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TAX LITIGATION ISSUES

Expert Analysis

Fifth Amendment and Government's War on Offshore Accounts

The government's efforts to crack down on undisclosed foreign bank accounts have been well-chronicled.[1] These efforts have resulted in more than 60 prosecutions of taxpayers and bankers on various criminal charges including failing to report income derived from offshore accounts, failing to disclose such accounts on individual income tax returns and failing to file Reports of Foreign Bank and Financial Accounts (FBARs). In light of these criminal enforcement efforts, a taxpayer might justifiably fear that producing records of a previously undisclosed account in response to a grand jury subpoena might lead to criminal charges, and therefore might seek to invoke the Fifth Amendment's privilege against self-incrimination to avoid producing such records.

Recently, two courts have split on attempts by taxpayers to invoke the privilege against self-incrimination in response to subpoenas seeking offshore account records: in *In re Grand Jury Investigation M.H.*,[2] the U.S. Court of Appeals for the Ninth Circuit rejected such a claim, while in *In re Grand Jury Subpoena*,[3] Judge Lynn N. Hughes of the U.S. District Court for the Southern District of Texas upheld a taxpayer's assertion of privilege. At issue in these cases was whether Treasury Department regulations requiring taxpayers to retain certain offshore account records fall within the "required records" exception to the privilege against self-incrimination. In light of the government's ongoing enforcement efforts, practitioners should be aware of arguments that may be available to clients facing similar subpoenas in the future.

Incriminating Documents

The Fifth Amendment provides, in relevant part, that "[n]o person…shall be compelled in any criminal case to be a witness against himself." This rule does not protect the incriminating contents of documents—rather, it applies only to testimonial communications that are incriminating. However, compliance with a subpoena calling for the production of documents may implicate the Fifth Amendment. The U.S. Supreme Court has stated that "the act of producing evidence in response to a subpoena nevertheless has communicative aspects of its own, wholly aside from the contents of the papers produced"—for example, that responsive documents exist, are in the possession or control of the subpoenaed party, or are authentic.[4]

Even if the act of producing subpoenaed documents would otherwise constitute an incriminating testimonial communication, a subpoenaed party will be unable to claim the Fifth Amendment privilege if the requested documents fall within the "required records" exception established by the Supreme Court in *Shapiro v. United States*[5] and *Grosso v. United States*.[6]

By
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In *Shapiro*, the petitioner, a produce wholesaler, sought to resist a subpoena calling for the production of sales records required to be maintained under the Emergency Price Control Act. The Court rejected petitioner's reliance on the Fifth Amendment, holding that "the privilege that exists as to private papers cannot be maintained in relation to records required by law to be kept in order that there may be suitable information of transactions which are the appropriate subjects of governmental regulation, and the enforcement of restrictions validly established."[7]

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In dissent, Justice Felix Frankfurter observed that virtually every major public law enactment includes record-keeping requirements, and pointed out the flaws in the majority's reasoning: "Subtle question-begging is nevertheless question-begging. …If records merely because [they are] required to be kept by law ipso facto become public records, we are indeed living in glass houses."[8]

In *Grosso*, the defendant failed to pay a special wagering excise tax and to file a related Internal Revenue Service form. In defense of his criminal prosecution, the defendant argued that paying the excise tax would have required him to incriminate himself. The Supreme Court agreed, holding that the Fifth Amendment protected the disclosures called for in connection with payment of the excise tax.

