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Accountants' Workpapers in Federal Tax Investigations: The Taxpayer's Privilege against Self-Incrimination

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NOTES

Accountants' Workpapers in Federal Tax Investigations: The Taxpayer's Privilege Against Self-Incrimination

Zakutansky, a certified public accountant, possessed workpapers which he had formulated as an aid in the preparation of taxpayer's income tax returns. Pursuant to an investigation of taxpayer's returns, Internal Revenue Service special agents served the accountant with a subpoena duces tecum to produce the workpapers.[1] The accountant refused, and thereafter turned the workpapers over to the taxpayer. Subsequently, administrative summonses were issued to both the accountant and taxpayer for the production of the papers. The accountant was unable to comply because he no longer possessed them and the taxpayer refused under a claim of the fifth amendment privilege against self-incrimination. The government filed a petition to enforce the summonses against both the accountant and the taxpayer.[2] The district court ordered the production of the accountant's workpapers,[3] and the taxpayer appealed. *Held, affirmed*: Where the taxpayer does not own the workpapers or hold them in his rightful and indefinite possession, he is not entitled to withhold them under a claim of privilege. *United States v. Zakutansky*, 401 F.2d 68 (7th Cir. 1968), *cert. denied*, 393 U.S. 1021 (1969).

I. The Privilege Against Self-Incrimination in Production of Workpapers

The compulsory production of incriminating books and papers is not significantly different from compelling a man to be a witness against himself.[4] Under the doctrine of *McCarthy v. Arndstein*[5] a taxpayer can invoke his fifth amendment privilege if it is likely that criminal charges may be brought against him as a result of the production of his papers or records.[6]

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[1] Int. Rev. Code of 1954, § 7602 provides: "For the purpose of ascertaining the correctness of any return . . . the secretary or his delegate is authorized—(1) To examine any books, papers, records, or other data which may be relevant to such inquiry . . . ."

[2] *Id.* § 7604(a) provides: "If any person is summoned under the internal revenue law to appear, to testify, or to produce books, papers, records, or other data, the United States district court . . . shall have jurisdiction to compel such attendance, testimony, or production of books, papers, records, or other data."

§ 7604(b) provides:

> Whenever any person summoned under section . . . 7602 neglects or refuses to obey such summons, or to produce books, papers, records, or other data . . . the secretary . . . may apply to the judge of the district court. It shall be the duty of the judge . . . to hear the application . . . and upon such hearing . . . to make such order as he shall deem proper . . . to enforce obedience to the requirements of the summons and to punish such person for his default or disobedience.

[3] United States v. Zakutansky, 278 F. Supp. 682 (N.D. Ind. 1968).

[4] Boyd v. United States, 116 U.S. 616 (1886). The privilege against self-incrimination is not the only means by which a taxpayer can frustrate the government's quest for production (*e.g.*, the fourth amendment privilege against unreasonable searches and seizures, and the attorney-client or accountant-client communication privilege). *See generally* Cohen, *Accountants' Workpapers in Federal Tax Investigations*, 21 Tax L. Rev. 183 (1965).

[5] 266 U.S. 34 (1921).

[6] The application of the *McCarthy* principle in an administrative proceeding by the Internal Revenue Service to enforce a summons rests upon an unstable foundation because of the landmark

The real enigma for the courts has been an interpretation of the *McCarthy* rule as to who may invoke the privilege. The guiding light has been *United States v. White*[7] where the Supreme Court, by way of dictum, said "the papers and effects which the privilege protects must be the private property of the person claiming the privilege or at least in his possession in a purely personal capacity."[8] While "in a purely personal capacity" has been misinterpreted by some of the federal courts,[9] the misinterpreters have recognized that the privilege does not rest on any narrow concept of ownership.[10] *In re House*[11] became the first federal case to apply the *White* test to a tax fraud investigation in holding that a taxpayer could claim the privilege against self-incrimination when he held accountant's workpapers in his "rightful and indefinite possession." Although the rightful and indefinite possession test was not necessary to uphold the taxpayer's claim in *House*, that test has been controlling in other situations.[12] Conversely, in fact situations substantially identical to those of *House*, other federal courts have refused to follow the rightful and indefinite possession test and have declared ownership to be a prerequisite to claiming the privilege.[13] Thus, the federal courts cannot agree whether rightful and indefinite possession or ownership[14] should be the basis for the taxpayer's privilege against self-incrimination.

