A CRITIQUE OF THE INTERNAL REVENUE SERVICE'S REFUSAL TO DISCLOSE HOW IT "DETERMINED" A TAX DEFICIENCY, AND OF THE TAX COURT'S ACQUIESCENCE WITH THIS VIEW

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INTRODUCTION

The Internal Revenue Service ("Service" or "IRS") enjoys a presumption of correctness in its factual assertions made in Statutory Notices of Deficiency ("Statutory Notice" or "Notice")[1] it sends to taxpayers whom the Service believes owes taxes. While the Notice usually states the reasons for its assertions, sometimes the reasons are not explained or are stated so generally that they are of little use to those taxpayers who must try to disprove these assertions. The issue is seen most pointedly in civil fraud tax cases, especially in multiparty conspiracy civil fraud tax cases.

Due to the clandestine nature of a conspiracy, and the fact that most

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Ryan is a rather typical civil fraud case which follows convictions under the Organized Crime Control Act, Title IX, the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-68 (1994 & Supp. III 1997) ("RICO"). *Ryan* dealt with four former narcotics officers who had been found guilty of stealing money and drugs and accepting bribes from drug dealers. In addition, they were convicted of willfully filing false tax returns because they did not report the illegal income. *See* United States v. Wilson, 742 F. Supp. 905 (E.D. Pa. 1989) (dealing primarily with joint and several liability for restitution-penalty of RICO conspirators). In addition, a fifth former officer pled guilty to these crimes. After these former officers had served their jail terms, each one received a Statutory Notice asserting deficiencies based upon the profits from the same acts for which they had been convicted criminally. Each filed a petition with the Tax Court, and their cases were consolidated for trial.

Many thanks to my colleague, Professor Michael Mulroney, and to all of the Villanova student-clinicians who contributed greatly to *Ryan* over the several years the case was in the Clinic. In particular, special thanks are due to the students who helped prepare for trial, who tried the case, and who helped with the brief. Their names are listed by the court in *Ryan*, at 1778, n.2. Their thoughts helped form some of the opinions discussed herein. Thanks are also due to several members of the Villanova Law Review who aided with the formatting of this Article. Finally, thanks are due to Ronald Giongo, one of the petitioners in *Ryan*, who consented to this presentation of his case.

1. The Statutory Notice of Deficiency ("Statutory Notice" or "Notice") is authorized by 26 U.S.C. § 6212 (1994). All further references to Title 26 U.S.C. will be cited as, for example, I.R.C. § 6212 (1999).

criminals do not keep records of their illegal income, the Service uses various techniques permitted by the United States Tax Court ("Tax Court") to attempt to prove fraud, and then to prove the amount of each conspirator's unreported fraudulent income. Although these techniques are generally proper, they often yield harsh results, as if conspirators must be "punished" in a civil arena, whether or not they have been punished in a prior criminal trial. These results can be especially severe when applied to a marginal conspirator involved in a large conspiracy.

Because most practitioners have only slight knowledge of the nature of a civil fraud case, Part I of this Article will give an overview of civil fraud tax cases and explain the differences between criminal and civil fraud tax cases.

Part II is a critique of the position taken by the Service, which often refuses to disclose exactly how it calculated the dollar amounts of the taxpayer's asserted tax deficiencies, based upon its overly broad interpretation of case law. This refusal to disclose details seems to be contrary to the discovery rules of the Tax Court; however, the court usually agrees with the Service's position because it does not wish to look into the inner administrative workings of the agency. The taxpayer must then refute the Service's assertions which are presumed to be correct; obviously, the difficulty of disproving these assertions is greatly exacerbated because the taxpayer cannot know how they were determined. The Service seems to take this position primarily to gain adversarial advantage in litigation.

Part III critiques the Service's position that all of its documents are privileged, and therefore not discoverable because they were prepared "in anticipation of litigation," or because the papers are subject to "executive privilege." The Service again seems to take this position primarily to gain adversarial advantage in litigation.

Part IV critiques the Tax Court's position that, because its trial is de novo, any administrative errors made by the Service will be corrected at trial. This position clearly ignores the fact that the Service's possible errors cannot be discovered when the taxpayer cannot obtain the discovery as shown in Parts II and III. Additionally, the position further ignores the fact that although the Notice clearly is a procedural necessity for Tax Court jurisdiction, it also carries substantive weight because it is presumed to be correct.

Part V deals with those limited circumstances when the Service's Statutory Notice may be deemed to be "arbitrary and excessive" because it is either unconstitutional or it asserts a "naked assessment."

Part VI deals with the problems that allegedly fraudulent taxpayers incur when multiple petitioners are before the court. Part VII critiques the onerous burden placed on each of these multiple parties due to the Service's so-called "protective position," in which multiple redundant assertions of the same income is made to several taxpayers.

Part VIII then reviews the concepts of collateral estoppel, as the Service uses it to bear its burden of proving fraud, whenever there has been a prior criminal conviction of the petitioner.

Part IX addresses the "badges of fraud," and their use by the Service in satisfying its burden to prove fraud.

Finally, the conclusion and suggestions for change follow.

I. CIVIL AND CRIMINAL TAX FRAUD CASES: A BASIC OVERVIEW

Federal income tax fraud consists of two types: criminal and civil.[2] The elements of the two types of tax fraud are identical; only the degree of required proof, and the possible consequences differ.[3] The elements of fraud include:

1. wilfully making a knowing falsehood;
2. an underpayment; and
3. an intent to evade.[4]

A. Criminal Tax Fraud Cases

Criminal tax fraud[5] is prosecuted by the Tax Division of the Department of Justice,[6] or, in some larger cities, by the local United States Attorney. Trials are held in a United States District Court, with a jury if requested.[7] As with any crime, fraud must be proven "beyond a reasonable doubt."[8] Incarceration and

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2. *See* Helvering v. Mitchell, 303 U.S. 391, 396-97 (1938) (examining elements of both civil and criminal tax fraud and holding prior criminal acquittal does not bar civil case because of differing burdens of proof); *see also* Gray v. Commissioner, 708 F.2d 243, 246 (6th Cir. 1983) (holding that taxpayer who previously pled guilty to criminal tax fraud is conclusively liable for civil tax fraud because elements are identical); Lydon v. Commissioner, 351 F.2d 539, 545 (7th Cir. 1965) (noting that acquittal from criminal tax fraud charges does not bar civil tax fraud charges, even though elements are the same, because of differences in standard of proof (citing *Helvering*)).

3. *See Gray*, 708 F.2d at 243; *see also* Fontneau v. United States, 654 F.2d 8, 10 (1st Cir. 1981) (applying doctrine of collateral estoppel to find taxpayer liable for civil tax fraud after plea of guilty to criminal tax fraud because elements are the same).

4. *See* Considine v. United States, 645 F.2d 925, 928-29 (Ct. Cl. 1981) (comparing elements of crime of filing a false return and of civil fraud and rejecting contention that there are significant differences). *But see* Wright v. Commissioner, 84 T.C. 636, 643 (1985) (holding that the elements of tax fraud, criminal as well as civil, were broader than the elements of the crime of filing a false return because fraud requires the intent to evade). *Wright* is more fully discussed at *infra* notes 195-205 and accompanying text.

5. *See* I.R.C. § 7201 (1999) which states in pertinent part:

> Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $100,000 ($500,000 in the case of a corporation), or imprisoned not more than 5 years, or both, together with the costs of prosecution.

Id.

6. 28 C.F.R. § 0.70 (1999) (assigning prosecution of criminal tax cases to Assistant Attorney General, Tax Division).

7. *See* U.S. CONST. amend. VI (providing for right to jury of peers).

8. Holland v. United States, 348 U.S. 121, 126 (1954) (noting that, in criminal tax fraud cases, Service must prove taxpayer's guilt beyond a reasonable doubt, unlike civil tax fraud cases

large monetary fines can be imposed.[9] Any appeal goes to the United States Court of Appeals of the appropriate circuit.[10]

In a criminal tax fraud case, as in any criminal case, if the defendant cannot afford a private attorney, the court will appoint counsel to comply with the Constitutional requirements of due process and the right to counsel for indigent defendants.[11] The court appointed attorneys usually are criminal defense attorneys who generally have no specific training in tax.[12] In addition to free representation, indigent criminal defendants are entitled to a transcript of their trial at no cost.[13]

B. Civil Tax Fraud Cases

Unlike criminal tax fraud cases, neither attorneys' fees nor a free transcript is available for indigent civil fraud petitioners because the Constitutional protections for criminal defendants generally do not apply to civil matters.[14]

Any civil tax case, whether fraud is alleged or not, usually begins when a taxpayer and the Service cannot administratively agree on the taxpayer's tax liability. To break this impasse, the Service will issue a Statutory Notice of

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where Service has the initial burden of proving fraud only by clear and convincing evidence); *see also* United States v. Schipani, 293 F. Supp. 156, 161 (E.D.N.Y. 1968) (concluding that Service proved, with substantial evidence, defendant's guilt beyond reasonable doubt).

9. *See* I.R.C. § 7201 (individual convicted of criminal tax fraud can be liable for $100,000 fine, five years in prison, or both). *But see* 18 U.S.C. § 3571(b)(3) (1994 & Supp. 1997) (raising fine for individual up to $250,000).

10. *See* FED. R. APP. P. 2. 4(b) (establishing procedure for appeal of criminal conviction).

11. *See* U.S. CONST. amend. V, VI, XIV; Gideon v. Wainright, 372 U.S. 335, 339-40 (1963) (due process requires indigent felony defendant to be furnished counsel). *See generally* Michael E. Tigar, *Constitutional Rights of Criminal Tax Defendants: A Bicentennial Survey and Modest Proposal*, 41 TAX LAW. 13 (1987) (examining consequences of constitutional interpretations on criminal tax proceedings).

12. *See* Theodore Tannenwald, Jr. & Mary Ann Cohen, *Tax Lawyering: A Changing Profession, A Dialogue Between Tax Court Judges*, 46 TAX LAW. 672, 673 (1993) ("[T]he taxpayer's representative is frequently a general practitioner who has little, if any, knowledge of the specific statutory provision or the underlying foundation of the case under the tax law."). Most tax lawyers have little, if any, experience with criminal trials. A criminal fraud trial is first and foremost a criminal matter that just happens to deal with tax matters.

13. *See* Griffin v. Illinois, 351 U.S. 12, 19-20 (1956) (holding that constitutional rights of due process and equal protection require government to furnish criminal defendants with a copy of the trial transcript, or equivalent, at no cost to defendant).

14. *See* Harper v. Commissioner, 54 T.C. 1121, 1137 (1970) (noting that Fifth and Sixth Amendments of Constitution are generally not applicable in civil cases, distinguishing *Miranda v. Arizona*, 384 U.S. 436 (1966), and *Escobedo v. Illinois*, 378 U.S. 478 (1964)). But persons may still refuse to testify against themselves as long as possibility of future criminal prosecution exists. *See id.*

Deficiency ("Statutory Notice" or "Notice")[15] which normally states the dollar amount the Service asserts that the taxpayer owes, together with the supporting schedules showing the Service's reasons for the added tax. No "assessment"[16] may be made without the Service issuing such a Notice, and the tax still may not be assessed for ninety days after sending the Notice.[17] Within those ninety days, the taxpayer may file a petition with the Tax Court; if he does, no assessment may be made until the court's decision is final.[18] If he does not so file, the Service may assess the tax following the ninetieth day after the Notice is sent.

If a petition is filed timely with the Tax Court, the taxpayer must choose the location of the trial from one of approximately thirty cities to which the court travels. The District Counsel of the Internal Revenue Service[19] for that city will answer on behalf of the Service.[20]

The Notice may also assert that an "addition to tax" (often called a "penalty") is due because the taxpayer is alleged to have been fraudulent.[21] In virtually all civil fraud cases, the taxpayer must litigate in the Tax Court, because paying the entire sum asserted and suing for a refund may be literally impossible.[22]

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15. *See supra* note 1.

16. A deficiency assessment pursuant to I.R.C. § 6201 (1999) is a recording of the taxpayer's liability for a given taxable year; it is not a public document, but it is entered within the Service's records. *See* I.R.C. § 6203; Treas. Reg. § 301.6203-1 (as amended in 1960).

No assessment (other than a jeopardy assessment pursuant to I.R.C. § 6331, which is beyond the scope of this Article) may be made before the taxpayer is sent a Statutory Notice of intent to assess, pursuant to I.R.C. § 6212. This Notice states that if the taxpayer does not submit a petition to the Tax Court within 90 days, *see* I.R.C. § 6213, assessment may be made on the 91st day after the mailing of the Notice. If a petition is filed with the Tax Court, no assessment may be made until the Tax Court's decision becomes final. *See* I.R.C. § 7481.

Assessment creates a debt owed by the taxpayer to the Treasury. *See* Bull v. United States, 295 U.S. 247, 259 (1935). This debt may be collected by levy. I.R.C. § 6331.

17. *See* I.R.C. § 6213 (a) (this issue is the same before and after amendment in 1998 by P.L. 105-206).

18. *See id*.

19. In the Tax Court the Service is represented by the local Office of the District Counsel, a subordinate of the Office of General Counsel to the Internal Revenue Service.

20. I.R.C. §§ 7444 & 7460 authorizes the chief judge to form "divisions" of the court. Typically one judge will be assigned as a "division" to each of approximately thirty cities in which the court sits. Some of the larger cities have more than one session per year.

21. This Article deals only with the addition to tax due to fraud under I.R.C. § 6663. Other additions to tax, such as the accuracy-related penalty of I.R.C. § 6662 and the failure to file or pay penalty of I.R.C. § 6651 are beyond the scope of this Article.

22. In theory, one could pay the entire deficiency asserted and sue for a refund in the United States District Court (where there is a right to a jury) or in the United States Court of Federal Claims. *See* 28 U.S.C. § 1346 (a) (1) (1994). However, in *Flora v. United States*, 362 U.S. 145 (1960), the Court ruled that the entire tax assessed must be paid before a refund suit may be brought.

In addition, in the vast majority of civil fraud cases, taxpayers simply cannot afford to pay for private counsel, therefore they must appear pro se.[23] Aside from the fact that any pro se taxpayer has many distinct disadvantages when he is opposed by an attorney for the Service, he may concede matters that should perhaps have been tried, and he may feel pressured to accept the Service's settlement offers, even if they otherwise would seem unreasonable. In addition, since most cases dealing with civil fraud are pro se, the precedential value of such cases should be diminished. When they are not, the path is made more difficult for future litigants.

Moreover, an indigent petitioner's inability to acquire a free transcript after trial greatly hampers a petitioner's case because the cost of obtaining a transcript may be prohibitive.[24] The lack of availability of a transcript may render

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In a typical conspiracy case, the dollar amount of the deficiency may be so high that the taxpayer could not possibly pay the amount of tax plus penalties plus interest. This problem is exacerbated by the Service's "protective position," see *infra* Part VII for discussion of protective position, in conspiracy cases by which the Service redundantly attributes all, or almost all, of the income of the conspiracy to *each* conspirator.

There is a split of authority concerning whether payment of the statutory interest imposed by I.R.C. § 6601 or any payment of additions to tax ("penalties") imposed by I.R.C. § 6663 is a condition precedent to a refund suit. In *Flora*, it was suggested that interest need not be paid before filing suit. *See Flora*, 362 U.S. at 171 n.37 ¶ d.

See Shore v. United States, 9 F.3d 1524 (Fed. Cir. 1993) (penalties and interest prepayment not jurisdictional prerequisite to refund suit); Kell-Strom Tool Co. v. United States, 205 F. Supp. 190 (D. Conn. 1962) (holding interest need not be paid before refund suit is brought; penalties not in issue); Magee v. United States, 24 Cl. Ct. 511 (1991) (jurisdiction proper even though fraud penalty was not paid). *But see* D.J. Lambropoulos v. United States, 18 Cl. Ct. 235 (1989) (penalties and interest must be paid before refund suit can be brought); Arnold v. United States, 82-2 U.S.T.C. ¶ 13,476 (N.D. Ohio 1982) (penalty paid; nonpayment of interest bar to refund suit); Horkey v. United States, 715 F. Supp. 259 (1989) (paid deficiency but not fraud penalty; held, no jurisdiction).

23. *See* Christopher Paul Sorrow, Note, *The New Al Capone Laws and the Double Jeopardy Implications of Taxing Illegal Drugs*, 4 S. CAL. INTERDISC. L.J. 323, 336-37 (1995) (noting that expense and ordeal of civil tax prosecution can be as punishing as criminal tax prosecution); *see also* Kathleen H. Musslewhite, Comment, *The Application of Collateral Estoppel in the Tax Fraud Context: Does It Meet the Requirements of Fairness and Equity?*, 33 AM. U. L. REV. 643, 653 n.62 (1984) (stating that criminal tax defense trials can also be very expensive, upwards of $15,000). Today the cost would be significantly higher than in 1984. Although a taxpayer's civil case might cost less than a criminal case, the legal expenses may total much more than the deficiency asserted. Additionally, the attorney's fee must be paid whether the petitioner wins or loses a civil case.

24. In *Ryan v. Commissioner*, 75 T.C.M. (CCH) 1778 (1998), the transcript cost almost $7000. Many petitioners in consolidated civil fraud cases cannot afford this sum because the profits of the enterprise have been spent or confiscated, and, as felons, they have low level jobs and income. Note that if a taxpayer prevails on appeal, he is entitled to "costs," which include the costs of printing the transcript and appendix on appeal. *See* Toner v. Commissioner, 76 T.C. 217 (1981). However, the court denies any award for the cost of obtaining the transcript from the reporter. *See*

petitioner's brief in the Tax Court, and also on appeal, ineffective because no specific references to the testimony are possible in the brief without the transcript.

The trial of a civil fraud case usually begins with the Service attempting to satisfy its burden of proving fraud by "clear and convincing evidence."[25] If the Service cannot prove fraud by this requisite standard, the taxpayer prevails.[26] Fraud cannot be presumed.[27] Once the Service has borne its burden of proving fraud, the petitioner must then bear the burden of *disproving* the amount of the deficiency asserted by a preponderance of the evidence.[28]

The taxpayer, if found fraudulent, must thereafter bear the burden of disproving the facts asserted in the Statutory Notice.[29] To the extent that he cannot rebut the assertions in the Notice, he faces payment not only of the tax owed on his increased taxable income, but also a civil penalty of seventy-five percent of that additional tax on the fraudulent portion of unreported income.[30]

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id. Of course, if the Service prevails, it is entitled to these costs.

Note that the transcript of a Tax Court trial may be inspected only in the office of the clerk of the Tax Court in Washington. It may not be photocopied there, under the contract between the court and the private court reporter company. No copy is available in the city in which the trial was held. Thus, unless one can spend much time reading and taking notes in Washington, purchasing the transcript from the court reporter is the only way to obtain the transcript.

25. I.R.C. § 6663 (b) (added by OMBRA 1989). I.R.C. § 6663(b) provides,

> If the Secretary establishes that *any portion* of an under-payment is attributable to fraud, the entire under-payment shall be treated as attributable to fraud, except with respect to any portion of the under-payment *which the taxpayer establishes (by a preponderance of the evidence*) is not attributable to fraud.

Id. (emphasis added).