In doing so, the Court defined the contours of the required records exception, identifying three "premises" for the doctrine: (1) the purposes of the government's inquiry are essentially regulatory; (2) information is to be obtained by requiring the preservation of records of a kind that the regulated party has customarily kept; and (3) the records themselves have assumed "public aspects" that render them at least analogous to public documents.[9]

Focusing on the first and third prongs, the Court held that the required records exception was inapplicable to the regulations at issue in *Grosso*. First, the Court found that the government's purpose in collecting information on gambling activities was not essentially regulatory; though its principal interest was the collection of tax revenue, the government inquiry involved "an area permeated with criminal statutes," i.e., gambling, and was required only of a group "inherently suspect" of criminal activities. Further, the IRS made the incriminating information it gathered available to local prosecutors.[10] Second, the Court held that "the information demanded here lacks every characteristic of a public document."[11] Though it did not identify the characteristics of a public document, the Court stated that the government's desire to obtain the information requested was insufficient to strip it of constitutional protection.[12]

Offshore Accounts

In addition to the requirement in the Bank Secrecy Act (BSA) that taxpayers file FBARs disclosing information regarding certain foreign financial accounts, the Treasury Department has adopted regulations requiring each person with a financial interest in or signature authority over an offshore account to retain and make available for inspection certain documents relating to the account.[13] In connection with its recent crackdown on undisclosed offshore accounts, the Department of Justice has subpoenaed such records from taxpayers suspected of holding offshore accounts. Taxpayers' efforts to resist such subpoenas have met with mixed results.

In *In re Grand Jury Investigation M.H.*, the taxpayer was one of the 250 individuals whose account information was turned over to federal prosecutors by UBS AG in February 2009 in connection with the bank's deferred prosecution agreement with the Department of Justice. As a result of UBS's disclosure, M.H. became the target of a grand jury investigation seeking to determine whether he had used foreign bank accounts to evade his federal income tax obligations. In response to a subpoena calling for the production of the records required to be maintained under the Treasury Department regulations, M.H. invoked the Fifth Amendment, arguing that producing the documents could show that his previously filed tax returns were inaccurate and expose him to criminal charges, while denying having the documents would expose him to criminal charges for failure to maintain the required records.

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In rejecting M.H.'s claim, the Ninth Circuit found that all three of the *Grosso* factors weighed against the taxpayer. First, the Court addressed what makes a record-keeping requirement "essentially regulatory," noting that the fact that the records in question would be useful in a criminal investigation was not controlling. Rather, citing its earlier decision in *United States v. Des Jardins*,[14] the Ninth Circuit explained that the regulatory-criminal analysis depends on whether the "requirement involves an area 'permeated with criminal statutes,' whether it is 'aimed at a highly selective group inherently suspect of criminal activities,' and whether complying with the requirement would 'generally…prove a significant "link in a chain" of evidence tending to establish guilt.'"[15]

The court then rejected M.H.'s claim that the provision in question was "criminal in nature" because the primary purpose of the BSA was to detect criminal conduct. Relying on a Supreme Court decision addressing other aspects of the BSA, the Ninth Circuit found that the statute was designed to address both civil and criminal enforcement matters.[16]

The *M.H.* court then reviewed *Des Jardins*, a case addressing reporting (as opposed to record-keeping) provisions of the BSA. In *Des Jardins*, the defendant was convicted of failing to comply with reporting requirements for the cross-border transport of currency, but was not accused of having engaged in any other criminal activity. Rejecting Lucille Ann Des Jardins' assertion that a statute that is not "exclusively regulatory" should be deemed "essentially criminal," the Ninth Circuit found no basis for applying the privilege against self-incrimination where reporting information such as the destination and route of the funds was "at best tangentially related to criminal activity."[17]

Applying *Des Jardins* to the record-keeping requirements at issue in *M.H.*, the Ninth Circuit stressed that, unlike the gambling at issue in *Grosso*, maintaining an offshore account is "not inherently criminal." Moreover, the possibility that the information in the records might lead to criminal charges did not negate the fact that requiring that taxpayers maintain records of such accounts was "essentially regulatory" and that providing such information to the government would not tend to prove the accountholder's guilt.[18]

Turning to the second *Grosso* factor, the Ninth Circuit held that the account records called for in the subpoena were of the type customarily kept, both because the information therein was required to be reported to the IRS each year, and because it was "essential information" to which the accountholder would necessarily have access, even if the records were physically held by the foreign bank.[19]