Those courts which have recognized ownership of workpapers as one of the tests for claiming the privilege have relied primarily on *United States v. White*.[15] However, this position is weakened by Supreme Court decisions holding that the owner of documents may not rely on a claim of privilege once he has lost possession,[16] even though the documents were stolen.[17] The

case of Shapiro v. United States, 335 U.S. 1 (1948). *Shapiro* established the "required records" exception to the fifth amendment privilege when the Supreme Court held that an individual under a claim of the fifth amendment privilege had no right to withhold records which the laws required him to keep. None of the federal courts have held that accountants' workpapers fall within the required records exception of *Shapiro*, and the Fifth Circuit, when presented with the opportunity to do so, chose to remain silent on the matter. Falsone v. United States, 205 F.2d 734 (5th Cir.), *cert. denied*, 346 U.S. 864 (1953).

[7] 322 U.S. 694 (1944).

[8] *Id.* at 699.

[9] In Bouschor v. United States, 316 F.2d 451 (8th Cir. 1963), the court, citing *White*, stated that an attorney could not claim a taxpayer's privilege against self-incrimination because the privilege had long been characterized as "personal." *Accord*, United States v. Boccuto, 175 F. Supp. 886 (D.N.J. 1959). This interpretation of *White* has received criticism from the Ninth Circuit. "It appears to us that the Supreme Court . . . used the term 'personal' in a sense of 'natural individual,' and the term 'representative' in the sense of 'representative of a non-privileged organization.'" United States v. Judson, 322 F.2d 460, 464 (9th Cir. 1963).

[10] United States v. Cohen, 250 F. Supp. 472 (D. Nev. 1965); Hughes v. Foster, 16 Am. Fed. Tax R.2d 5121 (W.D. Tex. 1965); *In re* Daniels, 140 F. Supp. 322 (S.D.N.Y. 1956); *In re* House, 144 F. Supp. 95 (N.D. Cal. 1956).

[11] 144 F. Supp. 95 (N.D. Cal. 1956). The district court found that the accountant and taxpayer had made an express agreement to transfer title to the papers to the taxpayer when the taxpayer requested the accountant to turn the workpapers over to his attorney.

[12] United States v. Cohen, 388 F.2d 464 (9th Cir. 1967); Hughes v. Foster, 16 Am. Fed. Tax R.2d 5121 (W.D. Tex. 1965).

[13] Bouschor v. United States, 316 F.2d 451 (8th Cir. 1963); United States v. Boccuto, 175 F. Supp. 886 (D.N.J. 1959).

[14] Ownership is the "collection of rights to use and enjoy property, including right to transmit it to others." BLACK'S LAW DICTIONARY 1260 (rev. 4th ed. 1968).

[15] 322 U.S. 694 (1944). *See also* text accompanying notes 7-8 *supra*.

[16] Perlman v. United States, 247 U.S. 7 (1918); Johnson v. United States, 228 U.S. 457 (1913).

[17] Burdeau v. McDowell, 256 U.S. 465 (1921).

fifth amendment privilege protects against self-incrimination; it does not prevent incrimination itself. Mr. Justice Holmes in *Johnson v. United States*[18] stated: "A party is privileged from producing the evidence, but not from its production. . . . If the documentary confession comes to a third hand *alio intuitu* . . . the use of it in court does not compel the defendant to be a witness against himself."[19] Possession seems to be the very foundation of the privilege, because absent a possessory interest, the taxpayer is not producing the evidence.