26. *See* Wynn v. Commissioner, 70 T.C.M. (CCH) 1646, 1653 (1995) (dismissing the case after finding that Service's allegations did not meet "clear and convincing" standard; one witness was absent minded and his equivocal testimony did not satisfy Service's burden of showing fraud by clear and convincing evidence).

27. *See* Davis v. Commissioner, 184 F.2d 86, 87 (10th Cir. 1950) (stating that "[f]raud implies bad faith, intentional wrong doing and a sinister motive" and that "[i]t is never imputed or presumed and the courts should not sustain findings of fraud upon circumstances which at most create only suspicion."), *rev'g*, 8 T.C.M. (CCH) 881 (1949) which found petitioner fraudulent.

28. *See* I.R.C. § 6663(b). However, in *Cipparone v. Commissioner*, 49 T.C.M. 1492, 1500 (1985), the Tax Court held that a minor conspirator who received an insignificant portion of the conspiracy income, and who was not knowledgeable or sophisticated, was not guilty of fraud. Apparently under some circumstances, a de minimis exception exists. This case is discussed at *infra* notes 148-54 and accompanying text.

29. *See* Welch v. Helvering, 290 U.S. 111, 114-15 (1933). "[The Commissioner's] ruling has the support of a presumption of correctness, and the petitioner has the burden of proving it to be wrong." *Id.* at 115. *See also* Helvering v. Taylor, 293 U.S. 507, 515 (1935); Tax Court Rule 142(a) ("The burden of proof shall be upon petitioner, except as otherwise provided by statute or determined by the Court. . . .").

30. *See* I.R.C. § 6663(a) (imposing penalty of 75% of the additional tax on that portion of

In addition, statutory interest on both the underpayment and the penalty are imposed.[31] Any appeal from the Tax Court goes to the United States Court of Appeals of the appropriate circuit.[32]

Finally, a petitioner who has been found guilty of criminal tax fraud may be collaterally estopped from denying the elements of the crimes of which he was convicted. And, even if a prior criminal tax case has ended with a not guilty verdict, the Service can still proceed in the civil arena because the evidence might prove sufficient to be "clear and convincing," even if it was not "beyond a reasonable doubt."

Obviously, even though the civil fraud litigant does not run the risk of prison, he will likely face substantial financial exposure, especially if he cannot afford professional assistance in his contest with the Service.

II. HOW THE SERVICE PREVENTS THE TAXPAYER FROM DISCOVERING POSSIBLE ERRORS IN THE STATUTORY NOTICE: *GREENBERG'S EXPRESS* AND *SCAR*

The way in which the Service determines the asserted deficiency in the Statutory Notice is a fact that is usually obvious from the Statutory Notice, when the attached schedules set forth such things as unreported income from a Form W-2 or Form 1099, or denies certain specific deductions. There are no real policy decisions involved in a revenue agent's determinations of this type of Notice. The agent should go "by the book" (the Internal Revenue Manual) and other Service documents. The deficiencies asserted in the Statutory Notice, are derived from the agent's investigation and his determinations of facts. This type of Statutory Notice should be unquestioned as properly prepared because of its specificity, and because it shows that the agent preparing that document made a "determination" of the facts asserted.[33] The Tax Court properly refuses to look behind this type of Statutory Notice.[34] The court may find as a matter of fact that

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taxable income attributable to fraud). Before the Omnibus Budget Reconciliation Act of 1989 (OMBRA), the Code imposed a 50% penalty and interest on the tax attributable to the entire underpayment, not just the portion of the underpayment attributable to fraud. *See* I.R.C. § 6653 (repealed 1989).

31. *See* I.R.C. § 6601(a) & (e)(2)(B) (imposing interest on statutory underpayment and penalty).

32. *See* I.R.C. § 7482(a) (giving exclusive jurisdiction to United States Courts of Appeals to review decisions of Tax Court).

33. See *Scar v. Commissioner*, 81 T.C. 855 (1983) (reviewed by the court), and its reversal on appeal 814 F.2d 1363 (9th Cir. 1987), for an analysis of the "determination" issue. *Scar* is discussed *infra* notes 75-104 and accompanying text.

34. *See* Luhring v. Glotzbach, 304 F.2d 560, 565 (4th Cir. 1962) (failing to comply with the Service's own internal procedural rules does not give due process grounds for enjoining jeopardy assessment); Human Eng'g Inst. v. Commissioner, 61 T.C. 61, 66 (1973) ("As far as the deficiency notice is concerned, it is . . . well established that the courts will generally not look behind such a notice to determine whether respondent's agents followed the established administrative procedures

some or all of the Service's assertions are not correct, but only after the petitioner has borne his burden of disproving the assertions in the Statutory Notice.[35]

A. "Naked Assessment"

However, where the Statutory Notice involves a petitioner who is believed to have had unreported income, especially illegal income, the presumption of the accuracy of the Statutory Notice is more questionable.[36]

Initially, the petitioner charged with receiving unreported income may challenge the Statutory Notice as asserting a "naked assessment." A naked assessment results when there is no minimal nexus between the taxpayer and the alleged source of that income. Any such minimal connection will negate a finding of a naked assessment. If the taxpayer asserts that there has been such a naked assessment, the court will put the burden on the Service to make that minimal showing.[37] This rare situation does require the Tax Court to "look behind" the Statutory Notice to see if such minimal connection exists. Quite surprisingly, the Supreme Court has held that the requisite minimal connection

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in respect of investigation and according the petitioners a hearing."); Pendola v. Commissioner, 50 T.C. 509, 511-14 (1968) (District Director in Manhattan sent Statutory Notice to taxpayer residing in Brooklyn district during investigation covering both districts; notice valid).

35. *See* Durkee v. Commissioner, 162 F.2d 184, 187 (6th Cir. 1947) ("But where it is apparent from the record that the Commissioner's determination is arbitrary and excessive, the taxpayer is not required to establish the correct amount. . . .") (remand to Tax Court for determination of tax owed, if any); *accord* Marx v. Commissioner, 179 F.2d 938, 942 (1st Cir. 1950) ("An arbitrary determination of deficiency by the Commissioner is not void and therefore a nullity. Such a determination is invalid, and if invalidity on that score can be established by the taxpayer, ground for redetermination by the Tax Court has been established."); *Human Eng'g Inst.*, 61 T.C. at 66 (dictum) (In a jeopardy assessment, the taxpayer has the burden of disproving determinations of Statutory Notice, and ordinarily the court will not look behind the Statutory Notice. If Notice was invalid, it is not void, but the burden shifts to the Service to prove the amount of the deficiency.).

36. *See* Anastasato v. Commissioner, 794 F.2d 884, 886-87 (3d Cir. 1986). The court explained that most cases utilizing the "no minimal connection" exception have involved illegal income. *Id*. *See also* Weimerskirch v. Commissioner, 596 F.2d 358 (9th Cir. 1979) (involving alleged income received from selling drugs; Service cannot rely on presumption alone where there is no substantive predicate evidence); Gerardo v. Commissioner, 552 F.2d 549 (3d Cir. 1977) (involving asserted income received from gambling; dismissed because no predicate evidence connected taxpayer with that source of income); Pizzarello v. United States, 408 F.2d 579 (2d Cir. 1969); Dellacroce v. Commissioner, 83 T.C. 269 (1984) (involving alleged income received from labor racketeering payoff) (no minimal contact for one taxable year, so within *Taylor*); Llorente v. Commissioner, 74 T.C. 260 (1980) (arbitrary because undercover agent never testified to taxpayer's participation and no other connection was made), *aff'd in part and rev'd in part*, 649 F.2d 152 (2d Cir. 1981).

37. *See Anastasato*, 794 F.2d at 887 (stating that Commissioner is entitled to presumption of correctness because he introduced evidence linking taxpayer to tax-generating activity).

may be obtained via an unconstitutional search, even if that evidence would be inadmissible at trial.[38]

B. Greenberg's Express

After a showing that the proposed assessment was not "naked," the Service maintains that a taxpayer has no right to "look behind" the Statutory Notice to see how the amount of the deficiency was determined. *Greenberg's Express v. Commissioner*[39] seemed to state the proposition that the Tax Court will never look behind a Statutory Notice.

> As a general rule, this Court will not look behind a deficiency notice to examine the evidence used or the propriety of respondent's motives or of the administrative policy or procedure involved in making his determinations. . . .The underlying rationale for the foregoing is the fact that a trial before the Tax Court is a proceeding de novo; our determination as to a petitioner's tax liability must be based on the merits of the case and not on any previous record developed at the administrative level.[40]

The Service quite often refuses to furnish any information concerning exactly how any deficiency was determined based upon this reference to *Greenberg's Express*, even though it begins "As a general rule . . . ," and specifically limits its applicability only to the Service's propriety, motives, policies or procedures.[41]

The Tax Court (and its predecessor, the Board of Tax Appeals) has a long history of refusing to look behind the Statutory Notice due to its perceived lack of jurisdiction,[42] or because it did not have the duty or the right to decide whether there were any errors in the Statutory Notice.[43] Some commentators feel that the Tax Court simply wants to avoid looking into the inner workings of the Service.[44]

The petitioners in *Greenberg's Express* argued that the Service discriminated against them by auditing them because they were related to notorious members

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38. *See* United States v. Janis, 428 U.S. 433 (1976).

39. 62 T.C. 324 (1974).

40. *Id.* at 327.

41. *Id*.

42. *See* Kerr v. Commissioner, 5 B.T.A. 1073 (1927) (stating that Board has no jurisdiction to assess motives of Service). Of course, the Tax Court has jurisdiction to determine the true tax of the individual taxpayer, and an essential factor in that determination is the assertions of the deficiency in the Statutory Notice.

43. *See* Levine Bros. Co. v. Commissioner, 5 B.T.A. 689 (1926) (stating that Board of Tax Appeals will not examine deficiency because it had neither the right nor the duty to do so).

44. Mary Ferrari, *"Was Blind, but Now I See" (Or What's Behind the Notice of Deficiency and Why Won't the Tax Court Look?)*, 55 ALB. L. REV. 407, 408 (1991) ("The Tax Court's refusal to look behind the notice of deficiency creates of the notice an impenetrable barrier that, in effect, shields the Service's administrative actions from scrutiny.").

of organized crime.[45] The petitioners asserted that the Service's Statutory Notices were arbitrary, unreasonable and capricious.[46] They moved the Court for an impoundment order to have the Service deliver "all documents . . . relating to the audit of petitioners' Federal income tax returns for 1966 through 1968. . . ."[47] This broad request for an order was sought to prevent the Service from "destroying or concealing" evidence that the petitioners' constitutional rights had been violated by the Service.[48] They further requested a review of those materials to prove their assertions of unconstitutional discrimination.[49]

The petitioners in *Greenberg's Express* argued that if such discrimination could be proven, the Statutory Notice would be null and void, or alternatively, that the burden of proof, or at least the burden of going forward, would shift to the Service.[50]

The court noted that there were other means of discovery under its regular discovery procedures and thus, the broad relief sought was improper.[51] The court also noted that these discovery procedures were available for petitioners to obtain the documents, as long as they were sought for a proper purpose and were not privileged.[52] However, because of *Greenberg's Express*, the Tax Court has consistently held, with few exceptions, that such information is not discoverable or admissible because it is either irrelevant, privileged, or prepared in anticipation of litigation.[53]

It should be noted that in *Greenberg's Express*, the Tax Court did not say that it would *never* look behind the Statutory Notice.[54] On the contrary, the court

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45. *See Greenberg's Express*, 62 T.C. at 325. Two petitioners were sons of Carlo Gambino, a notorious crime boss.

46. *See id.*

47. *Id. See also* TAX CT. R. PRACTICE & P. 103(a) (10) (governing impoundment orders).

48. *Greenberg's Express*, 62 T.C. at 326.

49. *See id.*

50. *See id.* (noting petitioner's request for shift in burden of proof to Service).

51. *See id.* at 326-27 (citing United States v. Birrell, 242 F. Supp. 191, 202-03 (S.D.N.Y. 1965); (in a bankruptcy proceeding the court stated that production of documents can be compelled through pretrial discovery, subpoenas duces tecum, or voluntarily by parties or witnesses to litigation).

52. *See id.* (noting procedures available to petitioners). *See generally* TAX CT. R. PRACTICE & P. 72 (stating rule for production of documents); P.T. & L. Constr. v. Commissioner, 63 T.C. 404 (1974) (noting existence of procedures to obtain documents from Service).

53. *See* Bennett v. Commissioner 74 T.C.M. (CCH) 1144, 1149 (1997) (granting pretrial request for report of independent expert evaluator for the Service because the information was relevant and not within either the work product privilege or the attorney-client privilege); Rosenfeld v. Commissioner, 82 T.C. 105, 112 (1984) (finding information sought on discovery deemed irrelevant); Branerton Corp. v. Commissioner, 64 T.C. 191, 193 (1975) (denying petitioner's motion to compel production of documents stating that at least some information may be privileged, but that documents prepared in the ordinary course by nonlawyers is not in anticipation of litigation). *Id.* at 198.

54. *See Greenberg's Express*, 62 T.C. at 327.

said it would do so, particularly when there was substantial evidence of unconstitutional behavior on the part of the Service's employees in preparing the Statutory Notice.[55]

However, even in such instances of unconstitutional behavior, the Statutory Notice would not be "null and void," as the petitioners argued.[56] Rather, the Statutory Notice would no longer carry the presumption of correctness that is normally conferred upon it.[57] In determining what standards would justify looking behind the Notice, the court referred to the tests developed dealing with prosecutorial discretion in a criminal case, and adopted similar rules.[58] The petitioners' allegations of unconstitutional selectivity did not satisfy this standard.[59]

The issue raised by the petitioners in *Greenberg's Express* had to do with *why* the Service chose to audit a particular taxpayer's returns, and whether impermissible factors were used in that selection. The selection of which returns to examine is a policy determination and should not be subject to inquiry, except in the extremely rare case of unconstitutional selectivity.[60] In addition, the *Greenberg's Express* court did not compel disclosure of the information sought by petitioners because it had determined that such information would not affect the resolution of the case.[61] Therefore, *Greenberg's Express* is of little pertinence to an inquiry into *how* (not why) a revenue agent may have committed errors in preparing his determination of the assertions set out in the Statutory Notice.

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55. *See id.* at 328 (recognizing exception when there is unconstitutional conduct by Service).

56. *See id.* (refusing to declare deficiency notices null and void).

57. *See* TAX CT. R. PRACTICE & P. 142(a) (noting that shift of burden of proof is determined by court); *see also* Human Eng'g Inst. v. Commissioner, 61 T.C. 61, 66 (1973) ("[I]f, at a trial, it appears that the taxpayer has established that the [Service's] determination is without foundation, he will be relieved of his burden of proof as to the amount of tax which may be due and that burden will be shifted to respondent." (citing Helvering v. Taylor, 293 U.S. 507 (1935))).

58. *See Greenberg's Express*, 62 T.C. at 328-29 (assuming that similar standards should be applied for criminal discrimination and civil tax litigation). The court stated the criminal rule that before a complaintant is entitled to relief, "it must appear that the law has been applied and administered by public authority with an evil eye and an unequal hand." *Id.* at 328 (quoting Yick Wo v. Hopkins, 118 U.S. 356, 373-74 (1886)).

59. *See id.* at 329 ("[W]e do not believe that petitioners' allegations, even if true, would be violative of the applicable requirements of due process.").

60. *See* Riland v. Commissioner, 79 T.C. 185, 201 (1982) (holding that, absent substantial evidence of unconstitutional conduct by the Service, the court will not examine motives or procedure leading up to deficiency determination, even if Service's employees did not follow procedures set forth in Internal Revenue Manual); Estate of David Smith v. Commissioner, 57 T.C. 650, 656 (1972) (where unconstitutional conduct is not involved courts will not inquire into administrative policies employed by Service even if administrative procedures were not as prescribed in the Service's Internal Revenue Manual).

61. *See Greenberg's Express*, 62 T.C. at 327 (excessive coverage of request for materials is beyond any reasonable grounds).

What the court actually held in *Greenberg's Express* is that matters relating to the Service's *policy* decisions are not reviewable by the Tax Court (at least up to the limits of selective prosecution).[62] The petitioners in that case cast a wide net, seeking any document even tangentially relevant to their case.[63] Their very broad discovery request did not directly deal with the assertion regarding the amount of the deficiency.[64] Thus, when limited to cases involving the Service's policy determinations, such as choosing which returns to audit, *Greenberg's Express* seems quite correct.

However, the Service often attempts, usually successfully, to extend the meaning of *Greenberg's Express* well beyond its holding by ignoring the factual context of the opinion, and emphasizing an overbroad interpretation.[65] The Service denies many taxpayer requests for information, including information related to *how* a deficiency was determined. However, the Tax Court's holding in *Greenberg's Express* was much narrower, and not even by analogy should it apply broadly to mere ministerial acts by any employees of the Service. Thus, as applied to such ministerial acts, the above excerpt from *Greenberg's Express* is dictum at best.[66]

Applying *Greenberg's Express* as the Service argues would shield almost all information that might tend to show that an employee of the Service acted improperly or carelessly.[67] Except for the most blatant and erroneous situations, such as an obvious and substantial mathematical error on the face of the Statutory Notice, or a Notice which clearly does not refer to the petitioner's income or deductions, a petitioner must know how the specific dollar assertions in the Statutory Notice were computed in order to begin to bear his burden of refuting the assertions. In answering such request for information, the Tax Court often ignores the difference between inquiries as to "how" something was done (which

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62. *See id*. (holding court would not look behind deficiency notice to examine administrative policy used in making its determinations).

63. *See id*. at 325-26 (stating that petitioners sought access to all documents relating to audit of petitioner's federal income tax returns for 1966 through 1968 and any documents relating to investigation of petitioners by Department of Justice, Internal Revenue Service or Federal Strike Force Against Organized Crime).

64. *See id*. (noting that taxable year in question is 1968 and information requested involves other years as well as other investigations not involving tax matters).

65. *See* Pasternak v. Commissioner, 990 F.2d 893, 898 (6th Cir. 1993) (stating that so long as valid summonses were issued, a trial court will not examine evidence obtained via those summonses); *Riland*, 79 T.C. at 201 (1982) (court's unwillingness to examine procedures used by Service leading to a determination of deficiency). For a discussion of the Service's argument in support of the proposition that the Tax Court should never look behind the Statutory Notice, see *supra* notes 39-64 and accompanying text. *See also infra* notes 66-74 and accompanying text.

66. *See* Hudspeth v. Commissioner, 914 F.2d 1207, 1214 (9th Cir. 1990) (reversing and remanding to Tax Court, which then held Commissioner's motives in determining deficiency irrelevant; Ninth Circuit distinguished *Greenberg's Express* saying instant case challenged accuracy of Statutory Notice, not the Service's motives for that Notice; therefore inquiry allowed).

67. *See* Ferrari, *supra* note 44.

should be proper) and inquiries as to "why" something was done (which are improper).[68]

In addition, as the *Greenberg's Express* court noted, the full range of discovery under the Tax Court's rules should allow the taxpayer access to all relevant information the Service possesses if it would be admissible at trial and is not otherwise privileged.[69] For example, a petitioner should have a right to obtain from the Service all relevant, non-privileged information, such as reports of special agents and testimony of third party witnesses.[70] Thus, there is a clear conflict between the discovery rules and the Service's view of *Greenberg's Express*.

