New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM

An incisivemedia publication
VOLUME 242—NO. 11
THURSDAY, JULY 16, 2009

TAX LITIGATION ISSUES

Expert Analysis

# Privilege Against Self Incrimination And Income Tax Filings

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The privilege against self-incrimination is one of the foundations of our criminal justice system, predating its incorporation into the Bill of Rights.[1] According to the U.S. Supreme Court, the privilege was incorporated into the Constitution to serve "as a shield against highhanded and arrogant inquisitorial practices" and has survived as "a wise and necessary protection of the individual against arbitrary power."[2]

The U.S. tax system relies on self-reporting by taxpayers of numerous aspects of their financial lives: income, professions, bank accounts, and claimed deductions. This system of self-reporting is naturally at odds with the privilege against self-incrimination, and often creates a dilemma for taxpayers and their lawyers during the course of criminal investigations. Commonly, a taxpayer faces the prospect that information reflected on an accurate return could provide a "link in the chain" of evidence against him. On the other hand, an ethical practitioner cannot counsel her client either not to file a required return or to file an inaccurate return as either course of action would constitute a separate crime.

One alternative is for the client to assert his Fifth Amendment privilege against self-incrimination on the face of the form. The U.S. Court of Appeals for the Second Circuit recently addressed the relationship between the Fifth Amendment and tax returns clarifying the viability of assertions of the privilege against self-incrimination in connection with tax filings.

### The Mechanics

The U.S. Supreme Court first addressed the application of the privilege against self-incrimination in the tax realm in *United States v. Sullivan*.[3] In *Sullivan*, the defendant was convicted of willfully refusing to file a return of his net income, derived almost entirely from his illegal trafficking of liquor in violation of the National Prohibition Act. The Supreme Court held that "[i]f the form of return provided called for answers that the defendant was privileged from making he could have raised the objection in the return, but could not on that account refuse to make any return at all."[4] Thus, under *Sullivan*, although a taxpayer cannot assert the Fifth Amendment as grounds for not filing a return, he can properly claim the privilege against self-incrimination in response to specific questions on the return itself.

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The Supreme Court amplified this concept in *Garner v. United States*.[5] In *Garner*, the defendant, Roy Garner, was charged with conspiring to violate various federal gambling statutes. At trial, the government introduced the defendant's income tax returns, on which he described himself as a "professional gambler" and reported substantial income from "gambling and wagering."

After conviction, Mr. Garner argued on appeal that the introduction of his tax returns at trial violated his privilege against selfincrimination. While *Sullivan* had held that the privilege should be claimed with respect to specific disclosures, and was not a defense to failing to file a return, Mr. Garner argued that a taxpayer who asserts the privilege on his return faces the possibility of prosecution under Section 7203 for failure to supply information. Thus, Mr. Garner claimed that this threat compels the taxpayer to make incriminating disclosures rather than claim the privilege.

The Court disagreed. Specifically, it noted that a conviction under Section 7203 could not be based on a valid exercise of the privilege. "The Fifth Amendment itself guarantees the taxpayer's insulation against liability of a valid and timely claim of privilege, broadened by Section 7203's statutory standard of 'willfulness.'" As a result, a taxpayer cannot be "at peril for every erroneous claim of privilege" because such conduct is not willful. However, because "Garner made disclosures instead of claim-

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ing the privilege on his tax returns his disclosures were not compelled incriminations. He therefore was foreclosed from invoking the privilege when such information was later introduced as evidence against him in a criminal prosecution."[6]

Accordingly, after *Sullivan* and *Garner*, information appearing on a form filed by a taxpayer can be used in a subsequent criminal prosecution. However, a taxpayer who specifically asserts the privilege against self-incrimination with respect to specific information sought on a tax return is immune from prosecution for failure to supply that information or file a tax return as long as the assertion of the privilege was made in good faith.

### Application of Cases

Several Circuit Courts of Appeals have referenced the holdings of *Sullivan* and *Garner* in considering the assertion of privilege against self-incrimination claims in the tax context.[7] One interesting example is *United States v.* Carlson,[8] in which the defendant was a tax protester who claimed excessive withholding exemptions on his W-4 form. This resulted in no federal income taxes being withheld from his wages for 1974 or 1975. In addition, Brian Carlson asserted the Fifth Amendment on his 1974 and 1975 tax returns in lieu of providing any information from which his tax liability could be calculated. Mr. Carlson was charged with willful failure to file income tax returns in violation of Section 7203. At trial, Mr. Carlson argued that his assertion of the Fifth Amendment on his 1974 and 1975 tax returns was a defense to the charges brought under Section 7203.