With respect to the third *Grosso* factor, citing *Shapiro*, the Ninth Circuit held that "if the government's purpose in imposing the regulatory scheme is essentially regulatory, then it necessarily has some 'public aspects.'" It rejected M.H.'s contention that such a holding would allow the required records exception to swallow the Fifth Amendment rule, stating that the privilege against self-incrimination survives in the precise circumstances of *Grosso*, i.e., where the regulation requiring the production of records is limited in its application to persons inherently suspected of criminal activities.[20]

A Competing Approach

In *In re Grand Jury Subpoena*, the government also served a subpoena seeking offshore account records. In response to the taxpayer's invocation of the privilege against self-incrimination, the government invoked the required records exception in an effort to compel production of the records. However, unlike the Ninth Circuit in *M.H.*, Judge Hughes rejected the government's arguments and upheld the taxpayer's reliance on the Fifth Amendment.

First, while the Ninth Circuit relied heavily on the fact that the BSA deals with both civil and criminal matters in concluding that the recordkeeping requirements were "essentially regulatory," Judge Hughes focused on how the government actually uses the records at issue. Rejecting the government's argument that the requirement that taxpayers keep records was principally regulatory because those records underlie the FBAR reports that purportedly help the government monitor the money supply, Judge Hughes noted that "the government does not manage the money supply or currency flows of the world's largest economy by annual reports from individual citizens."[21]

Judge Hughes next looked at the legislative history, which makes it plain that Congress' primary purpose in enacting the BSA's recordkeeping provisions was to detect crime by making more foreign account data accessible to law enforcement.[22] Judge Hughes found this legislative history far more determinative in assessing the purpose of the government's inquiry,[23] and concluded that "[t]he government instituted the reporting requirement not to regulate its citizens with business abroad but to catch crooks."[24]

Moreover, while the *M.H.* court considered whether foreign account information may be "inherently incriminating" in the abstract, Judge Hughes recognized that, "[w]hile having an account with a foreign financial institution is not in itself illegal, the [BSA] assumes a high correlation between American crime and foreign accounts."[25] Thus, Judge Hughes looked at the circumstances under which the government typically requests foreign account records. Because the government could not articulate reasons for requesting foreign account records outside of criminal investigations, Judge Hughes found that the BSA regulations did not serve an essentially regulatory function.[26]

Judge Hughes in 'In re Grand Jury Subpoena' looked at the legislative history, which makes it plain that Congress' primary purpose in enacting the BSA's recordkeeping provisions was to detect crime by making more foreign account data accessible to law enforcement.

With respect to the third *Grosso* factor, the Ninth Circuit equated the existence of a regulatory scheme calling for the retention of documents with a conclusion that such documents had "public aspects." By contrast, Judge Hughes first found that the account records at issue were not analogous to public records, as they were not filed with the court or otherwise made publicly available,[27] and then concluded that the duty to file FBARs does not render the underlying records public. While the government had offered a few non-criminal justifications for the FBAR and foreign account record-keeping requirements—monitoring the money supply, regulating banks, projecting tax revenues—it had effectively admitted that the foreign account records were not in fact used for these purposes. Thus, Judge Hughes rejected the government's argument that the offshore account records had lost their Fifth Amendment protection because the taxpayers were required to keep them.[28]

Finally, Judge Hughes rejected the notion that the voluntary decision to maintain a foreign account constitutes a waiver of the privilege against self-incrimination with respect to records of such accounts. Noting that "[l]ife in general is full of 'voluntary decisions,'" Judge Hughes concluded that "[t]he national government regulates nearly every aspect of life. It may not eviscerate the limits on its authority under the Constitution by turning every regulated decision into a constitutional waiver."[29]

Conclusion

The different outcomes in *M.H.* and *In re Grand Jury Subpoena* reflect the fundamental tension between the government's desire to obtain information and an individual's right to keep his papers private that have characterized the required records doctrine since *Shapiro*. Notwithstanding the Ninth Circuit's expansive view of the government's ability to override the privilege against self-incrimination through regulatory recordkeeping requirements, Judge Hughes' decision demonstrates that efforts to invoke the Fifth Amendment in response to subpoenas seeking offshore account records are not doomed to failure.