When a petitioner seeks to know how the Service arrived at a "presumed correct" conclusion, he is usually deterred by the Service's overly broad interpretation of *Greenberg's Express*.[71] Furthermore, the Tax Court generally acquiesces and does not require production of the revenue agent's work papers or testimony from the agent.[72] Yet, such productions of work papers and testimony will not harm the Service if the Statutory Notice had been properly prepared.[73] The Service's unwillingness to supply this information appears to

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68. *See* Abatti v. Commissioner, 644 F.2d 1385, 1389 (9th Cir. 1981) (stating that Notice is sufficient to confer jurisdiction on the Tax Court even if Service merely informs taxpayer of an amount of deficiency and does not mention specific ground for deficiency); Barnes v. Commissioner, 408 F.2d, 65, 68 (7th Cir. 1969) (stating that Service's Notice is not invalidated if it contains no particulars; Tax Court has jurisdiction); *see also* Ferrari, *supra* note 44, at 407 (stating that Tax Court has imposed minimal requirements on Service in refusing to look behind notice to method of determining deficiency).

69. *Greenberg's Express*, 62 T.C. at 327; *see also* P.T. & L. Constr. Co. v. Commissioner, 63 T.C. 404, 408 (1974) (stating that if executive privilege does not apply, then special agent's report, appellate conferee's report, and the transcript of interrogation of a third party are all subject to discovery under Tax Court rules). For a discussion of the Service's view of privilege, see *infra* notes 105-12 and accompanying text.

70. *See* Branerton Corp. v. Commissioner, 64 T.C. 191, 202 (1975) (holding taxpayer is entitled to inspect copy of Service's audit papers absent an applicable privilege); *P.T.& L. Constr.*, 63 T.C. at 411-13 (holding that petitioners were entitled to portions of special agent's report not covered by executive privilege and that third party statement is subject to discovery).

71. *See* Anastasato v. Commissioner, 794 F.2d 884, 886 (3d Cir. 1986) (stating that government's deficiency assessment is generally afforded presumption of correctness, unless no predicate evidence links petitioner to unreported income from illegal sources).

72. *See Abatti*, 644 F.2d at 1389 (Statutory Notice that does not contain any reasons for deficiencies is valid to confer Tax Court jurisdiction).

73. In *Ryan v. Commissioner*, 75 T.C.M. 1778 (1998), the Service did provide petitioners with four pages of hand written notes and calculations of the revenue agent who prepared the amounts of the deficiencies on each petitioner's Statutory Notice. When petitioner Giongo called the revenue agent to testify about apparent inconsistencies in those notes, the Service objected under *Greenberg's Express*. The trial judge overruled that objection, and the agent testified with some apparent confusion and inconsistencies. *See Ryan* Transcript, at 2288-2342 (on file with the *Indiana Law Review*) (hereinafter Transcript).

stem from its adversarial desire as a litigant to give as little information as possible to an adversary, in spite of the broad discovery granted under the Tax Court's rules.[74] This position also helps to sustain the public's perception that the Service is more interested in winning cases than in determining a taxpayer's true tax liability.

B. Scar v. Commissioner

An extreme example of the Tax Court's persistent refusal to look behind a Statutory Notice is *Scar v. Commissioner*.[75] The Service mailed what it purported to be a Statutory Notice to the Scars on June 14, 1982, asserting a deficiency of $96,600 due to the disallowance of deductions totaling $138,000 attributable to the "Nevada Mining Project."[76] The "[t]otal corrected income tax liability," $96,600, was calculated at seventy percent (the maximum marginal rate) of the disallowed $138,000.[77] An attached document with the title "Nevada Mining Project, Explanation of Adjustments" stated:

> In order to protect the government's interest and since your original income tax return is unavailable at this time, the income tax is being assessed at the maximum tax rate of 70%. The tax assessment will be corrected when we receive the original return or when you send a copy of the return to us.[78]

In addition, another attached document, also titled "Nevada Mining Project, Explanation of Adjustments" stated:

> It is determined that the alleged losses claimed by you in your income tax return for the taxable year(s) 7812 with respect to an alleged partnership known as NEVADA MINING PROJECT are not allowable because you have not established that the transactions in which the partnership was involved or in which you were involved with respect to the partnership were bona fide arm's length transactions at fair market value, that such transactions were entered into for profit, or that such transactions had any economic substance other than the avoidance of taxes.[79]

In addition, this second document stated, in the alternative, that no ordinary and necessary expenses had been incurred, and that no adjusted basis had been

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74. *See* Loren D. Prescott, Jr., *Challenging the Adversarial Approach to Taxpayer Representation*, 30 LOY. L.A. L. REV. 693, 699 (1997) (stating that antagonistic nature of system encourages parties to present only that information which supports their respective positions).

75. 81 T.C. 855 (1983), *rev'd*, 814 F.2d 1363 (9th Cir. 1987). For further discussion of the Ninth Circuit's discussion, see *infra* notes 94-104 and accompanying text.

76. *Scar*, 81 T.C. at 857.

77. *Id.*

78. *Id.*

79. *Id.*

shown for the investment (which would limit the loss deduction), and that any loss would be limited by Section 465 of the Code.[80]

The Scars filed a petition with the Tax Court in which they alleged that they had never had any interest in Nevada Mining, and therefore they had not claimed any deductions related to Nevada Mining.[81] In its answer, the Service simply denied the allegations in the petition.[82]

Petitioners moved to dismiss for lack of jurisdiction, alternatively arguing: (1) no "determination" of a deficiency was made by the purported Statutory Notice; (2) that if a "determination" had been made, no notice of that determination had been sent to the petitioners; and (3) the purported Notice improperly advised of an assessment concurrently with the Notice.[83] Any of these issues would be fatal to the validity of the purported Notice.[84]

In response to petitioners' motion to dismiss, the Service conceded that the petitioners never had any interest in any mining partnership or activity.[85] Then the petitioners moved for summary judgment based on the Service's concession.[86] The Service then moved for leave to amend its answer, to state the correct (and much smaller deficiency) due to a disallowance of deductions attributable to a completely different tax shelter. It admitted that the error was made by its agent who erroneously entered the wrong tax shelter number into the Service's computer.[87]

The Tax Court held that the Statutory Notice sent to the Scars conferred jurisdiction, even though it purported to deny a deduction not claimed by the taxpayers and even though the Service had stated in its Notice that it did not base its determination of the deficiency on the taxpayers' return (since it did not have that return).[88] The court held that because no particular form is required for a Statutory Notice, as long as (1) the taxpayer's name, (2) Social Security number, (3) the taxable year or years involved and (4) an amount of a deficiency are stated on the document, it qualifies as a valid Statutory Notice.[89]

The court also permitted the Service to amend its answer.[90] This amended answer was filed after the statute of limitations for the year in issue had expired.[91] In effect, the court's opinion permits the Service to avoid the statute

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80. *See id*. at 857-58.

81. *See id.* at 858.

82. *See id*.

83. *See id.*

84. *See id.*

85. *See id.*

86. *See id.* at 858-59.

87. *See id.* at 859.

88. *See id.* at 858-62.

89. *See id*. at 860.

90. *See id*. at 863-64.

91. The statute of limitations expired on September 3, 1982 (taxpayers had received an extension of time to file); Respondent's motion for leave to amend was filed April 5, 1983. *See id*. at 858.

of limitations by sending a generic letter with no details, informing the taxpayer that the Service intends to assess taxes against him, and assuming that the court will permit the Service to amend its answer to conform to the correct facts, as it did in *Scar*.[92]

The Tax Court held that I.R.C. § 6212 is purely procedural and has no substantive effect.[93] This position does not require the court to look behind the Notice of Deficiency to see if the deficiency asserted had been properly "determined" by the Service.

However, the Ninth Circuit reversed.[94] While the court agreed that a Statutory Notice need not be in any particular form,[95] and need not explain how the determinations were made, the court continued: "The notice must, however, "meet certain substantial requirements"[96] . . . . "The notice must at a minimum indicate that the IRS has determined the amount of the deficiency."[97]
The court went on to state that Section 6212(a) "'authorizes' the sending of a deficiency notice '[i]f the Secretary *determines* that there is a deficiency.'"[98]

Quoting Judge Goff's dissent below, the appellate court held "[e]ven a cursory review of this provision [section 6212 (a)] discloses that Congress did not grant the Secretary unlimited and unfettered authority to issue notices of deficiency."[99]

In addition, the circuit court cited with approval a very early opinion of the Board of Tax Appeals,[100] wherein the Board "construed the meaning of the term 'determine' as applied to deficiency determinations. By its very definition and etymology the word 'determination' irresistibly connotes consideration, resolution, conclusion, and judgment."[101]

Since the Service cited the wrong shelter and its attributes and did not have the tax return in question, there could not have been the requisite "determination." The "'determination' requirement of section 6212(a) has substantive content."[102] This appellate opinion clearly linked the requirements

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92. In his dissenting opinion of the Tax Court, Judge Sterrett satirically drafted a generic Statutory Notice illustrating how the Service could send a nonspecific document that could serve as a valid Statutory Notice for any taxpayer under the majority view. *See id*. at 869.

93. *See id.* at 869 (Sterrett, J., dissenting).

94. *See Scar*, 814 F.2d 1363 (9th Cir. 1987). Judge Hall dissented. *Id.* at 1371.

95. *See id.* at 1367.

96. *Id*. (citing Abrams v. Commissioner, 787 F.2d 939, 941 (4th Cir. 1986), *cert. denied*, *sub nom.* Eggleston v. Commissioner, 479 U.S. 882 (1986)).

97. *Id*. (citing Benzvi v. Commissioner, 787 F.2d 1541, 1542 (11th Cir.), *cert. denied*, 479 U.S. 273 (1986)).

98. *Id*. at 1368.

99. *Id.* (citing *Scar*, 81 T.C. 855, 872 (1983)).

100. Terminal Wine Co v. Commissioner, 1 B.T.A. 697, 701 (1925).

101. *Scar*, 814 F.2d at 1368.

102. *See id.* at 1369. "To hold otherwise, would read the determination requirement out of section 6212(a)." *Id*. at 1370.

of a Statutory Notice to the administrative "determination" of a deficiency.

In dissent, Judge Hall, a former Tax Court judge, stated that "the majority [opinion] undermines the jurisdiction of the Tax Court by constructing a superfluous yet substantial hurdle to its jurisdiction."[103]

The view of the Ninth Circuit in *Scar* seems correct. There really should be a "determination" as prescribed in the statute and the Service's published internal procedures, and then those determinations of fact and law should be spelled out in the Notice. This is necessary to permit fairness in litigation. The Statutory Notice not only confers jurisdiction on the Tax Court, in practical effect it is really also the initial pleading in the case. In spite of this, the Tax Court has limited the Ninth Circuit's *Scar* result to the peculiar facts of *Scar*, where the amount of the deficiency asserted on the face of the Notice was not that of the taxpayer.[104] Indeed, apparently the Ninth Circuit has also limited *Scar* to its facts.[105]

There seems to be no valid policy reason to deny access to the details of the calculations in the Statutory Notice, through discovery or an agent's testimony. The resulting perception is that such information is denied to protect the reputation of the Service or its employees. While an employee of the Service may sometimes be careless, such carelessness is probably rare. But no one knows exactly how rare, because of the Tax Court's refusal to look at any defects in the administrative process concerning how—as opposed to why—the assertions in the Notice were determined.

If the Service is "stonewalling" because it is hiding something, or at least seeking unfair advantage in litigation, this should be changed. Showing the truth of how the deficiency was prepared would defuse many of these suspicions. And, it would help assure that the agent and his superiors would be more careful in preparing their calculations.[106] At the very least, the procedures spelled out in the Internal Revenue Service Manual should be made mandatory, rather than directory.[107] This could be enforced by having a procedurally deficient (without explanations) Notice qualify as a "ticket to the Tax Court," but deny the presumption of correctness to the assertions made. This should present no problem if the agents are as careful as they should be in calculating six digit deficiencies. The taxpayer should be afforded due process of the law by the Service and the Tax Court.

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103. *Id*. at 1371.

104. *See* Campbell v. Commissioner, 90 T.C. 110, 112-113 (1988) (holding that only when it is apparent on the face of the Notice that it was not based on a determination, as on the peculiar facts in *Scar*, is the purported Notice invalid). *Campbell* distinguished *Scar*, stating that it would not go behind the Notice where the first page of the Notice correctly identified the taxpayer and the stated the correct amount of the taxpayer's deficiency asserted, even though the remaining pages of schedules had no connection with the taxpayer. *See id.* at 112-113.

105. *See* Clapp v. Commissioner, 875 F.2d 1396, 1402 (9th Cir. 1989).

106. *See* Ferrari, *supra* note 44, at 453-55.

107. *See id*. This could be accomplished by having the Treasury promulgate them as regulations, or by act of Congress through another Taxpayer Bill of Rights.

The Service may feel it is unfair to have an erroneous tax shelter number entered by an employee (as in *Scar*) deprive the government of needed revenue. This situation, however, is quite analogous to an agent mailing the Notice to the wrong "last known address,"[108] possibly barring any assessment against the taxpayer if the statute of limitations runs before a correctly addressed Notice can be sent. There should be some consequence when the Service's employees do not follow the rules.

In *Ryan,* the court permitted the taxpayers to call and examine the revenue agent who prepared the report upon which the Statutory Notice was based.[109] The trial judge wanted to hear his testimony because "I think the statutory notice needs all the explanation it can get."[110] Respondent had supplied some of the agent's work papers to petitioners' counsels. A student from the Villanova Tax Clinic[111] examined the agent. It was apparent that there were questions that he could not answer clearly.[112] He did describe how he and another agent went about determining the amounts of unreported income attributable to each of the five petitioners, by using the transcript of the criminal trial.[113] He was somewhat confused about certain inconsistencies in the work papers. For example, on one search the petitioners were alleged to have stolen cash, diamonds and casino chips totaling $93,300.[114] The sum of the value of the cash, $24,000,[115] the value of the diamonds, $13,000,[116] and the value of the chips, $65,000[117] ascribed to the petitioners on the agent's work sheets, does not equal the $93,300 total on the same work sheets. In addition, on one page of the work papers the total for three searches for 1983 appeared in one place as $121,500 and at another place on the same page of the agent's work papers the figure was $121,600 (the latter figure

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108. I.R.C. § 6612(b)(1) (1999).

109. *See* Transcript, *supra* note 73, at 2285-87.

110. *Id.* at 2319.

111. Jode Shaw was the student. She was a C.P.A.

112. To be fair to the agent, he probably expected that he would not be required to testify under *Greenberg's Express*, or due to privilege.

113. The agent was unaware that there had been two trials because the first trial had ended with a hung jury. *See* Transcript, *supra* note 73, at 2301. He described how he and another agent went about determining the amount of unreported income they felt each taxpayer had received. The other agent had read the transcript of the criminal trial and given him a summary based upon the conviction pages of the transcript. *See id.* at 2291-92. In addition to these summaries, he also referred to the indictments which led to the convictions, which differed in some particulars from the transcript, *see id.* at 2304, 2329, and he also read the special agent's report. *See id.* at 2234.

114. This was the Hitchens search on December 30, 1982. *Id.* at 2295-2301. The dollar amount is stated. *See id*. at 2298.

115. *See id*. at 2297.

116. *See id.* There was a further discrepancy in the value of the 13 diamonds stolen. In one place they were valued at $100 each, and at another place they were valued at $1000 each. *See id*. at 2299-2300. The agent used the higher value in calculating the deficiency.

117. *See id.* at 2297. There was also some confusion as to whether a sum of $14,000 in chips was included in the $65,000 or was an additional amount. *See id.* at 2297-98.

was used on the Statutory Notices).[118]

None of these errors represented a significant percentage of the total dollar figures asserted, and the deciding judge[119] presumably regarded these as harmless error. However, it must be remembered that the assertions in the Notice are presumed to be correct.[120] In the usual civil fraud case, where the court would not permit petitioners to "look behind" the Notice, these errors could not be detected. If in fact the Tax Court normally required the revenue agent's reports to be made available to petitioners and required the agent to testify as to how he or she formulated those reports, a petitioner could be sure the process (if not the dollar amounts computed) was correct. It should not require much extra time for revenue agents to be more careful, and the positives benefits of full disclosure of the process to the Service should more than offset any negatives. There seems to be no good reason for the no disclosure policy aside from the possibility of embarrassment. As long as the Service stonewalls, there will always be suspicion that the Service is intent on hiding its errors. Again, recall that all that is being sought is *how* the Service did or did not conform to its published procedures; it does not seek information on *why* the Service acted as it did.

III. HOW THE SERVICE PREVENTS THE TAXPAYER FROM DISCOVERING POSSIBLE ERRORS IN THE STATUTORY NOTICE: PRIVILEGE

In addition to the *Greenberg's Express* argument, the Service consistently argues that all documents supporting its computations of a deficiency are prepared in anticipation of litigation, and therefore are not discoverable.[121] But is a Revenue Agent's Report ("RAR"), compiled after an audit, prepared in

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118. *See id.* at 2312-14. The agent could offer no explanation for the difference. *See id.*

119. Remember that the trial judge had died before briefs were submitted, and the deciding judge did not have the benefit of watching the agent on the witness stand.

120. *See supra* note 29 and accompanying text.

121. *See generally* FED. R CIV. P. 26 (permitting discovery for non-privileged documents). Subsection (a)(1)(B) provides that "a party shall . . . provide to other parties . . . a copy of, or a description by category and location of, all documents . . . in the possession, custody, or control of the party that are relevant to the disputed facts alleged with particularity in the pleadings." FED. R CIV. P. 26(a)(1)(B). In addition, Rule 26 permits discovery for all documents not privileged. *See* FED. R CIV. P. 26(b)(1) ("Unless otherwise limited, . . . [p]arties may obtain discovery regarding any matter, not privileged, which is relevant to the subject matter involved in the pending action.").

Federal Rule of Evidence 501 states, "[T]he privilege of a witness . . . shall be governed by the principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience." FED. R. EVID. 501. The attorney-client privilege and work product protection for documents are recognized as the oldest of the privileges for confidential communications known to the common law. *See* United States v. Zolin, 491 U.S. 554, 562 (1989) (citing Upjohn Co. v. United States, 449 U.S. 383, 389 (1981)). In the Tax Court, the Service will often refuse to produce any documents they feel were produced in anticipation of litigation. *See infra* notes 120-25 and accompanying text (discussing the contrary view of the District Court in *Peterson v. United States*, 52 F.R.D. 317 (S.D. Ill. 1971)).

"anticipation of litigation"? While an RAR may actually be used to show the amount of the deficiency asserted in the Statutory Notice, that is not the primary function of the RAR.[122] In effect, the Service is asserting that *everything* its employees do at *any time* is potentially part of some future litigation and, thus, not discoverable. This position reinforces the Service's position in *Greenberg's Express*, sharply decreasing the likelihood that a petitioner will find a basis for any error in a Statutory Notice.