II. UNITED STATES V. ZAKUTANSKY

The Seventh Circuit in *Zakutansky* further confuses the body of substantive law in the area of accountants' workpapers in tax fraud investigations. Although the factual situation is unique, the decision is significant only in that it reinforces the conclusion that the federal courts cannot develop a workable body of law concerning the taxpayer's privilege under the fifth amendment.

In *Zakutansky* the court decided that the taxpayer could withhold the papers if he owned them *or* held them in his rightful and indefinite possession. This result is in line with the decisions of the Fifth and Ninth Circuits,[20] and opposed to those of the Third and Eighth Circuits.[21] But in deciding whether or not possession or ownership is the proper test as opposed to legal title, the Seventh Circuit improperly ignored constitutional law.

An ownership *or* rightful indefinite possession test will produce the proper result under the *Johnson* rule when the taxpayer has possession of the workpapers. But this test as used in *Zakutansky* implies that ownership without possession will support the privilege, and under the above precedents the issue of ownership should be irrelevant in determining whether or not the taxpayer can benefit by invoking the privilege.[22] Possession should be the only prerequisite for claiming the privilege. But why must possession be "rightful and indefinite?" What if the possession is wrongful? If the government seeks production of workpapers from a taxpayer who has stolen them from his accountant, the government's right to the workpapers is no greater than that of the taxpayer. In such an instance, ordering production would be no less self-incriminating to the taxpayer than if his possession were "rightful."[23] However, the privilege

[18] 228 U.S. 457 (1913).

[19] *Id.* at 458-59.

[20] United States v. Cohen, 388 F.2d 464 (9th Cir. 1967); Hughes v. Foster, 16 Am. Fed. Tax R.2d 5121 (W.D. Tex. 1965).

[21] Bouschor v. United States, 316 F.2d 451 (8th Cir. 1963); United States v. Boccuto, 175 F. Supp. 886 (D.N.J. 1959).

[22] The Ninth Circuit has held that ownership of accountants' workpapers is not the proper test to be applied because ownership without possession cannot be used to claim the privilege. United States v. Cohen, 388 F.2d 464 (9th Cir. 1967); *see* McCarthy v. Arndstein, 266 U.S. 34, 41 (1924).

[23] Judge Learned Hand stated in *In re* Grant, 198 F. 708, 709 (C.C.S.D.N.Y. 1912), *aff'd*, 227 U.S. 74 (1913):

> [S]uppose that A., knowing that B. has papers which would incriminate him, gets wrongful possession of them from B., whom they do not incriminate. If B. is content, and leaves A. in possession, I do not understand that it would be any

against self-incrimination does not "relieve one from compliance with the substantive obligation to surrender property [to the owner]."[24] Hence, a taxpayer could not wrongfully withhold incriminating workpapers from their owner (the accountant) and thereby prevent the owner from turning them over to the government.[25] But the privilege should operate so as to protect a possessor from surrendering documents to anyone but the legal owner.

Although the decision in *Zakutansky* can be criticized for adopting the "ownership or rightful and indefinite possession" test, the result is equitable. The critical fact for the court is that when the summons was served on the accountant, he possessed the workpapers. The court reasoned that because the summons was served prior to a transfer of possession of the workpapers, the accountant had a moral, if not legal, obligation to surrender them. Regardless of any independent moral duty found by the court, the legal duty arising from statutory authority seems sufficient to give the government some interest in the workpapers.[26] Nevertheless, with or without any such governmental interest, the production of the workpapers in *Zakutansky* resulted in compulsory self-incrimination to the taxpayer. However, in this instance public policy required that the privilege give way to the exercise of a legitimate governmental investigation. To allow the taxpayer in *Zakutansky* to withhold the workpapers would effectively render meaningless the authority of the Internal Revenue Service to issue a subpoena.[27]

III. Conclusion

The increasing employment of criminal sanctions by the Internal Revenue Service to police our self-assessment income tax system demands that the constitutional privilege against self-incrimination in this area be uni-

> answer whatever to A. to say: 'You cannot keep these back, because you came by them wrongfully, or at least you have no right to them now.' All the law considers is whether A. has possession in fact, and whether the documents actually will tend to incriminate him. To get them in evidence the law would have to force him to bring them out of a possession which is good enough against anyone but B. Certainly, I can find nothing in the books which suggests such a distinction, and it contradicts the whole history of the matter.

