commission and enacted into law by the United States Congress. U.S. Sentencing Guidelines Manual Ch. 1, Pt. A, intro. Comment 2 (2001). The sentencing guidelines seek uniformity of sentencing for similar offenses before different judges and in different districts. Their purported mission is to remedy disparate sentencing. *Id.*, Comment 3.

How one arrives at the appropriate guideline for a particular tax crime is based on certain variables. These variables include, but are not limited to, the amount of the attempted tax loss, the prior criminal history of a defendant, whether the defendant utilized any sophisticated concealment to hide the crime, and whether a defendant accepted responsibility by pleading guilty. In essence, the guidelines' manual contains a chart with levels for different crimes with varying factors, which may enhance or mitigate the potential sentence. Where a defendant scores out on the grid indicates the range of months to which a defendant must ultimately, with certain exceptions, be sentenced to serve. The guidelines provide a benefit to the defendant who accepts responsibility by pleading guilty. Thus, it may sometimes behoove the client to plead guilty.

A plea may help avoid indictment of family members - as occurred in a case involving one of our clients - mitigate punishment, and allow a client to put and end to often prolonged periods of uncertainty.

It's Art and Not Science

Though there is an appropriate methodology in handling a criminal tax case, it should always be remembered that the practice of law is far more art than science. Prosecutors, special agents, and judges are all human beings with biases, predilections, foibles, preferences, and philosophies. It is knowing how honestly and appropriately to approach those biases, predilections, foibles, preferences, and philosophies that may make the difference between a client being indicted and not being indicted.