In *Peterson v. United States*,[123] the Service asserted that all of its reports and documents were prepared in anticipation of litigation and were therefore undiscoverable.[124] The District Court concluded, however, that all reports and documents are *not* prepared in anticipation of litigation.[125] The court held that documents that are privileged as prepared in anticipation of litigation do *not* include the following:

(1) documents that are routinely prepared before a lawsuit is filed;
(2) documents that are not prepared at the direction of an attorney involved in preparing a case if litigation develops;
(3) documents that are not designed to be adversarial, but impartial between the taxpayer and the Service;
(4) documents that do not pertain to the Service's theory of a trial of that case; and
(5) reports resulting from evidence submitted by the taxpayer and the Service.[126]

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122. *See* Block-Southland Sportswear Co. v. United States, No. 1563, 1972 WL 455, at *1 (E.D.N.C. Nov. 24, 1972) (explaining primary purpose of RAR). "The purpose of such letter and report is to inform the taxpayer of the results of an income tax audit for a particular year and to extend to him an opportunity to request a conference for a further discussion of a proposed adjustment in his tax liability." *Id.*

123. 52 F.R.D. 317 (S.D. Ill. 1971).

124. *See id.* at 320 (expressing Service's conclusory view that documents are not discoverable).

125. *See id.* at 320-22 (holding documents discoverable because they were not prepared in anticipation of litigation). It must be noted that before a taxpayer can bring a refund suit in the District Court (or the Court of Federal Claims), he must pay the entire deficiency. *See supra* note 22. In most instances of fraud, the asserted deficiencies—especially if a "protective position," *see infra* Part VII, is asserted by the Service—are so large that prepayment is not an option. Therefore, taxpayers must litigate in the Tax Court, even if there is a more favorable discovery decision in another forum.

126. *Peterson*, 52 F.R.D. at 320-21 (identifying documents that were not privileged). In *Peterson* the Service argued that disclosure of documents prepared prior to litigation would inhibit free and open discussion among officials and, thus, violated public policy. *See id.* at 321 (discussing Service's public policy assertion based on prior legal precedent). The court noted that those officials had submitted affidavits stating that opinions at the various levels of the Service were impartial expositions of the facts and the law, and that revealing those opinions should not embarrass the government. *See id.*

No further commentary is needed. The Tax Court should adopt this rational, sensible approach. There seems to be no obvious downside to the District Court's position, except for the Service's loss of an unfair litigation advantage. It is particularly unfortunate that the Tax Court does not adhere to this view, because almost all civil fraud cases must be in fact be brought in the Tax Court.[127]

IV. THE TAX COURT'S "DE NOVO" TRIAL DOES NOT CURE ERRONEOUS STATUTORY NOTICES

The Tax Court has consistently held that, because its trial is de novo, it will weigh any errors in a Statutory Notice.[128] Of course, this does not solve the problem for a petitioner who is the possible victim of the Service's "stonewalling" under *Greenberg's Express* and the assertion of privilege. The de novo trial really does not address these problems because the Service still benefits from the "presumptive correctness" of its (possibly erroneous) Statutory Notice,[129] and the Tax Court usually does not permit inquiry into the Service's methods of determining a deficiency. And, even where the Statutory Notice is invalid on its face, as in *Scar*, the Tax Court will not look behind the Notice.[130]

Therefore, in a most important sense, the Tax Court trial is not truly de novo. The court seems to focus on its jurisdiction as the sole function of the Statutory Notice.[131] However, in addition to its procedural jurisdictional effect, the Notice is a substantive document quite analogous to the initial pleading in any other type of case, except that its allegations are presumed to be correct. These presumptively correct assertions become fact determinations unless they are successfully rebutted by the petitioner.[132] The problems created by this substantive effect of the Notice are especially difficult for taxpayers who are marginal members of a conspiracy and must disprove a sum likely to be greatly in excess of anything they received because of the "protective position" even if

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127. Keep in mind that few civil fraud cases can be brought anywhere but the Tax Court. *See supra* note 22.

128. Riland v. Commissioner, 79 T.C. 185, 201 (1982) (stating that a trial before the Tax Court is proceeding de novo, citing *Greenberg's Express v. Commissioner*, 62 T.C. 324, 328 (1974)) (fact that Service personnel did not follow internal procedures as stated in Internal Revenue Manual is not a denial of due process, citing *United States v. Canceres*, 440 U.S. 741 (1979)).

129. *See* Anastasato v. Commissioner, 794 F.2d 884, 886 (3d Cir. 1986) (stating government's deficiency assessment is generally afforded presumption of correctness once Service has shown evidence linking petitioner to income source). *But see* Hudspeth v. Commissioner, 914 F.2d 1207, 1214 (9th Cir. 1990) (reversing Tax Court which had held Service's motives in determining deficiency are irrelevant; distinguishing *Greenberg's Express* by noting that the instant case challenges accuracy of Statutory Notice, not the Service's motives for that Notice).

130. "The fact that it subsequently develops even prior to trial that there was no deficiency on the basis of the grounds set forth in the deficiency notice is irrelevant." Scar v. Commissioner, 81 T.C. 855, 861 (1983).

131. *See, e.g.*, 814 F.2d at 1371-72 (Hall, J., dissenting).

132. *See supra* note 29 and accompanying text.

they have no knowledge of the finances of the conspiracy.[133]

Clearly, application of *Greenberg's Express* must be limited to cases involving facts similar to those in that case,[134] and the assertion of privilege must also be limited. The court's notion that its de novo trial will cure any failures or errors in the administrative process is hard to justify. It seems that the underlying basis for the Service's refusal to produce documents and testimony is simply adversarial advantage. Only the Tax Court can remedy this secrecy by permitting discovery of these documents. However, the Tax Court simply does not wish to delve into the internal workings of the Service.[135]

The Tax Court's position is that the primary function of the Statutory Notice is to determine whether that Notice is adequate to confer jurisdiction on the court, rather than to see if the taxpayer has received due process under the Service's own stated administrative procedures.[136]

A de novo trial of a civil fraud case cannot bring any failures or errors made by the Service to light because even simple computational errors could not be discovered under the Service's extreme view of *Greenberg's Express*. In short, only issues of *policy* within the Service should be subject to this evidentiary exclusion. Similarly, the judiciary should view the Service's assertions of privilege skeptically, as the District Court did in *Peterson*.[137]

V. *HELVERING V. TAYLOR*, ERRONEOUS NOTICES, AND THE EVIDENTIARY PROBLEMS POSED BY *GREENBERG'S EXPRESS* AND PRIVILEGE

Helvering v. Taylor,[138] shifted the burden from the taxpayer to the Service to show the amount of tax due where the asserted deficiency was "arbitrary and excessive."[139] *Taylor* has never been overruled. It is rarely applied by the lower courts however,[140] due in large part to the Service's reading of *Greenberg's Express* and privileges as shields against discovery. Unless there is obvious evidence of substantial errors within the Service, the courts' history of shielding non-policy, internal decisions effectively prevents many taxpayers from knowing how the amount of the asserted deficiency was determined and, therefore, from knowing if the Service committed any errors. The result of the Service's refusal to disclose how deficiencies were determined makes a petitioner's burden of disproof even more onerous than the already difficult burden he bears to disprove

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133. *See infra* Part VII.

134. For a discussion of *Greenberg's Express*, see *supra* notes 39-74 and accompanying text.

135. *See* Ferrari, *supra* note 44.

136. *See id.* at 423-28.

137. *See supra* notes 123-29 and accompanying text.

138. 293 U.S. 507 (1935).

139. *Id.* at 515.

140. *See* Portillo v. Commissioner, 932 F.2d 1128, 1133 (5th Cir. 1991) (finding taxpayer had proven assessment to be arbitrary and without foundation); Estate of Todisco v. Commissioner, 757 F.2d 1, 5 (1st Cir. 1985) (holding that Service's determination of profit percentage was arbitrary and excessive and therefore unsustainable).

the assertions made in the Statutory Notice.[141]

Where the courts have applied *Taylor*, some cases say that it results in a shift of the burden of going forward to the Service, but the taxpayer still retains the ultimate burden of persuasion.[142] Other courts have held that the burden of persuasion also shifts to the Service.[143] Either way, if the taxpayer has no information regarding how the asserted deficiency was determined, he could not begin to show whether the amounts shown in the Statutory Notice are in fact "arbitrary and excessive," or even simply erroneous.[144] Under the Service's view of *Greenberg's Express*, a taxpayer cannot even contest an erroneous transposition of figures, a computational error, or sloppiness.[145] Remember that these possibly erroneous assertions are presumed correct.[146]

The Service should not oppose disclosure of such errors, however, because the effect of such disclosures will foster confidence in the fairness of the process. In addition, it would show that the Service cares about fairness, even if the agents must take more time and be more careful in preparing Statutory Notices. There is no obvious reason, other than adversarial advantage, why the Service should oppose more carefully prepared documents and the testimony of the agent who

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141. *See* Vessio v. Commissioner, 59 T.C.M. (CCH) 495 (1990) (discussing presumption of correctness attaches to Statutory Notice and noting that in case of criminal loansharking, Service showed connection of hoard of cash to taxpayer's activity); Callan v. Commissioner, 42 T.C.M. (CCH) 796 (1981) (noting that presumption of correctness attaches to statutory notice with respect to disallowed deductions).

142. *See* Higginbotham v. United States, 556 F.2d 1173, 1176 (4th Cir. 1977) (holding that burden of persuasion remains with taxpayer once taxpayer has introduced evidence that assessment is arbitrary and excessive); United States v. Rexach, 482 F.2d 10, 16 (1st Cir. 1973) (same, based on regularity of taxpayer having records).

143. *See* Keogh v. Commissioner, 713 F.2d 496, 501 (9th Cir. 1983) (dictum) (burden of persuasion shifts to government when taxpayer overcomes presumption of correctness by showing naked assessment, because jeopardy assessment cannot be enjoined); United States v. Stonehill, 702 F.2d 1288, 1294 (9th Cir. 1983) (dictum).

144. *See Keogh*, 713 F.2d at 500 (stating that petitioners were unable to rebut presumption of correctness because they did not present evidence showing that Service's assessment was incorrect).

145. *See* Pasternak v. Commissioner, 990 F.2d 893, 898 (6th Cir. 1993) (stating that court will not look behind Statutory Notice based on evidence obtained via summonses as long as the summonses were validly issued, citing *Greenberg's Express*); Riland v. Commissioner, 79 T.C. 185, 201 (1982) (stating court's unwillingness to examine procedures used by Service to determine deficiency, citing *Greenberg's Express*).

Even if the Service in fact furnishes a copy of the revenue agent's rough worksheets used to calculate the amount of the fraudulent deficiencies to the petitioner, as occurred in *Ryan*, the revenue agent, if called to testify at trial, can still invoke *Greenberg's Express* to preclude his testimony concerning those work papers. In *Ryan* the court overruled the Service's objection under *Greenberg's Express*. Transcript, *supra* note 73, at 2285-87.

146. For a discussion of the presumption of correctness, see *supra* note 29 and accompanying text.

prepared the Statutory Notice.

Given the recently publicized congressional hearings dealing with abuses committed by the Service, the openness suggested herein might help reduce public suspicion of the Service.[147]

VI. COMPLICATIONS IN A MULTI-PARTY SITUATION

When the petitioner's fraudulent activity is part of a RICO[148] or other conspiracy charge, his burden of disproof compounds dramatically because he must not only bear part of the burden of disproving the gross amount of the income asserted for the entire conspiracy, but he must also bear the burden of disproving the Service's assertions of his own portion of that total income.[149] This approach may be reasonable if the taxpayer knows, or should know, the inner workings of the conspiracy. However, for a marginal conspirator who does not know these details, placing the burden of proof on that petitioner seems quite unreasonable. Indeed, a conspirator on the fringe of the conspiracy may in fact know nothing about the conspiracy or its profits aside from what the primary conspirators tell him. Moreover, if a conspirator is deemed a member of the conspiracy solely by virtue of participating in a cover up, he may not have received a distribution of any monetary proceeds.

In *Cipparone v. Commissioner*,[150] for example, a conspirator who had been convicted of a criminal act under RICO and of engaging in a bribery conspiracy under state law, which did not require his receipt of money, was found not to have committed fraud and not to have received substantial money from the conspiracy.[151]

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147. *See* Hudspeth v. Commissioner, 914 F.2d 1207, 1214 (9th Cir. 1990) (reversing and remanding to Tax Court which held Commissioner's motives in determining deficiency irrelevant, and distinguishing *Greenberg's Express* saying instant case challenges accuracy of Statutory Notice, not the Service's motives for that Notice). For a discussion of legitimate exclusions of evidence under *Greenberg's Express*, see *supra* notes 60-67 and accompanying text.

148. Organized Crime Control Act Title IX, 18 U.S.C. §§ 1961-68 (1994).

149. Once fraud has been shown by the Service, each petitioner must bear the burden of disproving the amount of the income asserted against him in the Notice. *See supra* note 29. Because of the cumulative and redundant assertions of virtually the entire income of the conspiracy income against each taxpayer under the protective position, such disproof is difficult. Such disproof is especially difficult for a minor conspirator, because the relatively small amounts of illegal income he received is dwarfed by the total income of the conspiracy. See *infra* note 175 for the large dollar figures of unreported income attributed to Giongo in the Statutory Notice in *Ryan,* and the dramatically lesser amount he was determined to have received by the court.

150. 49 T.C.M. (CCH) 1492 (1985).

151. *Id.* at 1500 (finding insufficient evidence of fraud). "We cannot find petitioner's failure to report his share of kickback income, of which he may never have received more than an insubstantial portion, to be clear and convincing evidence of fraud." *Id.* The court posited that because the petitioner was not at all familiar with tax laws, there was no way he should have known of the requirement to file when he believed no income was received. *See id.* Due to his lack of

Cipparone, the Court Administrator of the Philadelphia Traffic Court, was involved in an illegal kickback scheme with two others.[152] The other two conspirators personally collected the traffic court fines, divided the money between themselves, and allegedly gave some small sums to the petitioner.[153] The Tax Court found that the petitioner received substantially less than the others because:

(1) the others were in control of the distribution;
(2) petitioner was not present when the money was divided;
(3) the other two were close friends;
(4) the two main witnesses lacked credibility;
(5) the petitioner testified as to his modest standard of living; and
(6) the petitioner was neither knowledgeable nor sophisticated about tax laws.[154]

Cipparone's failure to report the income, which was an insubstantial part of the proceeds of the entire conspiracy, was held not to constitute clear and convincing evidence of fraud.[155] Thus, a truly minor conspirator may be deemed not to have committed fraud despite his receipt of some minimal income.[156]

Furthermore, in *United States v. Sarbello*,[157] a criminal fraud case, the Third Circuit held that if one conspirator clearly played a major role in a conspiracy compared to a co-conspirator who had only a minor role, then the minor conspirator's Eighth Amendment rights are violated if he is charged with the same RICO restitution penalty[158] as the major conspirator.[159]

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specific intent to defraud, the court found in his favor on the issue of fraud. *See id.* at 1500-01.

152. *See id.* at 1493-94.

153. *See id.* at 1494-95 (identifying petitioner's limited role in conspiracy).

154. *See id.* at 1496-97 (determining petitioner's receipt of smaller amount of income compared with other conspirators).

155. *See id.*

156. *See id.* at 1500 (finding minor member in conspiracy not fraudulent because he did not pay taxes on minimal income). This is contrary to the literal language of I.R.C. § 6663(b) (1999) (referring to *any* fraud, with no de minimis exception). For an interpretation of the language of I.R.C. § 6663 (b), see *supra* notes 25-30 and accompanying text.

157. 985 F.2d 716 (3d Cir. 1993).

158. This RICO restitution penalty is created by 18 U.S.C. § 1963 (1994).

159. *See Sarbello*, 985 F.2d at 724 (finding violation of Eighth Amendment when minor conspirator is given same restitution penalty as major conspirators). The court recommended a balancing test to weigh the seriousness of the crime against the severity of the sanction being imposed. *See id*. at 723 (explaining need for proportionality in non-capital punishments). Therefore, a minor member of the conspiracy (like Mr. Sarbello) had a viable claim under the Eighth Amendment if he is charged with the same RICO restitution penalty under 18 U.S.C. § 1963 as those who played a more significant role in the conspiracy. *See id.* at 724.

In *United States v. Wilson*, 742 F. Supp. 905 (E.D. Pa. 1989), *aff'd without opinion*, 909 F.2d 1478 (3d Cir. 1990) (the prior criminal trial involving the facts in *Ryan*) the jury determined that three of the four convicted men had to pay a $5000 RICO restitution penalty, but the fourth,

Both *Cipparone* (a civil action) and *Sarbello* (a criminal action) stand for the proposition of proportionality. An obviously minor conspirator should be deemed to have received very little, or possibly nothing, compared with major conspirators.[160] Unfortunately for such minor players, the Service takes a "protective position," asserting redundantly that each conspirator has received all, or almost all, of the income of the conspiracy.[161]

VII. THE SERVICE'S "PROTECTIVE POSITION"

Disproving an asserted deficiency in a consolidated conspiracy civil tax trial can prove especially difficult for any one petitioner because the Service can argue that, because of the clandestine nature of a criminal conspiracy, only the conspirators themselves can know the amount of the income of the conspiracy and how it was divided. Thus, the courts permit a redundant allocation of all of the income from the conspiracy to *each* conspirator.[162] Because it protects the Service from the "whipsaw" of each petitioner claiming "the others" received all of the proceeds, this position is sometimes called the "anti-whipsaw" position. This redundant multi-allocation of the same income, called the "protective position," has consistently been upheld by the courts.[163] Although the two

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Giongo, did not have to pay any restitution penalty. *See id.* at 907. Upon motion of the United States Attorney, the District Court held each of the four men convicted to be jointly and severally liable for $180,700, the entire sum that the jury determined to be the total fruits of the conspiracy. *See id.* at 909 (holding that joint and several liability on gross proceeds of conspiracy is consistent with "statutory scheme" of RICO).

It would seem that a minor conspirator (like Giongo) who was found by the jury to have a zero restitution penalty, and the amount of whose penalty was remolded by the court to create full joint and several liability, has had his Eighth Amendment rights abridged under *Sarbello*. *See id.* Apparently the Eighth Amendment issue was not presented on appeal in *Wilson,* because nothing in the Third Circuit's decision reflects this issue being raised. Since *Sarbello* was decided by the same court three years later, the argument, if made in *Wilson* on Giongo's behalf, might have prevailed. Of course, the Eighth Amendment's effect on the RICO restitution penalty was not relevant in the civil fraud case. *See* Ryan v. Commissioner, 75 T.C.M. (CCH) 1778 (1998).

160. *See Sarbello*, 985 F.2d at 724 (differentiating minor conspirator's role from that of major conspirator in determining the restitution-forfeiture penalty under RICO after conviction in criminal case); Cipparone v. Commissioner, 49 T.C.M. (CCH) 1492, 1498-1500 (1985) (same, in a civil case).

161. See *infra* Part VII for an analysis of the "protective position."

162. *See* Arouth v. Commissioner, 64 T.C.M. (CCH) 1390 (1992) (allowing Commissioner to take protective position regarding prescription drug conspiracy). The court permitted the protective position until further information was uncovered; when no records or reliable testimony were uncovered regarding the conspirators' division of income, the court determined that it was "appropriate to approximate the respective percentages of the sales proceeds that each petitioner received." *Id*. at 1395. The court eventually held that the income should be allocated to each conspirator equally. *See id*. The protective position is discussed *infra* in Part VII.

163. *See id.* (upholding Service's protective position); Gerardo v. Commissioner, 552 F.2d

methods most often used do not have actual names, it is useful to refer to them as the "slice of the pie" and the "act-by-act" methods.