## Tax Filings

In assessing the validity of Mr. Carlson's Fifth Amendment claims, the U.S. Court of Appeals for the Ninth Circuit considered: (1) whether the privilege was asserted at the time of filing the return and in response to specific questions, (2) whether the taxpayer was faced with a "real and appreciable danger of self-incrimination," and (3) whether the taxpayer had reasonable cause to believe an honest response to the questions would "provide a link in the chain of evidence needed to prosecute him for a crime."[9]

The court found that Mr. Carlson had asserted the privilege in a timely manner while facing a real and appreciable hazard for prosecution for having previously filed a false withholding form. Further, the court concluded that providing this information would have provided evidence that could have been used to prosecute him. However, applying the Supreme Court's decision in *California v. Byers*,[10] the Ninth Circuit went on to note that Mr. Carlson's claim of privilege reflects a "collision of two critical interests: the privilege against self-incrimination, and the need for public revenue collection by a process necessarily reliant on selfreporting." Thus, the Ninth Circuit was concerned that affirming Mr. Carlson's assertion of the privilege would sanction conduct—the filing of false withholding forms—which undermines the system of personal income tax collection.[11]

Ultimately, the court concluded that the "character and urgency of the public interest in raising revenue through self-reporting weigh[ed] heavily against affording the privilege to Carlson." Though Mr. Carlson may have properly sought protection against self-incrimination for former tax crimes, he did so only as part of a "calculated effort" to evade taxes. "We therefore hold that an individual who seeks to frustrate the tax laws by claiming too many withholding exemptions, with an eye to covering that crime and evading the tax return requirement by assertion of the Fifth Amendment, is not entitled to the amendment's protection."[12] While recognizing that, under *Garner*, a defendant could not be convicted for an erroneous, yet good faith, claim of the privilege, the Ninth Circuit concluded that Mr. Carlson did not assert his claim in "good faith" because, as a tax protester, Mr. Carlson was clearly following an overall plan to evade taxes.

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### The Second Circuit: Two Cases

The Ninth's Circuit's decision in *Carlson* had been criticized, but it reflects a general antagonism to claims of privilege on tax returns.[13] Historically, the Second Circuit has been more respectful of the privilege against self-incrimination in the tax context. In *United States v. Romano*,[14] the defendant was stopped by U.S. customs officials attempting to transport $359,000 in cash from the United States into Canada. The government seized the currency and the Internal Revenue Service (IRS) immediately served Benedetto Romano with an assessment for $169,973 in income taxes due on the money. The IRS also filed a levy on the Customs Director, demanding a portion of the seized money, and a tax lien in the appropriate county clerk's office, and the government initiated a civil forfeiture action seeking the entire amount seized.[15]

Mr. Romano also was charged with tax evasion. On appeal from his conviction, Mr. Romano argued that the government had failed to prove either willfulness or that he took an affirmative act of evasion. To support its case, the government argued, in part, that Mr. Romano's failure to file a tax return after the funds had been seized supported a finding that he affirmatively attempted to evade his taxes. Mr. Romano claimed that he relied, in good faith, on advice from his attorney not to file a return for fear of surrendering his Fifth Amendment right not to incriminate himself.

The Second Circuit found that Mr. Romano's failure to file a tax return could not, by itself, support a finding that he affirmatively attempted to evade taxes. The Second Circuit expressly noted that Mr. Romano was not excused from filing a tax return on the grounds that it might incriminate him and that his failure to do so could have been the basis for a failure to file a charge under Section 7203. "However, given that Romano was required to provide only the bare minimum of information under *Sullivan*, to protect his [F]ifth [A]mendment rights, information which the government already had and which Romano knew the government had, we cannot accept the government's claim that Romano's failure to file under these circumstances has probative weight in establishing the more serious crime of tax evasion."[16]

The Second Circuit recently revisited *Romano* in its decision in *United States v. Josephberg*.[17] In *Josephberg*, the defendant, Richard Josephberg, promoted and sold various tax shelter transactions between 1977 and 1985 which "resulted in hundreds of millions of dollars of bogus losses being claimed by investors," including Mr. Josephberg and his partners. In the early 1990s, the IRS determined that Mr. Josephberg's personal tax liability exceeded $1.5 million.