[24] Justice Brandeis in McCarthy v. Arndstein, 266 U.S. 34, 41 (1924).

[25] In United States v. Cohen, 388 F.2d 464 (9th Cir. 1967), an accountant had turned over workpapers to the taxpayer and had told revenue agents that he had no property interest in the workpapers. Thereafter, the accountant demanded the workpapers from the taxpayer so that he could comply with the administrative summons. Without determining the ownership of the workpapers, the Ninth Circuit held that the taxpayer did not have to produce them. Although the court mentions that wrongful possession may be sufficient to claim the privilege, they reasoned that the taxpayer's possession was rightful, because the accountant denied ownership of the papers and demanded their return only so he could turn them over to the government.

[26] *See* note 1 *supra*.

[27] United States v. Bryan, 339 U.S. 323, 331 (1950):

> [P]ersons summoned as witnesses by competent authority have certain minimum duties and obligations which are necessary concessions to the public interest in the orderly operation of legislative and judicial machinery. A subpoena has never been treated as an invitation to a game of hare and hounds, in which the witness must testify only if cornered at the end of the chase. If that were the case, then, indeed, the great power of testimonial compulsion, so necessary to the effective functioning of courts and legislatures, would be a nullity. We have often iterated the importance of this public duty, which every person within the jurisdiction of the Government is bound to perform when properly summoned.

formly and adequately defined. Unfortunately, it is not. *Zakutansky* allows the privilege when the taxpayer owns the workpapers or holds them in his rightful and indefinite possession. Other than implying that wrongful possession is insufficient, the court does not define possession which is "rightful and indefinite." Historically, under the constitutional precedents of the early twentieth century the Seventh Circuit's formulation is incorrect. The privilege should be allowed when the taxpayer has *bare* possession of workpapers, whether it be rightful or wrongful, definite or indefinite. Ownership without possession is not a proper criteria because the privilege guards against self-incrimination and *not* against incrimination by others.

The Supreme Court precedents underlying the rationale of the bare possession test were developed before the current emphasis on due process. The Court's recent liberalization of constitutional rights does support an argument that under "due process" the High Court might extend the fifth amendment privilege to a taxpayer who owned workpapers but did not have possession of them. Such an extension, however, would seem unwarranted. The Court has clearly stated that the privilege only arises when compulsion exists.[28] In addition, within the last five years the Court has twice held that the fourth amendment privilege against unreasonable searches and seizures does not protect an individual from his misplaced trust in another person.[29] How can it be said that the fifth amendment protects a person from voluntarily surrendering incriminating papers to another? Any decision allowing a taxpayer to protect workpapers under the fifth amendment when he has ownership without possession seems far removed from compulsory self-incrimination.

In the enforcement of the subpoena duces tecum there is some authority to the effect that a taxpayer should be given greater protective rights than those afforded by the Constitution and the usual rules of evidence.[30] But whether the privilege against self-incrimination should be expanded beyond its current bounds is doubtful. In criminal proceedings the search for truth continues to be a forceful policy argument against enlarging the scope of constitutional protection. Those exemplary historical exemptions which often frustrated this policy need not be expanded to shield a taxpayer who is under no actual compulsion.

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[28] Hoffa v. United States, 385 U.S. 293 (1966).

[29] *Id.*; Lopez v. United States, 373 U.S. 427 (1963).

[30] Wigmore argues that the specialization required for practicing before administrative agencies should create communication privileges (*e.g.*, an accountant-client communication privilege). *See* 8 J. WIGMORE, EVIDENCE § 2300(a) (rev. ed. 1961).