A. The "Slice of the Pie" Approach

If the Service first attempts to prove the total income of the illegal enterprise and then attempts to allocate that gross sum pro rata among the conspirators, the protective position makes sense.[164] Once the size of the total "pie" is determined, there is a zero-sum conflict among the conspirators. If one conspirator proves his share of the profits of the entire illicit conspiracy was less than that asserted by the Service, of necessity, some other conspirator must be allocated that sum in order to keep the size of the pie constant.

A major problem with the "size of the pie" approach occurs whenever there are members of the conspiracy who were not convicted in a prior criminal fraud case, but who may have received part of the proceeds. There can be unindicted co-conspirators, conspirators who were tried and found not guilty of any RICO or tax crimes,[165] and members of the conspiracy who cooperated with the Service giving evidence against their co-conspirators.[166] Any or all of these conspirators might have received part of the entire "pie," but if no Statutory Notice had been issued to them, they would not be subject to the Tax Court's jurisdiction. Thus, there could be some difficulty in using this approach in multi-party cases where conspirators other than those before the court possibly received a share of the spoils.

B. The Act-by-Act Approach

When many separate illegal acts are part of a continuing conspiracy and each act possibly involves different members of the conspiracy, the Service may attempt to prove the dollar sum taken during each illegal act, and how the conspirators divided the income from each of those separate illegal acts.[167] The Tax Court then follows the evidence presented, focusing upon each separate

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549, 555 (5th Cir. 1977) (permitting "inconsistent, alternative assessments" if each has an accepted legal basis); Stone v. United States, 405 F. Supp. 642, 649 (S.D. N.Y. 1975) (same).

164. Often the Service will attempt to prove the total proceeds of the RICO enterprise, and then assert relatively equal allocations to each conspirator. This makes sense when all conspirators are relatively equal "partners." In cases where there were many separate fraudulent acts, the Service may adopt the act-by-act approach, attempting to determine the profits from each act separately and dividing those proceeds among the conspirators act-by-act as the findings of fact indicate. *See* Ryan v. Commissioner, 75 T.C.M. (CCH) 1778, 1788-97 (1998).

165. *See id.* (noting that there were over a dozen unindicted co-conspirators involved in conspiracy at issue); *see also* Johnson v. Commissioner, 41 T.C.M. (CCH) 769, 773-75 (1981) (finding no fraud in the cases of unindicted co-conspirators whose testimony was not believable).

166. In *Ryan*, two former co-conspirators testified against the petitioners. *See Ryan*, 75 T.C.M. at 1784. *See also* United States v. Register, 496 F.2d 1072 (5th Cir. 1974) (involving conspirators who turned against their co-conspirators and testified at their trial).

167. *See Ryan*, 75 T.C.M. (CCH) at 1788-97 (applying act-by-act approach).

criminal act, and determines the amount, if any, received by each conspirator, act-by-act.[168]

The logic behind the protective position is somewhat faulty in act-by-act cases. Because there is no "pie," there is no zero-sum issue in an act-by-act fraud case. Instead, the court determines a specific dollar sum of income for each illegal event, and then determines how much of the income from each of these events is to be allocated to each conspirator.[169] These are findings of fact, and cannot be reversed on appeal unless clearly erroneous.[170] Few conspirators can effectively challenge this type of decision because of the standard of review and, therefore, the Service's protective position is unnecessary. If there are clear findings of fact concerning the amount of money or property each conspirator received from each event, no protective position is needed, short of an unlikely finding of clearly erroneous on appeal.[171]

Even within the act-by-act approach, the Service can assert a series of protective positions. That is, the Service can determine the income generated by each illegal act and make redundant assertions of that income from each illegal act, because it can argue that only the conspirators can know how the income from each illegal act was divided. The result of this series of protective positions under the act-by-act approach will be quite similar to the result under a slice-of-the-pie approach, unless it is clear that certain conspirators did not share in the proceeds of a particular illegal act, and therefore those conspirators should not be allocated anything from that particular act.[172]

In *Ryan*, there was a further complication. The two co-conspirators who testified against the others said that there had been a "policy" of sharing the proceeds of a search between the officers making the arrest and their partners and supervisors. This had the effect of inflating the amounts attributed to those who were not present at the raid. The *Ryan* decision did not attribute any of the

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168. In *Ryan*, at trial the Service asserted claims against each petitioner for all or most of the proceeds from 23 separate criminal acts of the conspiracy. *See id.* at 1778-79. Of course, the Service can assert redundant "protective" sums within each alleged illegal act.

169. *See id.* at 1788-97 (showing how court determined total income received by each conspirator by looking at each criminal act and determining the profits from each act separately, then dividing those profits among the conspirators involved in that act).

170. *See* I.R.C. § 7482(a) (1999) (requiring United States Courts of Appeal to review Tax Court decisions "in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury"); FED. R. CIV. P. 52(a) ("Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses."); *see also In re* King Resources Co. v. Charles A. Baer, 651 F.2d 1326, 1335 (10th Cir. 1980) ("[A] determination by the district court of valuation is a finding of fact which will not be reversed on appeal unless clearly erroneous.").

171. For a statement of the clearly erroneous standard, see *supra* note 170. The protective position on appeal also makes sense if the appeal is based upon some procedural error below.

172. In *Ryan*, the Service requested the court to determine the amount each petitioner received search by search. *See Ryan*, 75 T.C.M. (CCH) at 1787.

proceeds under this "policy."[173]

After the Tax Court determines the liability of each taxpayer, on appeal the Department of Justice can continue the protective position by cross-appealing against each appellant. However, since the trial court's determination of the profits from each search and of each participant's share of each search is almost always within the clearly erroneous standard, there is no real possibility of reallocation of the act-by-act decision, as under a "slice of the pie" approach.[174]

Because of the great adversarial advantage the Service gains from the protective or anti-whipsaw position, as well as because of the difficulties the Service would have in showing the division of total income amongst the clandestine conspirators, the Service will likely assert the protective position in virtually every multiparty civil fraud tax case. Assuming this position is argued by the Service, the issue is not the validity of redundant allocations for the "protective position" in either a "slice of the pie" or an "act-by-act" situation. The true issue is *when* must the Service abandon the protective position.

Unless and until the Service abandons its protective position, a minor individual conspirator cannot know the specific (non-protective position) dollar sum he must bear the burden to negate. Even if the Service reduces the amount it asserts the particular taxpayer "really" received after the testimony is complete,[175] it comes too late to aid the taxpayer in countering the overlarge

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173. *Ryan*, 75 T.C.M. (CCH) at 1787-88.

174. *See* I.R.C. § 7482(a) (1998) (requiring United States Courts of Appeal to review Tax Court decisions "in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury"); *see also* Commissioner v. Duberstein, 363 U.S. 278, 289-91 (1960) (holding Tax Court factual findings must be upheld unless clearly erroneous); Eli Lilly & Co. v. Commissioner, 856 F.2d 855, 861 (7th Cir. 1988) (applying clearly erroneous standard to appellate review of Tax Court's reallocation of income); Thomson v. Commissioner, 406 F.2d 1006, 1010 (9th Cir. 1969) (recognizing that review of Tax Court's decision on apportionment of income is limited to determining whether apportionment was clearly erroneous).

Some believe that the courts of appeals have overemphasized I.R.C. § 7482(a) and ignored the preexisting I.R.C. § 7482(c)(1) (2000): "[The appellate courts] shall have power to affirm or, *if the decision of the Tax Court is not in accordance with law,* to modify or reverse the decision . . . as justice may require." (emphasis added). *See* David F. Shores, *Deferential Review of Tax Court Decisions:* Dobson *Revisited*, 49 TAX LAW. 629 (1996); David F. Shores, *Rethinking Deferential Review of Tax Court Decisions*, 53 TAX LAW. 35 (1999). Although Professor Shores primarily argues for a theory which would require the appellate courts to defer to the Tax Court on issues of law unless the decision is "not in accordance with law," he does suggest that the present standard of reviewing issues of law de novo, and issues of fact by the clearly erroneous standard is not set in stone.

175. This was done in *Ryan*, 75 T.C.M. (CCH) at 1787. It must be noted that the originally asserted deficiency in income in the Statutory Notice against Giongo was $ 214,900, *see id.* at 1786, which was reduced to $ 25,966 after trial, when the protective position was dropped. *See id.* at 1787. The deciding judge found Giongo's unreported income totaled $ 7150 from four searches: Lees, $650, *see id*. at 1791; Roeder, $5000, *see id*. at 1793; Carr, $500, *see id.* at. 1794; and Megna, $1000. *See id*. at 1795. This dramatizes the inequity of the protective position to marginal

redundant protective assertions.

VIII. THE SERVICE'S BURDEN OF PROOF OF FRAUD: COLLATERAL ESTOPPEL

The Service must prove a taxpayer's fraud by clear and convincing evidence.[176] Although it can attempt to prove fraud in several ways, the most common method is to collaterally estop a petitioner from denying he was fraudulent after a prior criminal conviction against the petitioner.[177] Even when collateral estoppel does not preclude a petitioner's denial of all of the essential elements of fraud, partial collateral estoppel may still preclude his denial of at least some of the elements of fraud.[178]

Collateral estoppel does not have statutory roots; it is a judge-made rule designed to promote judicial economy.[179] It arises *only* if there has been a prior judicial determination that is relevant to a later case between the same parties.[180]

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conspirators.

176. *See* I.R.C. § 6663 (b) (added by OMBRA 1989).

177. *See, e.g.*, Gray v. Commissioner, 708 F.2d 243, 246 (6th Cir. 1983). The court in *Gray* prior criminal conviction for income tax evasion to preclude the taxpayer from attempting to disprove fraud in subsequent civil tax fraud matter by collateral estoppel). *See id.* at 248. However, the dissent felt that a plea of guilty should not create collateral estoppel when the defendant was not apprised of the collateral effects of his plea, and he had no full and fair opportunity to litigate the issues. *See id.*247- 48 (Merritt, J., dissenting). Plunkett v. Commissioner, 465 F.2d 299, 307 (7th Cir. 1972) (holding prior tax evasion conviction after guilty plea produces the same collateral estoppel as a trial on merits concerning issue of civil fraud in civil proceeding); Amos v. Commissioner, 360 F.2d 358 (4th Cir. 1965) (same); Moore v. United States, 360 F.2d. 353 (4th Cir. 1965) (same in refund suit).

178. *See, e.g.*, Cadwell v. Commissioner, 70 T.C.M. (CCH) 1318, 1320 (1995) (summary judgment motion by Service granted in civil case because of collateral estoppel from prior criminal conviction for the same taxable years; concerning years not involved in the criminal conviction, taxpayer was found to have committed fraud based on the "badges of fraud" analysis); Considine v. Commissioner, 68 T.C. 52 (1977) (finding that taxpayer's prior criminal conviction of filing a false return had partial collateral estoppel effect on proving I.R.C. § 6653(b) violation). *But see* Wright v. Commissioner, 84 T.C. 636 (1985) (limiting the scope of collateral estoppel from a conviction for filing a false return in a subsequent civil case). *Wright* is discussed *infra* notes 194-99 and accompanying text.

179. *See* David H. Brown, *Collateral Estoppel Effects of Administrative Agency Determinations: Where Should Federal Courts Draw the Line?*, 73 CORNELL L. REV. 817, 821 (1988) (commenting on usefulness of collateral estoppel theory, stating that courts clearly have accepted efficiency as justification for doctrine, and arguing that decisions of administrative agencies sitting in judicial capacity should also invoke the doctrine of collateral estoppel); Eli J. Richardson, *Taking Issue with Preclusion: Reinventing Collateral Estoppel*, 65 MISS. L.J. 41, 46 (1995) (identifying purposes behind common law collateral estoppel doctrine: conservation of judicial resources, preservation of court system integrity by preventing inconsistent resolution of issues, promotion of finality of judgments and protection of defendants from repetitive litigation).

180. *See* Montana v. United States, 440 U.S. 147, 153 (1979) (citing Parklane Hosiery Co.

Thus, no estoppel can arise from a prior case settled with the Service, because a settlement is not a judicial determination.

The leading Supreme Court case dealing with collateral estoppel, *Commissioner v. Sunnen*,[181] is a tax case.[182] Explaining *Sunnen*, the Court in *Montana v. United States*[183] stated that collateral estoppel exists when all three prongs of the following test are satisfied:

(1) the issues in the second case are substantially the same as those resolved in the first;
(2) there has been no significant change in the facts or law since the first case; and
(3) there are no special circumstances that permit the court to deviate from the usual rules of preclusion.[184]

In civil tax cases one must differentiate fraud cases from non-fraud cases in discussing collateral estoppel. In non-fraud cases, collateral estoppel can only arise when the same parties (or their privies) are contesting an issue that has been judicially determined in a prior case.[185] This can only occur if in two separate taxable years, the same taxpayer (or his privy) is involved.[186] Each taxable year creates a separate cause of action, therefore if the taxpayer is the same for each of two or more taxable years, and if the facts and law have not significantly changed, there is no need to relitigate any issue actually decided in the first case.[187]

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v. Shore, 439 U.S. 322, 326 n.5 (1979)) (discussing role of collateral estoppel); Commissioner v. Sunnen, 333 U.S. 591, 597-98 (1948) (requiring actual judicial determination before collateral estoppel may attach); Trapp v. United States, 177 F.2d 1, 4 (10th Cir. 1949) (construing collateral estoppel doctrine narrowly in non-fraud tax cases).

181. 333 U.S. 591 (1948).

182. *See id.* at 594-95 (not a fraud case; discussing whether husband received taxable income from royalties assigned to him by his wife on same facts and law over succeeding years).

183. 440 U.S. 147 (1979).

184. *See id.* at 155 (enumerating necessary inquiries to determine appropriate application of collateral estoppel).

185. *See, e.g.*, *Sunnen*, 333 U.S. at 598 (stating that doctrine prohibits relitigation of matters actually litigated and judicially determined in prior proceeding); Commissioner v. Thomas Flexible Coupling Co., 198 F.2d 350, 353 (3d Cir. 1952) (recognizing that estoppel applies only to controverted points actually determined in previous suit, not from settlements).

186. *See Sunnen*, 333 U.S. at 599 ("[W]here two cases involve income taxes in different taxable years, collateral estoppel must be used with its limitations carefully in mind so as to avoid injustice."); Tait v. Western Md. Ry. Co., 289 U.S. 620, 624 (1933) (recognizing that doctrine is applicable only when two or more separate tax years are involved).

187. *See Sunnen*, 333 U.S. at 599 ("[C]ollateral estoppel . . . is designed to prevent repetitious lawsuits over matters which have once been decided and which have remained substantially static, factually and legally."); Jones v. United States, 466 F.2d 131, 134-35 (10th Cir. 1972) (applying collateral estoppel when subsequent claim was between same parties as in prior case, arose under same contractual arrangement, applicable tax laws had not changed, and the only difference was taxable years involved).

In a civil fraud case in which a taxpayer has been convicted of a tax crime, or certain other crimes, for the same taxable years as in the subsequent civil tax fraud case, each essential element of those crimes should not be relitigated.[188]

If, in a civil fraud case, there has not been a prior criminal trial, or if the taxpayer has been acquitted in a criminal trial, collateral estoppel cannot arise, because there was no prior judicial determination concerning any of the essential elements of fraud.[189] Even if there were no prior criminal cases or convictions of the taxpayer and, therefore, no collateral estoppel, the Service can still proceed with the civil fraud tax case.[190]

When collateral estoppel does not itself prove all of the elements of fraud, the Service can use partial collateral estoppel to preclude relitigation of at least

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188. *See* Blohm v. Commissioner, 994 F.2d 1542, 1554 (11th Cir. 1993) (holding that criminal tax fraud conviction after plea estops taxpayer from denying liability for civil fraud under I.R.C. § 6653 (b) for same year); Klein v. Commissioner, 880 F.2d 260, 262 (10th Cir. 1989) (same).

189. *See* Helvering v. Mitchell, 303 U.S. 391, 397-98 (1938) (holding that taxpayer's prior acquittal of attempted tax evasion did not bar Commissioner from asserting civil penalty for same year). "The difference in degree of burden of proof in criminal and civil cases precludes application of [collateral estoppel in this instance]." *Id.* at 397 (discussing different nature of civil and criminal cases concerning payment or evasion of taxes). A taxpayer's victory in a criminal tax fraud case means merely that the Government did not prove every element beyond a reasonable doubt. *See id.* (noting criminal acquittal did not imply party had not "willfully attempted to evade the tax" civilly). If the government has failed to prove any element of the crime charged beyond a reasonable doubt, it is still possible for the Service to prove the lesser standard of "clear and convincing evidence." *See id.* at 397-98 (stating that, in such instance, some issues presented were litigated and determined in criminal proceeding). Accordingly, it is not significant for collateral estoppel purposes that the taxpayer was acquitted in criminal case. *See id.* (noting difference in standards of proof do not prevent subsequent civil case when criminal case failed). Collateral estoppel is therefore a no-win situation for the taxpayer: heads the Service wins, tails the taxpayer loses.

190. *See, e.g.*, Traficant v. Commissioner, 884 F.2d 258, 263 (6th Cir. 1989) (holding taxpayer's acquittal on RICO bribery and criminal filing of a false return charges did not bar civil tax fraud proceeding on issue preclusion grounds); Neaderland v. Commissioner, 424 F.2d 639, 641 (2d Cir. 1970) (holding acquittal of taxpayer in prior criminal prosecution did not bar finding of tax fraud in civil proceeding through doctrine of collateral estoppel).

The civil fraud addition to tax prescribed by I.R.C. § 6663(b) is not criminal, but rather remedial, in nature. *See Mitchell*, 303 U.S. at 401 ("The remedial character of sanctions imposing additions to a tax has been made clear by this Court . . . [t]hey are provided primarily as a safeguard for the protection of the revenue and to reimburse the Government for the heavy expense of investigation and the loss resulting from the taxpayer's fraud."). Thus, because the second case is civil, not criminal, there is no double jeopardy issue. *See id.* at 404 (holding that remedial sanction does not duly burden defendant in civil enforcement action). But especially when it is quite apparent that the Service will collect little or nothing from the petitioners who have spent or forfeited their profits and have few assets, this rationale makes no sense.

some of the elements of fraud which had been determined in the prior case.[191] In that situation, the Service can still prove the missing elements of fraud by other means, usually with a "badges of fraud" argument.[192]

Collateral estoppel, as applied to a civil fraud tax case, prevents only the relitigating of any determinations *necessarily* made in a prior criminal case between the particular taxpayer and the United States, and for the same taxable year or years.[193] In cases where a taxpayer has been found guilty of some crime necessarily requiring the receipt of money or its equivalent, collateral estoppel prevents the relitigation concerning the receipt of money.[194] However, collateral estoppel cannot preclude relitigation of any determinations that were not necessary to the prior criminal conviction.[195]

If collateral estoppel exists from a prior criminal case, the extent of how that doctrine affects a later civil tax fraud case depends on the specifics of that prior conviction.

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191. *See, e.g.*, Cadwell v. Commissioner, 70 T.C.M. (CCH) 1318 (1995) (granting Service's summary judgment motion for tax fraud violation under I.R.C. § 6663(b) (1999), when Service invoked the doctrine of collateral estoppel based upon a guilty plea to tax evasion under I.R.C. § 7201 for two years, and a "badges of fraud" analysis for other years); Huff v. Commissioner, 56 T.C.M. (CCH) 838 (1988) (holding that plea of guilty for one year of criminal tax fraud collaterally estops taxpayer from denying willfulness element of civil fraud, but for other years a bank deposits analysis and application of the badges doctrine of fraud satisfies burden of Service to prove fraud).