Over the next decade, Mr. Josephberg sought to evade the payment of these taxes by putting assets into nominee bank accounts established in the names of his children, directing income to be paid to corporate and partnership entities he created, controlled, and used to pay various personal expenses, and filing bankruptcy petitions for himself and his wife. As a result of these various measures, the government alleged that Mr. Josephberg caused false information regarding his income and assets to be submitted to the IRS and in civil bankruptcy proceedings.[18]

After a four-week trial, Mr. Josephberg was convicted of 21 counts of tax evasion, conspiracy to defraud the Internal Revenue Service and a health care insurer, filing false tax returns, willful failure to file returns, obstructing and attempting to obstruct the administration of tax laws, and health care fraud for his failure to pay taxes owed since 1977.

On appeal, Mr. Josephberg argued that his failure to file tax returns for the years 1999 through 2002 should be excused because, in light of the ongoing investigation into his tax liability and the validity of losses claimed from the earlier tax shelter transactions, the very filing of returns for the years in question would tend to incriminate him. Thus, according to Mr. Josephberg, given the government's view of the underlying transactions, if he continued to claim the losses at issue on his current returns, he would subject himself to prosecution for filing false returns, but if he did not claim the losses, it "would be tantamount to an admission" that his prior claims were impermissible.

In rejecting this argument, the Second Circuit noted that *Sullivan* and its progeny make clear that the Fifth Amendment does not provide a blanket defense for a failure to file tax returns.[19] Mr. Josephberg contended, however, that under *Romano*, the Fifth Amendment provided protection from willful failure to file charges where there was an ongoing investigation into the taxpayer's affairs.

The court disagreed, however, stating that Mr. Josephberg's argument was "squarely contradicted by *Romano* itself," which specifically noted that Mr. Romano could have been prosecuted under section 7203.[20] Thus, regardless of whether the failure to file any return qualifies as an affirmative act of evasion supporting a tax evasion prosecution, *Josephberg* provides a useful reminder for practitioners that a taxpayer's privilege against self-incrimination is "protected by his right to refuse, with a *Sullivan* citation, to answer the questions that implicate that privilege," as opposed to a refusal to file any return whatsoever.[21]

1. McCormick on Evidence 248 (1972).
2. *United States v. Washington*, 431 U.S. 181, 193 (1977) (Brennan, J., dissenting).
3. 274 U.S. 259 (1927).
4. Id. at 263.
5. 424 U.S. 648 (1976).
6. Id. at 665.
7. See *United States v. Farber*, 630 F.2d 569 (8th Cir. 1980); *United States v. Edelson*, 604 F.2d 232, 234-36 (3d Cir. 1979); *United States v. Johnson*, 577 F.2d 1304, 1310-11 (5th Cir. 1978).
8. 617 F.2d 518 (9th Cir.), cert. denied, 101 S.Ct. 564 (1980).
9. Id. at 520
10. 402 U.S. 424 (1971)
11. *Carlson*, 617 F.2d. at 520-21.
12. Id. at 523.
13. The Ninth Circuit's decision, balancing a statutory obligation against a constitutional right, seems illogical and is not without its critics. "Although the Ninth Circuit adopted a balancing test for analyzing the validity of a taxpayer's fifth amendment claim when invoked to avoid self-incrimination of a tax crime, the decision is not supported by case law, legal commentaries, or reason. The *Carlson* balancing test focuses on the government's need to collect revenue, not on the incriminating aspects of the disclosures for which Carlson had claimed the fifth amendment. The court also failed to explain why the government's need to collect revenue is greater in tax crime situations than in nontax crime situations." Richard B. Stanley, "Conflict Between the Internal Revenue Code and the Fifth Amendment Privilege Against Self-Incrimination," 15 Univ. of Baltimore L. Rev. 527, 540-41 (Spring 1986).
14. 938 F.2d 1569 (2d Cir. 1991).
15. 938 F.2d at 1570-71.
16. Id. at 1574.
17. 562 F.3d 478 (2d Cir. 2009).
18. U.S. Attorney, Southern District of New York, Press Release, "Investment Banker Sentenced by Federal Court to 50 Months in Prison in Multimillion-Dollar Scheme to Evade Taxes Owed from Tax Shelter Transactions" (Sept. 5, 2007).
19. 274 U.S. at 263-64.
20. 562 F.3d at 493.
21. These rules also may apply to a tax-payer's obligation to file a Report of Foreign Bank and Financial Accounts (FBAR) as required in 31 U.S.C. §5314. See *United States v. Grabinski*, 558 F.Supp. 1324, 1332 (D. Minn. 1983) (assertion of the privilege with respect to information sought in FBARs is proper where a defendant can articulate a real and appreciable danger of self-incrimination). But see, *United States v. Sturan*, 951 F.2d 1466 (6th Cir. 1991) (court stated in dicta that disclosures required by the FBAR do not subject the filer to a real danger of self-incrimination because it does not call for disclosure of the source of funds in the foreign account).