1. See, e.g., Jeremy H. Temkin, "One Last Chance for Offshore Account Holders," New York Law Journal (May 14, 2009); Jeremy H. Temkin, "Offshore Banking: the End of the World as We Know It?," New York Law Journal (Jan. 14, 2010); Lynnley Browning, "I.R.S. Offers a Tougher Amnesty Deal for Offshore Accounts," N.Y. Times, Feb. 8, 2011; Paul Sullivan, "Voluntarily Disclose Your Offshore Accounts, or Else," N.Y. Times, Aug. 26, 2011.
2. 648 F.3d 1067 (9th Cir. Aug. 19, 2011).
3. No. 11-mc-174 (S.D. Tex. Sept. 21, 2011).
4. *Fisher v. United States*, 425 U.S. 391, 408-10 (1976) (holding that "the Fifth Amendment would not be violated by the fact alone that the papers, on their face, might incriminate the taxpayer").
5. 335 U.S. 1 (1948).
6. 390 U.S. 62 (1968).
7. 335 U.S. at 33.
8. Id. at 51.
9. 390 U.S. at 67-68.
10. Id. at 64, 68.
11. Id. at 68.
12. The Court also cited *Marchetti v. United States*, 390 U.S. 39, 57 (1968), decided the same day as *Grosso*. That case similarly failed to define "public aspects," but held that a statutory record-keeping requirement, standing alone, was insufficient to render the information public.
13. The account records that must be maintained pursuant to the regulations "shall contain" the name of the accountholder, account number, bank at which the account is held, the type of account, and the maximum value of the account each year. 31 C.F.R. §1010.420. This data is identical to the information required to be reported on the FBAR form. See 31 C.F.R. §1010.350.
14. 747 F.2d 499 (9th Cir. 1984).
15. *In re Grand Jury Investigation M.H.*, 648 F.3d at 1073 (citations omitted).
16. Id. at 1074 (citing *California Bankers Ass'n v. Schultz*, 416 U.S. 21, 76-77 (1974)).
17. *Des Jardins*, 747 F.2d at 509 .
18. *In re Grand Jury Investigation M.H.*, 648 F.3d at 1074-75.
19. Id. at 1076.
20. Id. at 1076, 1078.
21. *In re Grand Jury Subpoena*, No. 11-mc-174 at 4.
22. See generally H.R. Rep. 91-975, 1970 WL 5667 at **10 (1970), Sen. Rep. 91-1139, Cal. No. 1155 at 176 (1970)(c) (both stating that the principal purpose of the BSA is to provide law enforcement with evidence of criminal financial transactions, such as tax evasion, that it has been unable to obtain due to foreign bank secrecy laws).
23. *In re Grand Jury Subpoena*, No. 11-mc-174 at 4-5; see also *United States v. San Juan*, 405 F.Supp. 686, 693 (D. Vt. 1975) (holding that purposes of Congress in passing the BSA's foreign reporting requirements were "fundamentally prosecutorial."); *United States v. Hajecate*, 683 F.2d 894, 901 (5th Cir. 1982) ("[W]e find a presumption by Congress [in the BSA] that secret foreign bank accounts and secret foreign financial institutions are inevitably linked to criminal activity in the United States").
24. *In re Grand Jury Subpoena*, No. 11-mc-174 at 5.
25. Id.
26. Id. at 6.
27. Id. at 2-3.
28. Id. at 4, 6. Cf. *In re Doe, M.D.*, 711 F.2d 1187, 1192 (2d Cir. 1983) (holding that psychiatrist's patient files had "public aspects" because "there is a strong correlation between the purpose of the New York law which requires that patient files be kept and that for which their production is sought here").
29. Id. at 6-7.