192. Alexander Shokai, Inc. v. Commissioner, 34 F.3d 1480, 1487 (9th Cir. 1994) (listing "badges of fraud," including understatements of income, inadequate records, implausible or inconsistent explanations of behavior, concealment of assets, failure to co-operate with tax authorities, and a lack of credibility of taxpayer's testimony); Bradford v. Commissioner, 796 F.2d 303, 307 (9th Cir. 1986) (stating court may infer fraudulent intent through circumstantial "badges of fraud"); Toussaint v. Commissioner, 743 F.2d 309, 312 (5th Cir. 1984) (same).

193. *Cf.* I.R.C. § 7422(c) (when res judicata applies, the "identical party test" is satisfied even though Department of Justice prosecuted criminal case and Department of Treasury tries civil fraud case); the same rule should apply to collateral estoppel because both are grounded on the same juridical purpose. *See also* Tait v. Western Md. Ry. Co., 289 U.S. 620, 627 (1933) ("[W]here a question has been adjudged as between a taxpayer and the government or its official agent. . . the collector, being an official inferior in authority, and acting under them, is in such privity with them that he is estopped by the judgment.").

194. *See, e.g.*, Brown v. Commissioner, 42 T.C.M. (CCH) 579 (1981) (granting summary judgment to Service after criminal conviction for false filing on subsequent assertion of civil fraud penalty [note that this case preceded *Wright*, discussed *infra* notes 201-06, granting only partial collateral estoppel]); Rodney v. Commissioner, 53 T.C. 287, 306 (1969) (holding taxpayer's prior conviction on criminal tax fraud estops him from denying civil tax fraud for same year; however, spouse of criminal is not estopped by his conviction).

195. *See* Montana v. United States, 440 U.S. 147, 153 (1979) (requiring controverted issue to be "actually and necessarily determined" in prior case before collateral estoppel doctrine can apply); Fitzpatrick v. Commissioner, 70 T.C.M. (CCH) 1357, 1359 (1995) (stating that closing letter from the Service is not a judicial determination and therefore cannot generate collateral estoppel).

A. If the Taxpayer Has Been Convicted of Criminal Tax Fraud

Collateral estoppel prevents a petitioner from relitigating any of the elements of fraud because the elements of criminal tax fraud and civil tax fraud are identical.[196] Because fraud had to have been proven beyond a reasonable doubt in the criminal trial, a fortiori the lesser standard of clear and convincing evidence is satisfied. In the subsequent civil fraud case, the Service has automatically carried its burden of proving fraud by a complete collateral estoppel from the prior criminal case. Therefore, the Tax Court must merely determine the amount of the deficiency for each petitioner.[197]

B. If the Taxpayer Has Been Convicted of Willfully Filing a False Tax Return

"Willfully" has the same meaning for filing a false return as for fraud.[198]

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196. *See* Gray v. Commissioner, 708 F.2d 243, 246 (6th Cir. 1983) ("The elements of criminal tax evasion and civil tax fraud are identical."); Hicks Co. v. Commissioner, 470 F.2d 87, 90 (1st Cir. 1972) (same); Moore v. United States, 360 F.2d 353, 356 (4th Cir. 1965), *cert. denied*, 385 U.S. 1001 (1967) (recognizing that criminal tax evasion conviction necessarily involves same ultimate factual determinations needed for finding of fraud under I.R.C. § 6653 (b)); Amos v. Commissioner, 360 F.2d 248 (4th Cir. 1965) (same). Although these cases were decided under I.R.C. § 6653 (repealed in 1989), the definition of fraud was not changed for I.R.C. § 6663 (added in 1989).

197. *See Gray*, 708 F.2d at 250 (stating that a guilty plea has given taxpayer his day in court, and acts as complete collateral estoppel). *But see id*. at 247 (dissent, stating that there are other reasons for a guilty plea, not every fact has been determined, and taxpayer had not been warned of collateral effects of plea) (Merritt, J., dissenting). *See also* Note, *Collateral Estoppel in Civil Tax Fraud Cases Subsequent to Criminal Conviction*, 64 MICH. L. REV. 317, 322 (1965) (recognizing that application of complete collateral estoppel in this instance may not save time or conserve judicial resources). In establishing criminal tax evasion, the Service need not prove the exact amount of the evasion. *See id.* (noting that only some amount of evasion must be proven to establish willful evasion). Therefore, the exact deficiency to which the present seventy-five percent penalty imposed by I.R.C. § 6663 (a) will attach is still subject to litigation. *See id.* (recognizing that taxpayer is collaterally estopped from relitigating issue of fraud in subsequent action). To determine the precise amount of deficiency, the court must perform a review of the taxpayer's every item of income and expense for the year, and careful consideration of this evidence involves many judicial hours. *See id.* (noting that collateral estoppel only applies to findings of fact "upon which the prior conviction necessarily rests"). Therefore, "whether or not collateral estoppel is applied, the court must re-examine the voluminous evidence." *Id.*

198. United States v. Bishop, 412 U.S. 346, 360 (1973) (holding that willfully means voluntary, intentional violation of known legal duty, or bad faith and evil intent); *see also* Daniel Anker, Comment, Cheek v. United States*: Beliefs That Tax Credulity Still Get to the Jury*, 41 CASE W. RES. L. REV. 1311, 1314 (1991) (discussing mens rea element in federal tax jurisprudence). Commentators have discussed the meaning of the term "willfully" in tax statutes in terms of the theory of mens rea:

> In tax statutes, "the word 'willfully' . . . generally connotes a voluntary, intentional

However, fraud requires proof of an intent to evade taxes,[199] while filing a false return does not.[200]

In the leading Tax Court case on collateral estoppel in this context, *Wright v. Commissioner*,[201] the Tax Court reversed its prior holding,[202] limiting collateral estoppel from a criminal conviction for filing a false return. Only those essential elements of tax fraud[203] which are also essential elements of filing a false return create collateral estoppel.[204] The court held that there was no complete collateral estoppel in this situation because a necessary element of fraud—the intent to evade taxes—is not an element of the crime of filing a false return.[205]

> violation of a known legal duty. It [may be] 'bad faith or evil intent,' or 'evil motive and want of justification in view of all the financial circumstances of the taxpayer.' [Courts] . . . seek[] an "element of mens rea" where the tax law uses the word "willfully," in order to "implement[] the pervasive intent of Congress to construct penalties that separate the purposeful tax violator from the well-meaning, but easily confused, mass of taxpayers."

Id.; Richard A. Carpenter, *Practical Guide to Understanding Criminal Tax Matters*, 60 TAX'N FOR ACCT. 292, 292 (1998) (noting that during most recent reporting period federal grand juries indicted 2,282 individuals for tax crimes leading to eighty-nine percent conviction rate). The most frequent form of tax violation is filing a false income tax return. *See id.* at 293 (noting that these returns substantially understate income or overstate deductions).

199. *See* elements of fraud, *supra* note 4 and accompanying text.

200. *See* Wright v. Commissioner, 84 T.C. 636, 639-43 (1985) (discussing burdens of proof and elements necessary for conviction under filing of a false return under I.R.C. § 6206(1)); *see also* Jeffrey S. Parker, *The Economics of Mens Rea*, 79 VA. L. REV. 741, 811 (1993) (proposing economic explanation of mens rea including tax crimes.)

201. 84 T.C. 636 (1985).

202. *See* Goodwin v. Commissioner, 73 T.C. 215 (1979).

203. *See supra* note 4 and accompanying text.

204. *See Wright*, 84 T.C. at 643-44 (stating that conviction was a fact to be considered at trial) (overruling prior collateral estoppel rule where a false filing conviction created collateral estoppel in civil fraud trial established in *Goodwin v. Commissioner*, 73 T.C. 215 (1979)). *See generally* Murray H. Falk, *Collateral Effects of the Criminal Tax Case*, C254 ALI-ABA 239, 239-45 (1988) (discussing collateral estoppel in civil and criminal tax cases); Martin M. Lore & Marvin J. Garbis, *Denial of Fraud Was Not Collaterally Estopped*, 62 J. TAX'N 377, 377-78 (1985) (discussing holding in *Wright*).

205. *See Wright*, 84 T.C. at 641 (stating that "the intent to evade taxes is not an element of the crime covered by section 7206(1)"); *see also* I.R.C. § 7206(1) (1999) (establishing basis of culpability for fraud and false statements). Section 7206(1) provides, in relevant part:

> Any person who—
>
> (1) Declaration under penalties of perjury.—Willfully makes and subscribes any return, statement, or other document, which contains or is verified by a written declaration that it is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter; . . . shall be guilty of a felony. . . .

Id. For a treatment of other cases holding that the intent to evade taxes is not an element of the crime covered by I.R.C. § 7206(1), see *United States v. Tsanas*, 572 F.2d 340, 343 (2d Cir.), *cert.*

The Service must prove this missing element by presenting other evidence of an intent to evade taxes, urging the Tax Court to find the missing intent element "on all of the facts."[206] For example, in *Ryan*, the court held that a conviction under RICO in the same year as the filing of a false return is sufficient to constitute fraud, even if none of the predicate acts underlying the RICO conviction require the receipt of money.[207] Thus, with only partial collateral estoppel (from the elements common to fraud and filing a false return), the

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denied, 435 U.S. 995 (1978) (comparing elements of crimes covered by § 7201 and § 7206(1) and finding latter is lesser included offense of the former); *United States v. DiVarco*, 484 F.2d 670, 673-74 (7th Cir 1973) (noting that proof of specific intent to evade taxes was not required in such matters); *Siravo v. United States*, 377 F.2d 469, 472 n.4 (1st Cir. 1967) ("[I]ntent to evade taxes is not an element of the crime charged under [section 7206(1)]."); *United States v. Hans*, 548 F. Supp. 1119, 1123-24 (S.D. Ohio 1982) (distinguishing between elements of § 7201 actions and elements of § 7206(1) actions regarding proof of willful intent).

206. *See* I.R.C. § 7482 (establishing standard of review on appeal). Such a finding of fact will normally not be reversible, because the standard for review of Tax Court decisions under I.R.C. § 7482(a) is the same as an appeal from a district court in a non-jury civil case. *See id.* The standard for appeal from a decision of the District Court is that no case can be reversed unless the findings of fact are clearly erroneous. *See generally* Farcasanu v. Commissioner, 436 F.2d 146, 148 (D.C. Cir. 1970) (holding that burden rests with appellant to show that findings that Romanian Communist government's confiscation of his property constituted theft for tax purposes; were clearly erroneous); Baldwin Bros., Inc. v. Commissioner, 361 F.2d 668, 670 (3d Cir. 1966) (holding that burden is on taxpayer to establish that challenged ruling of tax court was arbitrary).

207. The overwhelming number of conspirators convicted in any RICO case are convicted of predicate acts requiring the receipt of money or property. *See* G. Robert Blakey & Kevin P. Roddy, *Reflections on* Reves v. Ernst & Young*: Its Meaning and Impact on Substantive, Accessory, Aiding and Abetting and Conspiracy Liability Under RICO*, 33 AM. CRIM. L. REV. 1345, 1423 (1996) (discussing RICO criminal and civil accomplice liability). The Service makes the inference that this assumed receipt of money or property which is not reported equals fraud. *See also* Pamela H. Bucy, *Criminal Tax Fraud: The Downfall of Murderers, Madams and Thieves*, 29 ARIZ. ST. L.J. 639, 669 (1997) ("Whenever the income not reported or taxes evaded arise from fraudulent activity, the tax fraud charges may "piggy-back" other charges arising from the fraud, such as RICO, embezzlement, or money laundering."). This is true, assuming the willfulness element of fraud is satisfied. However, where the jury has found guilt only of conspiracy or aiding and abetting, there is no necessary finding of the receipt of money; therefore, the taxpayers are not estopped to deny the receipt of money in the later civil suit. *See* Ryan v. Commissioner, 75 T.C.M. (CCH) 1778, 1797 (1998).

See also United States v. Shenberg, 89 F.3d 1461, 1479 (11th Cir. 1996) (holding that on retrial of certain counts of a RICO case, collateral estoppel precluded government from using predicate acts of which defendants had been acquitted in first trial as "an essential element" of mistried counts).

Of course, when the trial court finds on all the facts that a petitioner actually received money from the conspiracy, the practical result is the same, but it is not derived from collateral estoppel. *See* Ryan 75 T.C.M. at 1789-97.

Service can still prove the other elements of civil fraud by other means.[208] This would satisfy the element of evasion not supplied by collateral estoppel, and thus could prove fraud by clear and convincing evidence.

C. If the Taxpayer Has Committed Some Non-Tax Crime

The taxpayer cannot relitigate any essential element of a prior judicial determination.[209] Therefore, if the receipt of money or its equivalent is an essential element of the crime for which the petitioner was convicted, such as for robbery or bribery, the petitioner cannot deny the receipt of money or its equivalent.

On the other hand, if the prior criminal conviction is for a crime such as aiding and abetting robbery, which in most statutes does not have the receipt of money or equivalent as an essential element of that crime, collateral estoppel alone cannot bar the taxpayer from attempting to show he received no income.

D. If the Taxpayer Has Been Convicted of the Crime of Conspiracy

No collateral estoppel can arise from a prior conviction for conspiracy unless the statute, federal or state, defines conspiracy as requiring the receipt of money or the equivalent.[210]

If the taxpayer has been convicted of RICO conspiracy,[211] that violation must

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208. *See* Carpenter, *supra* note 198, at 293 (discussing badges of fraud and fact that badges can be used as means of inferring fraud on part of the taxpayer). While looking for fraudulent behavior, the IRS looks for certain "badges of fraud" including:

> [A] consistent pattern by the taxpayer of underreporting income or overstating deductions, omission of an entire source of income on a tax return, claiming completely fictitious deductions, keeping two sets of books or no books at all, making false entries in the books, providing the accountant with false information concerning the preparation of the tax return, destroying tax records, . . . filing a False form W-4 with an employer claiming excess exemptions to reduce the taxes withheld, backdating tax records, dealing in large sums of cash without an adequate explanation, concealment of bank accounts . . . and other property.

Id. (noting that taxpayer must have acted voluntarily and intentionally); *see also infra* Part IX.

209. *See, e.g.*, Instituto Nacional De Comercializacion Agricola v. Continental Ill. Nat'l Bank & Trust Co., 858 F.2d 1264, 1271 (7th Cir. 1988) (not a tax case; holding that issues actually litigated for purposes of criminal conviction conclusively establish those issues for later federal civil litigation); Fidelity Stand. Life Ins. Co. v. First Nat'l. Bank, 510 F.2d 272, 273 (5th Cir. 1975) (not a tax case; holding collateral estoppel applies to bar relitigation of identical issues, even where prior state court judgment is subject to appellate review; also uses full faith and credit argument); Kiker v. Hefner, 409 F.2d 1067, 1068 (5th Cir. 1969) (holding collateral estoppel applies to bar relitigation even where prior judgment was clearly incorrect, as long as issue could have been raised).

210. *See* Musslewhite, *supra* note 23, at 650 (noting that automatic application of collateral estoppel is inappropriate).

211. Organized Crime Control Act, Title IX, 18 U.S.C. §§ 1961-68 (1994).

be based upon at least two "predicate" criminal acts which underlie the conspiracy.[212] If the predicate crimes of which a RICO defendant was found guilty necessarily require the receipt of money or the equivalent, the taxpayer will be estopped from denying such receipt[213] If, however, the predicate crimes do not necessarily require the receipt of money, collateral estoppel cannot bar the taxpayer from contesting the assertion of his receipt of unreported income.[214] The Service must then prove the fraudulent receipt of income by other means.

IX. THE SERVICE'S BURDEN OF PROOF OF FRAUD: "BADGES OF FRAUD"

Tax fraud is usually proven by circumstantial evidence.[215] The most common way is by matching the taxpayer's actions against those "badges of fraud" that have been used since the days of English common law.[216] In the context of tax

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212. *See id.* § 1961(5) (requiring at least two predicate acts in furtherance of conspiracy).

213. *See supra* note 209 and accompanying text (discussing importance of commission of non-tax crime in relationship to collateral estoppel in civil fraud case); *see also* 18 U.S.C. § 2 (establishing statutory elements of aiding and abetting). The general provisions of 18 U.S.C. § 2 provide, in relevant part:

> (a) Whoever commits an offense against the United States or aids, abets, counsels, commands, induces or procures its commission, is punishable as a principal.
>
> (b) Whoever willfully causes an act to be done which if directly performed by him or another would be an offense against the United States, is punishable as a principal.

Id.

214. *See supra* notes 209-13 and accompanying text (noting that in conviction for conspiracy, collateral estoppel cannot arise unless state defines conspiracy as requiring receipt of money or property). For general discussions of aiding and conspiracy abetting in both criminal and civil contexts, see Harvey L. Pitt, *The Demise of Implied Aiding and Abetting Liability*, 211 N.Y. L.J. 1 (1994) (discussing statutory and judicial treatment of aiding and abetting).

215. *See* Bradford v. Commissioner, 796 F.2d 303, 307 (9th Cir. 1986) ("Because fraudulent intent is rarely established by direct evidence, this court has inferred intent from various kinds of circumstantial evidence."); Hicks Co. v. Commissioner, 56 T.C. 982, 1019 (1971), *aff'd*, 470 F.2d 87 (1st Cir. 1972) (noting that requisite specific intent necessary to prove existence of fraud is rarely susceptible of direct proof); *see also* Reed Tinsley & Joseph V. Pease, Jr., *Guidelines for Protecting the Tax Practitioner from Criminal Liability*, 40 TAX'N FOR ACCT. 94, 95 (1988) (stating that knowledge of fraud is usually established by circumstantial evidence).

216. *See* Peter A. Alces, Comment, *Fraud Bases of Bulk Transferee Liability*, 63 Temp. L. Rev. 679, 685-87 (1990). Alces noted:

> Fraudulent disposition law developed early in commercial jurisprudence, claiming roots in the Roman statutes, and assuming the form we would perhaps first recognize in the Statute of 13 Elizabeth, a penal statute. Accordingly, liability under the specific language of the statute was actual fraud liability. . . . Recognition of constructive fraud liability began in earnest with Twyne's Case [76 Eng. Rep. 809 (Star Chamber 1601)]. In that case, the court enumerated the . . . "badges of fraud" as an adjunct of actual fraud liability. . . . Development of the badges, and therefore, the bases of constructive fraud liability, resulted from an evidentiary predicament: how to prove an actual intent to

fraud, the "badges of fraud" are not only indicia of fraud generally, but they may also provide specific evidence of the intent to evade taxes, a necessary element of fraud.

Some of the more common "badges of fraud" that may arise in a civil tax fraud case include:

A. A Pattern of Understatement.
B. Concealment of Assets or Sources of Income.
C. Dealings in Cash.
D. Failure to Maintain Books and Records.
E. Engaging in Illegal Activities.
F. Attempting to Conceal Illegal Activities.
G. Failure to Cooperate with Tax Authorities.
H. Showing a Willingness to Defraud Business Associates or Others.
I. Taxpayer's Sophistication, Education, and Knowledge of Duty to Report Income.
J. Giving Implausible Explanations.[217]

A. A Pattern of Understatement

Repeated understatement of taxable income by a taxpayer is considered a major badge of fraud.[218] The Service will use testimony and other evidence to show repeated understatements of the receipt of money from criminal activities.[219] To the extent the testimony and corroboration are credible, such

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hinder, delay, or defraud . . . .

Id. See also Mary Leiter Swick, *The Power of Avoidance: A Bankruptcy Perspective on the Developing Law of Fraudulent Transfers in Nebraska*, 25 CREIGHTON L. REV. 577 (1992) (noting that American courts adopted and expanded English common law badge of fraud concepts).

217. *See* Estate of Upshaw v. Commissioner, 416 F.2d 737, 741 (7th Cir. 1969), *cert. denied*, 397 U.S. 962 (1970) (Tax Court's finding of fraud is a fact determination and is subject to clearly erroneous standard on appeal; citing taxpayer's failure to keep adequate books and records as indicia of fraud); O'Connor v. Commissioner, 412 F.2d 304, 310 (2d Cir. 1969) (noting taxpayer's experience and knowledge of tax law as a CPA is indicia of fraud); Foster v. Commissioner, 391 F.2d 727, 733 (4th Cir. 1968) (noting failure to report the size and frequency of omissions from income over extended period of time as indicia of fraud); Henry v. Commissioner, 362 F.2d 640, 643 (5th Cir. 1966) (discussing concealment of bank accounts as indicia of fraud); Estate of Granat v. Commissioner, 298 F.2d 397, 398 (2d Cir. 1962) (indicating that omissions of income and failure to provide access to records is indicia of fraud). Afshar v. Commissioner, 41 T.C.M. (CCH) 1489, 1509 (1981), *aff'd*, 692 F.2d 751 (4th Cir. 1982), *cert. denied*, 461 U.S. 928 (1983) (noting that taxpayer's fraud in business transaction may point toward a willingness to defraud government); *see also* INTERNAL REVENUE MANUAL § 4231 (1998) (listing common badges of fraud).

218. *See* Holland v. United States, 348 U.S. 121, 139 (1954) (holding evidence of consistent pattern of underreporting large amounts of income supports inference of willfulness on part of taxpayer); *cf.* Cipparone v. Commissioner, 49 T.C.M. (CCH) 1492 (1985) (noting minimal under-reporting of income from illegal kickback scheme not fraudulent).

219. *See* I.R.C. § 7201 (1999) (establishing penalties for willful tax evasion); United States

evidence indicates the receipt of unreported money.[220] At this stage, where the sole issue is whether or not there was fraud, there is no need for the Service to show the precise amounts received by a particular taxpayer in a conspiracy. Any recurring receipt that is properly included in gross income, which is not reported as taxable income, or any recurring deductions that are not proper, can create a "pattern."[221]

A "pattern" will be found to exist if there are several instances of such unreported income, possibly even if they are within a single year.[222] Of course, a "pattern" cannot be established if there is a single incident. But are two incidents sufficient to constitute a pattern? If not, what is the minimum number which will constitute a pattern?

In any year for which the taxpayer has been convicted of filing a false return, under I.R.C. § 7206(1) (1999), the Service will treat that year as part of a pattern of understatement, thereby helping prove the intent to evade.[223] However, this reasoning is circular and illogical. In *Wright*, the Tax Court decided that a conviction for filing a false return under I.R.C. § 7206(1) (1999) does not equal fraud, because the required intent to evade tax is not an element of I.R.C. § 7206(1) (1999).[224] It is quite illogical to say that § 7206(1) requires an additional

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v. Larson, 612 F.2d 1301, 1305 (8th Cir. 1980) (holding consistent pattern of understatement of income may be used to establish essential element of willfulness); *Upshaw's Estate*, 416 F.2d at 741 (holding that consistent pattern of understatement of substantial amounts of income over period of years is not mere understatement and is persuasive evidence of fraudulent intent to evade taxes); Kramer v. Commissioner, 389 F.2d 236, 239 (7th Cir. 1968) (holding taxpayer systematically under reported large amounts of income over number of years (citing *Holland*, 348 U.S. at 139)).

220. *See* Ryan v. Commissioner, 75 T.C.M. (CCH) 1778, 1797-98 (1998) (discussing proof of willfulness through pattern of under-reporting).

221. *See Cipparone*, 49 T.C.M. at 1500 (a few dollars of understated income might not suffice to constitute a clear underpayment or a "pattern"); *see also Holland*, 348 U.S. at 138 (noting that Government must prove every element of offense beyond reasonable doubt).

222. The "pattern" of understatement usually refers to year-to-year understatements, however, one might argue that a "pattern" could be discerned from multiple under reporting of items of income or overstating deductions within one year.

Prior to passage of I.R.C. § 7525 (1998) (added in 1998 by P.L. 105-206), which created a practitioner-client privilege, the Service could have subpoenaed the records of the taxpayer's accountant to gather evidence of a possible pattern. *See* Kenneth Winter & Robert Carney, *Dealing Without an Accountant-Client Privilege*, 53 TAX'N FOR ACCT. 356, 362 (1994) (noting that because there was no accountant-client privilege, Service often tried to establish intent via pattern of understatement in multiple years using accountant's papers). Obviously, I.R.C. § 7525 will make it harder for the Service to show a "pattern" for multiple years.

223. *See Ryan*, 75 T.C.M. (CCH) at 1798 (this type of assertion was made with respect only to petitioner Giongo).

224. *See* Wright v. Commissioner, 84 T.C. 636, 643 (1985) (discussing elements of § 7206(1)). Refer to *supra* note 4 and accompanying text listing the three elements of fraud. Only the intent to evade was missing in *Wright*. *See Wright*, 84 T.C. at 643. The *Wright* court noted: "In a criminal action under section 7206(1), the issue actually litigated and necessarily determined

factor to show fraud, and then attempt to prove that additional factor by invoking § 7206(1) itself.

B. Concealment of Assets or Sources of Income

Obviously, concealment of assets or sources of income is, and should be, a prime badge of fraud.[225] Unexplained income and an unexplained accumulation of assets, or both, strongly suggest the receipt of unreported income. The attempted concealment of such income and assets further implies there is something to hide. Both civil and criminal fraud may be shown by an indirect method of determining a taxpayer's unreported income under a "net worth," a "cash expenditures," or a "bank deposit" method.[226] To be convincing, the

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is whether the taxpayer voluntarily and intentionally violated his or her known legal duty not to make a false statement as to any material matter on a return." *Id.* *See also* United States v. Pomponio, 429 U.S. 10, 12 (1976) (holding willfully simply means voluntary, intentional violation of known legal duty); United States v. Bishop, 412 U.S. 346, 361 (1973) (willfully has same meaning for tax misdemeanors and felonies).

225. *See* Spies v. United States, 317 U.S. 492, 499 (1943) (discussing tax evasion and holding that motive and concealment of assets and other willful attempts to evade must be shown); Gendelman v. United States, 191 F.2d 993, 996 (9th Cir. 1951), *cert. denied*, 342 U.S. 909 (1952), (noting government was not required to prove exact amounts of unreported income); Braswell v. Commissioner, 66 T.C.M (CCH) 627 (1993) (noting questionable tax practices and fraud through use of charitable contributions).

226. *See* BORIS I. BITTKER & MARTIN J, MCMAHON, JR., FEDERAL INCOME TAXATION OF INDIVIDUALS ¶¶ 43.2-43.4 (2d ed. 1995); see also I.R. MANUAL HANDBOOK 9.5, THE INVESTIGATIVE PROCESS, Ch. 9 Method of Proof [9.5]- [9.7] for official detail of these methods.

The Court in *Holland* was acutely aware of the inherent pitfalls in the employment of the net worth method:

> As we have said, the method requires assumptions, among which is the equation of unexplained increases in net worth with unreported taxable income. Obviously such an assumption has many weaknesses. It may be that gifts, inheritances, loans and the like account for the newly acquired wealth. There is great danger that the jury may assume that once the Government has established the figures in its net worth computations, the crime of tax evasion automatically follows. The possibility of this increases where the jury, without guarding instructions, is allowed to take into the jury room the various charts summarizing the computations; bare figures have a way of acquiring an existence of their own, independent of the evidence which gave rise to them.
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> . . .
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> While we cannot say that these pitfalls inherent in the net worth method foreclose its use, they do require the exercise of great care and restraint. The complexity of the problem is such that it cannot be met merely by the application of general rules. Trial courts should approach these cases in the full realization that the taxpayer may be ensnared in a system which, though difficult for the prosecution to utilize, is equally hard for the defendant to refute.
>
> Charges should be especially clear, including, in addition to the formal

unexplained funds and assets should clearly be *substantially* in excess of what a person with the same reportable taxable income could reasonably be expected to accumulate or to spend.[227]

C. Dealings in Cash[228]

The practice of dealing in cash is a badge of fraud that overlaps the preceding badge, because concealment of income is usually accomplished by the receipt and payment of cash, which unlike checks and credit cards, does not leave a traceable record. Because all taxpayers generally conduct at least some transactions in cash, this badge must refer to the excessive use of cash by a petitioner relative to his economic level. On the other hand, there are some who, for whatever reason, do not trust banks.[229]

But if a taxpayer who had been dealing primarily with checks and credit cards began dealing exclusively with cash around the time of the conspiracy, it would be an especially strong indication of fraud.

> instructions, a summary of the nature of the net worth method, the assumptions on which it rests, and the inferences available both for and against the accused. Appellate courts should review the cases, bearing constantly in mind the difficulties that arise when circumstantial evidence as to guilt is the chief weapon of a method that is itself only an approximation.

Holland, 348 U.S. at 127-29. *See generally* Ian M. Comisky, *The Likely Source: An Unexplored Weakness in the Net Worth Method of Proof*, 36 U. MIAMI L. REV. 1 (1981) (discussing weaknesses of net worth method and noting that government has used net worth method for over fifty years).

227. *Cf.* Cipparone v. Commissioner, 49 T.C.M.(CCH) 1492 (1985) (discussing unreported insubstantial income as result of bribery and kickback scheme).

228. *See* Spies v. United States, 317 U.S. 492, 500 (1943) (noting that defendant insisting on cash transactions and keeping cash accounts under family members' names are indicia of fraud); Pittman v. Commissioner, 100 F.3d 1308, 1314 (7th Cir. 1996) (noting defendant attempted to eliminate paper trail by dealing only in cash, and keeping double set of books with multiple false entries and false documents). Various other indicia of unreported income include paying cash for an automobile or a boat or taking expensive vacations. *See id.* Conti v. Commissioner, 39 F.3d 658, 664 (6th Cir. 1994) (stating that taxpayer's explanations of sources of large amounts of cash were not credible); Steven M. Harris, *Temporary Regulations Clarify Over-$10,000-Cash Reporting, but Leave Many Questions*, 63 J. TAX'N 138, 141 (1985) (noting that dealings in cash are very incriminating).

229. *See* United States v. Ludwig, 897 F.2d 875, 877 (7th Cir. 1990) ("Ludwig told Internal Revenue Service Special Agent Lawrence Hart that because he did not trust banks, he kept the $65,000 to $75,000 cash proceeds from this bowling alley sale in a box in a closet in his Freedom, Wisconsin, home from 1971 until 1981 when he built the Kaukauna furniture store."); Morris v. United States, 813 F.2d 343, 345-46 (11th Cir. 1987) ("The testimony of K.A. Morris, the appellant, was generally to the effect that he had saved funds during his entire working life, that he did not trust banks, and that he engaged in many 'extra-curricular' activities, such as bee-keeping and buying and selling real estate, and that the profits from such transactions were not banked by him but were secreted around the house.").

D. Failure to Maintain Books and Records

A taxpayer's failure to maintain accurate books and records is allegedly a prime badge of fraud.[230] In fact, this badge should probably be stated as a conscious and deliberate failure to maintain accurate books and records.[231]

Two situations should be distinguished with regard to this badge. First, when a taxpayer is engaged in an otherwise lawful business, particularly one in which receipts are largely in cash, applying this badge makes sense because the taxpayer presumably has records of his lawful income, and therefore he knows how to keep books and records. Not showing his fraudulent income may be more damning than if he had never kept books. Also any illegal income may possibly be "laundered" by disguising it within records kept for the lawful activities.

In contrast, when an illegal enterprise is not conducted as part of a lawful business, this badge is somewhat less persuasive. Rarely are books kept by most illegal enterprises. In effect, the Service constructs the books the conspiracy should have kept. Of necessity, these must be estimates. An argument is advanced based on the conspiracy's recreated estimated books and records, and the allocation of its income among the conspirators. It is especially unpersuasive when used against marginal conspirators who may know nothing about the conspiracy's overall profits, or how these profits were divided among the other conspirators.[232]

In any case, the absence of books and records is logically as consistent with a taxpayer claiming he received nothing as it is with his sharing in the profits of fraud.

E. Engaging in Illegal Activities

Another recognized badge of fraud is a record of engaging in illegal activities.[233] "Engaging in illegal activities" presumably refers to illegal activities

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230. *See* I.R.C. § 446 (1999) (requiring each taxpayer use methods of accounting to maintain records that clearly reflect income).

231. *See id.* (specifying federal guidelines regarding accounting practices).

232. *See Cipparone*, 49 T.C.M. at 1494 (stating that Cipparone was not present when illegal income was divided up and he did not exercise control of division of income nor did he see receipts from illegal income).

233. Clearly police officers who obtain warrants not based on probable cause, and their supervisors who know, or should have known, of these acts, and acquiesced in them have committed crimes, even if all of the suspects were in fact guilty. *See, e.g.*, Rodriquez v. Furtado, 950 F.2d 805, 813 (1st Cir. 1991) (illustrating situation in which claim was brought against supervising officer and city for failing to supervise adequately detectives in obtaining search warrants). *See also* Myron W. Orfield, Jr., *Deterrence, Perjury, and the Heater Factor: An Exclusionary Rule in the Chicago Criminal Courts*, 63 U. COLO. L. REV. 75, 82-83 (1992) (citing study indicating that police dishonesty does occur in investigative process due to police creating artificial probable cause). One can argue, though, that these types of non-monetary crimes are not indicative of a tendency to commit monetary crimes.

different from the conspiracy in question; otherwise, the same acts would be counted twice.[234] Thus, RICO convictions based on predicate acts which do not require the receipt of money or property can be used against the taxpayer as if the predicate acts did require such receipt.[235]

F. Attempting to Conceal Illegal Activity

A person may participate in a conspiracy of silence without profiting from the underlying conspiracy.[236] One who knew, or should have known, of the existence of the illegal acts of others may well participate in the conspiracy through his silence in helping to conceal the underlying conspiracy from the authorities.[237] Such a conspirator does not necessarily profit in monetary terms from the underlying conspiracy; thus, the application of this badge of fraud may

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234. *See* Sundel v. Commissioner, 75 T.C.M. (CCH) 1853, 1860 (1998) (badges of fraud in connection with taxpayer's unreported income from drug smuggling; to constitute willful fraud motive for failure to report as income need not be primary motive).

235. *See, e.g.*, Ryan v. Commissioner, 75 T.C.M. (CCH) 1778, 1798 (1998) (stating that although crimes such as conspiracy, aiding and abetting bribery, and aiding and abetting robbery do not necessarily involve receipt of money; the court found that these convictions can be considered as factors in determining fraud on all of the facts).

236. *See* Vasquez v. Hernandez, 60 F.3d 325, 327-28 (7th Cir. 1995) (assessing effect of defendant police officers' conspiracy of silence on plaintiff's right to judicial relief). The plaintiff, while in her home, was shot in the ear by a stray bullet from an off-duty officer's gun. *See id*. at 326 (stating that off-duty officers had been charged with violating Cicero Code of Ordinances by using and carrying firearms while off-duty). The plaintiff alleged that there was a conspiracy of silence because another officer, who was not involved in the actual shooting, failed to submit the bullet to the property clerk. *See id*. at 328 (illustrating situation in which person may be part of conspiracy by helping to conceal it without actually profiting in monetary terms from that conspiracy). The lower court held that there was sufficient information to find a conspiracy of silence, and this ruling was affirmed by the Seventh Circuit. *See* Vasquez v. Hernandez, No. 91 C 4088, 1994 WL 201092, at * 11 (N.D. Ill. May 18, 1994), *aff'd*, 60 F.3d 325, 329 (7th Cir. 1995) (civil rights action under 42 U.S.C. § 1983 acknowledging "deplorable nature" of defendants' conduct but the delay caused by defendants' "alleged conspiracy failed to deprive the Vasquezes of their right to access [to the state courts]").

237. *See* Deere & Co. v. Zahm, 837 F. Supp. 346, 351-52 (D. Kan. 1993) ("The court finds that the allegation of silence of the defendants accompanied by an alleged tacit agreement that the silence perpetuate a fraudulent scheme states a cause of action for civil conspiracy."); Howard B. Klein, *Fighting Corruption in the Philadelphia Police Department: The Death Knell of the 'Conspiracy of Silence,'* 60 TEMP. L.Q. 103, 107-08 (1987) (describing conspiracy of silence to shield fellow officers in Philadelphia police department from prosecution and stating that conspiracy probably arose from social pressures within police department, such as being labeled "traitor," being ostracized by other officers or being subject to professional or social retaliation). This article focused on corruption of units of the Philadelphia Police Department other than the unit involved in *Ryan*.

not prove an intent to evade taxation.[238] For example, a marginal conspirator's silence could have been based, not on monetary rewards, but on such things as fear of retaliation by the other conspirators.[239]

G. Failure to Cooperate with Tax Authorities

Failure to cooperate with authorities is often considered a badge of fraud. A defendant's denial of any receipt of income is an example of conduct that may be treated by the Service as a "lack of cooperation."[240] Indeed, any admission of illegal income less than the amount asserted by the Service could be deemed a lack of cooperation.[241]

In the tax fraud context, this particular badge has certain flaws. For example, when a conspiracy is connected with a regular lawful business, and the records of the business were not produced, such lack of cooperation in not supplying

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238. *See* Cipparone v. Commissioner, 49 T.C.M. (CCH) 1492, 1498-99 (1985) (finding that because Cipparone did not receive substantial amounts of income from kickback scheme, his failure to report such income was not evidence of fraud; rather, court found Cipparone lacked specific intent to avoid tax liability).

239. *See* White-Ruiz v. City of New York, No. 93 CIV.7233, 1996 WL 603983, at *3 (S.D.N.Y. Oct. 22, 1996) (citing Mollen Commission report finding that "code of silence" exists in New York City's police force, where "even honest officers are expected to protect corrupt colleagues from detection and punishment."); Gabriel J. Chin & Scott C. Wells, *The "Blue Wall of Silence" as Evidence of Bias and Motive to Lie: A New Approach to Police Perjury*, 59 U. PITT. L. REV. 233, 251-54 (1998). The authors indicate that this code consists of unwritten rules developed due to strong loyalty among fellow officers resulting from "the closed nature of the culture, the resentment of police by the public, the dangers and volatility of police work, and officers' dependence upon one another for mutual safety." *Id*. at 252.

240. *See* United States v. Beacon Brass Co., 344 U.S. 43, 45-46 (1952) ("The language of § 145(b) [the present I.R.C. § 7201] which outlaws willful attempts to evade taxes 'in any manner' is clearly broad enough to include false statements made to Treasury representatives for the purpose of concealing unreported income" even though the statute of limitations for the crime of lying to a federal official under 18 U.S.C. § 1001 (1994) had run.); Black v. Commissioner, 53 T.C.M. (CCH) 679, 680-81 (1987) (finding petitioner's lack of cooperation with government, evidenced by acts such as failing to report taxable income, denying awareness and participation in kickback scheme and continuing to deny receipt of illegal income to government agents, was demonstration of petitioner's fraudulent intent). Query: Is the failure to report income that a petitioner contends he never received considered a lack of cooperation per se?

241. *See* Klein v. Commissioner, 48 T.C.M. (CCH) 651, 657 (1984) (stating that incomplete or misleading statements made during interviews by tax agent could be considered evidence of lack of cooperation; there was prior criminal fraud convictions for some years, and badges of fraud analysis did not prove fraud for other years); *see also* Jerome v. Commissioner, 65 T.C.M. (CCH) 2269, 2271-72 (1993) (stating that petitioner, a tax resister, did not cooperate with tax agents as evidenced by presenting frivolous arguments, failing to respond to summonses for information and failing to make any required estimated tax payments).

accurate records may well be a clear badge of fraud.[242] Yet lack of cooperation can also be cited as a badge of fraud if a taxpayer does not confess to most every dollar alleged against him.[243] In large part, this is exacerbated by the protective position's overly large assertions of the taxpayer's unreported income.

If a marginal participant on the periphery of the conspiracy claims that he knows little or nothing, this may not in itself constitute a lack of cooperation. Such a marginal member of the conspiracy may in fact have no information concerning the details of the conspiracy. Even if a marginal conspirator is in fact without knowledge of how the primary conspirators shared the proceeds of the conspiracy, the Service may doubt the marginal conspirator's ignorance and ascribe a lack of cooperation to him. Nevertheless, this can be grounds for the Service to assert that the taxpayer has not cooperated. Quite conceivably, a marginal conspirator whose underlying criminal acts do not require the receipt of money and who denies the receipt of money, and against whom there is nominal evidence of his receipt of money, may fit within this badge of fraud, even if the conspirator never received any money.[244]

Realistically, is it reasonable to assume that a taxpayer who received very little, if any, income and who receives a Statutory Notice asserting that he has received large unreported receipts as augmented by the "protective position," will

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242. *See* Webster v. Commissioner, 63 T.C.M. (CCH) 2757, 2759 (1992) (presuming intent to conceal based on fact that taxpayer kept no records of his unreported income from his illegal gambling activities); Steines v. Commissioner, 63 T.C.M. (CCH) 1771, 1775 (1992) (finding that failure to maintain or submit records of deductions and income-producing activities, as well as failing to comply with the rules of court, were evidence of fraud); Nachison v. Commissioner, 41 T.C.M. (CCH) 1079, 1083-84 (1981) (stating that refusal to answer request for admissions is deemed to admit those facts and that refusal to provide records in order to delay and frustrate investigation of tax liability was additional indicia of fraud).

243. *See* Ryan v. Commissioner, 75 T.C.M. (CCH) 1778 (1998). (Service alleged that Giongo had additional gross income of $ 214,900, and he therefore owed $ 102,331 in additional tax (plus additions) from the RICO enterprise, including allocations under protective position). After trial, on brief the Service dropped its protective position, and said Giongo had unreported income of $25,966. *See id*. at 1787. He was determined to have received $ 7150 of fraudulent income from the conspiracy. *See id.* For a further discussion of lack of cooperation, see *supra* note 241 and accompanying text.

With such a disparity between the original amount asserted, and the ultimate sum determined by the court, there is very little room for "cooperation" before trial.

244. *See Ryan*, 75 T.C.M. at 1798 (noting that one taxpayer (Giongo) who had been convicted under RICO only of conspiracy and aiding and abetting was not estopped to deny receiving any money; but stating that although he was not collaterally estopped to deny receipt of money, the court found that as matter of fact, he did receive income from the conspiracy). Although the court held that collateral estoppel did not apply to this situation, in view of these specific findings of receipt of money, such a determination was not necessary. *See id.* at 1797-98 (finding that underpayment of tax was established by clear and convincing evidence and that this deficiency was due to fraud because of his convictions for racketeering and filing of false return).

cooperate with the authorities by admitting to any amount close to that sum?[245]

An extreme illustration of how the Service views a lack of cooperation occurred when a taxpayer's assertion of his Sixth Amendment right to counsel after being informed by a special agent that he was the subject of a criminal investigation was deemed by the Service to be a lack of cooperation.[246] Is a confession the only form of cooperation the Service recognizes?

H. Showing a Willingness to Defraud Business Associates or Others

This badge is presumably based on a taxpayer's supposed predisposition to commit fraud.[247] The reasoning behind this badge is that a petitioner who cheats others is likely to cheat the Service.[248] This badge should fail, however, if the Service does not prove that the defendant actually committed fraudulent monetary acts, either against other members of the conspiracy by taking an "unfair" share of the spoils, or against third parties.[249] It should not be a badge of fraud against one who is only part of a "cover-up conspiracy of silence" of the underlying conspiracy.

I. The Taxpayer's Sophistication, Educational Level, and Knowledge of Duty to Report Income

In effect, this badge helps the Service to prove the "willful" element in tax evasion.[250] It entails looking at the particular conspirator and determining

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245. For an example of the disparity in the amount the Service alleged was received and the amount that the taxpayer was found to have actually received, see *supra* note 243.

246. See *Klein v. Commissioner*, 48 T.C.M. (CCH) 651, 657 (1984) in which the court, based on the Sixth Amendment, curtly dismissed the Service's contention that a taxpayer who hired a criminal lawyer after a special agent informed him of a criminal investigation was a badge of fraud as a failure of cooperation. *Cf.* Dellacroce v. Commissioner, 83 T.C. 269, 283-86 (1984) (Service contended that taxpayer's invocation of his Fifth Amendment rights was a failure of cooperation; court held that invocation of his Fifth Amendment rights presented a fact issue that could be used to show guilt, as in a criminal case).

247. *See* Solomon v. Commissioner, 732 F.2d 1459, 1462 (6th Cir. 1984) (stating that "taxpayer's willingness to defraud another in a business transaction may point towards willingness to defraud the Government also.").

248. *See id*.

249. If the Service treated one's willingness to share in the money that he is alleged to have stolen as an intent to defraud, the Service is clearly double counting because it presupposes the sharing of the theft proceeds and the cover up, and it therefore duplicates other badges.

250. *See* Sommers v. Internal Revenue Serv., 209 B.R. 471, 480 (N.D. Ill. 1997) (bankruptcy case; finding defendant's business background to discredit argument that he was "an innocent pawn" in tax evasion scheme); Berkery v. Commissioner, 192 B.R. 835, 842 (E.D. Pa. 1996) ("Such sophistication and intelligence, the bankruptcy court submits, is indicative of appellant's clear intent to file a fraudulent return and consequently, evade a tax due."); Stephenson v. Commissioner, 79 T.C. 995, 1006 (1982) (citing fact that petitioner was well educated to prove willful element of fraud).

whether his educational level and sophistication make it likely that he would know of the duty to report the illegal income as taxable.[251]

This badge really posits a negative: can a person be deemed not to know of his duty to report any illegal income he has received, even if that income was minimal and illegal? The Service apparently feels that almost everyone should know of the obligation to report all income received, whether illegal or not. As the Tax Court found in *Cipparone*, however, even an honest, ordinary citizen might not know of the duty to include small amounts of illegal income in gross income.[252]

In 1946, the Supreme Court determined that embezzled income was not includable in the embezzler's gross income.[253] Fifteen years later, the Court reversed itself, holding that embezzled funds are includable in income.[254] If the

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251. *See Sommers*, 209 B.R. at 471 n.28 ("It is hard to accept the proposition that someone who could bring a company [a gross profit in excess of $2.4 million] would be so lacking in sophistication as not to have questioned and understood the transactions [underlying the charge of tax evasion]."); *see also Berkery*, 192 B.R. at 842 (discussing appellant's sophistication). In *Berkery*, the appellant, who was accused of tax evasion, was a college graduate and had been active in real estate speculations among several other businesses. *See id.* at note 10. Also, the appellant successfully defended himself in a criminal conviction. *See id.* The court held that there was sufficient proof to support a finding that appellant's evasion of taxes was "willful." *Id.* at 842. *See also Stephenson*, 79 T.C. at 1006 (stating that "[i]t is hard to believe any individual, much less one as well educated as petitioner, could honestly believe that he could escape liability for income taxation").

252. *See* Cipparone v. Commissioner, 49 T.C.M. (CCH) 1492, 1500 (1985) (stating "[p]etitioner was not very knowledgeable nor sophisticated with respect to tax laws, and it is therefore highly unlikely that he would have appreciated the legal requirement of reporting the 'deemed' partnership income that we have concluded he is liable for.").

253. *See* Commissioner v. Wilcox, 327 U.S. 404, 408 (1946) (stating that embezzled income is not taxable income because taxpayer is obligated to return or repay money). In *Wilcox*, a taxpayer had been convicted of embezzling over $12,000 from his employer. *See id.* at 406 ("The taxpayer was convicted in a Nevada state court in 1942 for the crime of embezzlement."). The Commissioner "determined that the taxpayer was required to report" the embezzled money as income and pay tax on this amount. *See id.* at 407 (stating Commissioner's position: "[a]s against all the world except the true owner the embezzler is the legal owner, at least while he remains in possession."). The Supreme Court, however, held that the taxpayer did not owe taxes on the embezzled income because he was under an obligation to repay the money to his employer. *See id.* at 408 (stating that embezzled income is not taxable income because it does not bear "essential characteristics of a gain or profit" within the meaning of tax code).

254. *See* James v. United States, 366 U.S. 213, 221 (1961) (stating that "*Wilcox* was wrongly decided"). Prior to *James*, the Court decided that extorted money, unlike the embezzled money in *Wilcox*, was taxable income. *See* Rutkin v. United States, 343 U.S. 130, 138 (1952) ("We do not reach in this case the factual situation involved in *Commissioner of Internal Revenue v. Wilcox*.") (citation omitted). The differing results in *Wilcox* and *Rutkin* caused trouble for the lower courts. *See, e.g.*, Macias v. Commissioner, 255 F.2d 23, 26 (7th Cir. 1958) ("In our view, the Court in *Rutkin* repudiated its holding in *Wilcox*; certainly, it repudiated the reasoning by which the result

Supreme Court, at one time, felt that at least some illegal income is not taxable, should an ordinary unsophisticated citizen be held to a higher standard? If everyone knows of a duty to pay tax, does it necessarily follow that everyone knows of a duty to pay tax on small amounts of illegal income?[255]

In a much different context, but where knowledge and sophistication of a taxpayer are also very relevant, is the qualification of a taxpayer as an "innocent spouse."[256] In a somewhat surprising case, the Fifth Circuit held that an *attorney*, who had graduated from two prestigious universities, was an innocent spouse because she had little knowledge of tax law.[257]

J. Giving Implausible Explanations

Is it implausible that a convicted conspirator received no money?[258] The probable response would be that the conspirator "must have" received something of monetary value for his participation.[259] But this is only an inference; it is not

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was reached in that case."); United States v. Bruswitz, 219 F.2d 59, 61 (2d Cir. 1955) ("It is difficult to perceive what, if anything, is left of the *Wilcox* holding after *Rutkin* . . . ."); Marienfeld v. United States, 214 F.2d 632, 636 (8th Cir. 1954) ("We find it difficult to reconcile the *Wilcox* case with the later opinion of the Supreme Court in *Rutkin* . . . .").

255. *See Cipparone*, 49 T.C.M. 1492.

256. Reser v. Commissioner, 112 F.3d 1258, 1262-63 (5th Cir. 1997) (citing I.R.C. §6013(e)). The court explained:

> [T]o assert the innocent spouse defense successfully, a spouse must establish that (1) a joint return was made for the taxable year; (2) on that return there is a substantial understatement of tax attributable to grossly erroneous items of the other spouse; (3) in signing the return, the spouse did not know, and had no reason to know, of such substantial understatement; and, (4) taking into account all the facts and circumstances, it would be inequitable to hold the spouse liable for the deficiency.

Id.

257. *See Reser*, 112 F.3d at 1260 (finding wife eligible for "innocent spouse" status though she was "a personal injury defense lawyer who obtained an undergraduate degree in history from Stanford University and a law degree from the University of Texas"). Although the court stated that "a spouse's level of education" is one factor in determining that spouse's "reason to know" of the fraudulent tax return, the court did not conclude that this particular spouse's legal background should have made a difference here because the illegal deductions on her husband's tax return looked legitimate. *Id.* at 1267-69. "Had Reser asked [her husband or any of his business associates] about the deductions, they would have told her what they believed—that [the company's] losses were properly deductible in full." *Id.* at 1269.

258. *See* Conti v. Commissioner, 39 F.3d 658, 661-62 (6th Cir. 1994) (stating that taxpayer's explanations of sources of large amounts of cash were unbelievable); Niedringhaus v. Commissioner, 99 T.C. 202, 211 (1992) (listing "implausible or inconsistent explanations of behavior" among factors of circumstantial evidence that may support finding of fraudulent intent).

259. *See Cipparone*, 49 T.C.M. at 1496 (noting "*Keogh* [34 T.C.M. (CCH) 844 (1975)] supports petitioner's position that the amount of money received is not 'essential' to a bribery or conspiracy conviction").

proof. Although such inferences may usually be correct, it is certainly possible for one to be a conspirator in the cover up for non-financial reasons without participating financially in the underlying conspiracy.[260] In practice, however, if the story varies from the Service's assertions, it may be deemed to be implausible, rather than simply unlikely.[261]

K. Summary of Badges of Fraud in Civil Fraud Cases

The difficulty with a "badges of fraud" approach in a civil tax fraud case is that some of the badges alleged against a taxpayer may have quite plausible, non-fraudulent explanations. The Service can assert, as an indicia of fraud, every badge of fraud against a taxpayer that could possibly be true. Of course, the Service will not assert any countervailing factors. Case law suggests that when the Service suspects that a taxpayer's acts are fraudulent, the evidence constituting a badge of fraud can be marshaled against the taxpayer.[262] One may suspect that these badges, as applied by the Service, seem to be based on a notion that because the taxpayer is a convicted felon, he is not worthy of any positive interpretation of his record.

Once the Service has proven fraud by collaterally estopping the taxpayer from relitigating the issues determined in a prior trial, or by a badges of fraud approach, the taxpayer must then bear the burden of disproving the income ascribed to him by the Statutory Notice.[263]

CONCLUSION

There is no reason for the Service to be so secretive about the way it performs its mandated duties to determine a taxpayer's true income tax. The Service's expansive use of *Greenberg's Express*, its position that there need not

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260. *See supra* notes 237-38 and accompanying text.

261. *See* Bahoric v. Commissioner, 363 F.2d 151, 153 (9th Cir. 1966) (stating that taxpayer's testimony regarding his income was not plausible). In *Bahoric*, taxpayer allegedly understated the income from his dry cleaning business by over $400,000. *See id.* at 152-53. The taxpayer first explained the understatement by stating that $50,000 of the alleged understatement was not income, but rather money he had previously left in his sister's safekeeping and later retrieved. *See id.* at 153. Next, the taxpayer claimed he was simply too ignorant to report his income properly. *See id.* at 154. The court, however, found both arguments implausible. *See id.* at 153 (stating "the ridiculousness of such an alibi in the situation here could very properly entitle a trier of the facts to conclude that cheating on his income tax was [taxpayer's] motivation over the years"); *see also* Van Heemst v. Commissioner, 72 T.C.M. 26, 31 (1996) (calling taxpayer's rendition of facts implausible because he had given "conflicting stories").

262. *See, e.g.*, Klein v. Commissioner, 48 T.C.M. (CCH) 651, 654 (1984) (mentally disturbed taxpayer blamed understatements on various non fraudulent circumstances and court found no fraud for some years and fraudulent for years in which he had been found guilty of criminal fraud; in addition, collateral estoppel is not affected by fact that new witnesses arguably could have affected result in prior criminal case).

263. *See* I.R.C. § 6663(b) (1999); *see also supra* note 25.

be a considered "determination" of a deficiency, and its broad assertions of privilege combine to create the appearance and possibly the fact of unfairness in taxation. What is needed is an openness of the Service and its employees to assure the public that its procedures have produced fair and proper results.

The Service has immense power to assess and collect taxes and to interfere in the life of taxpayers. Recent congressional hearings and resulting statutory amendments have dealt with some excesses of the Service. But the issue of the accuracy of the Statutory Notice does not generate much interest. However, it is part of the overall picture of the Service's position that its internal workings are not subject to review.

As noted in Parts II and III of this Article, the full range of discovery that is available under the Tax Court's rules should be available to discover all relevant information the Service possesses, provided that such information would be admissible at trial and is not privileged under *Peterson*.

The ministerial acts of the revenue agent in determining the amount of a deficiency need not be protected if the agent made significant errors. Therefore, at least the work papers showing how the agent calculated the asserted deficiency must be made available to the petitioner.[264] Furthermore, that agent should be required to testify if he is called to explain the documents.[265] If the revenue agent's work is proper, the Service has nothing to fear. If the worksheets and the testimony explaining those documents are markedly inaccurate, the Service should lose its presumption of correctness. In reality, adopting this position might cause revenue agents and their supervisors to be more careful in the future.[266]

The Service can use testimony and other evidence to determine the total income of the illegal conspiracy with reasonable accuracy. However, as the Service argues, because only the conspirators themselves can know how that total income was divided, the protective position is the only way to protect the revenue. Ascribing all or almost all of that income to a conspirator on the periphery of the conspiracy, who may have received little, if any, of the income, places an unfair burden on that peripheral taxpayer. The protective position may be necessary when the Statutory Notices are issued, but the Service should end its multiple redundant assertions of income in order to state its true figures of income to each conspirator as soon as possible. In many situations that would be

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264. *See, e.g.*, Branerton Corp. v. Commissioner, 64 T.C. 191, 198-99 (1975) (finding work papers of revenue agent, including revenue agent reports and related audit workpapers, two district conferee reports, memoranda and appellate conferee report, were not prepared in anticipation of litigation because they were prepared by non-attorney, and therefore rejecting respondent's contention that they constitute nondiscoverable work product).

265. Examination of the revenue agent concerning how he determined the amounts of unreported income on the Statutory Notices was allowed in *Ryan*, over the objection of the Service. Transcript, *supra* note 73, at 2285-87.

266. Congressional hearings in 1997 showing abuses by the Service led to passage of the Internal Revenue Service Restructuring and Reform Act of 1998, P.L. 105-206, which began attempts to make the Service more "user-friendly."

after the Service has presented its case-in-chief, at which point all of the evidence against the conspirators will have been presented.[267]

Any allocation of the total income of a conspiracy must take into account the fact that some may have been major participants, while others were only minor participants. In other words, a minor conspirator should not be allocated the same sum as a major conspirator. The status of a minor conspirator, if not obvious from the start, will be quite clear at the end of the Service's case-in-chief.

Using *Greenberg's Express*, privilege, and *Scar*, the Service combines with the Tax Court to keep the taxpayer from obtaining information about how the Service made its determination of the taxpayer's deficiency. This is unfair. All taxpayers, including convicted felons, are entitled to fairness in taxation.

267. In *Ryan*, the Service reduced its dollar assertions after trial.