New Policy Adopted by the Internal Revenue Bureau in Fraud Cases

Joseph Berman
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By

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"Tax dodgers" are usually uncovered in the following manner:

(1) Through investigations carried on in war or emergency by other bureaus of the federal government.

(2) Through investigations carried on by state income tax agencies.

(3) Through investigations carried on by city or state sales tax agencies.

(4) Through "squeal" letters mailed in to the Bureau of Internal Revenue.

(5) Through information obtained by the bureau in newspapers, trade journals, etc.

(6) By investigation carried on in regard to other taxes.

(7) In estate tax cases through the bureau's checks on returns from probate court proceedings.

(8) Through information obtained from informers who are paid usually ten per cent of taxes, penalties and fines collected. This provision has now been changed allowing the treasury to pay whatever reward it considers proper in view of the value to it of the information obtained from the informer. If a reward is desired for information furnished, the informer must so state. Information can be given either orally or in writing to (a) the Commissioner of Internal Revenue, (b) the Office of the Intelligence Service, (c) the technical staff, (d) the Internal Revenue agent-in-charge, or (e) the Collector of Internal Revenue in his district. It is advisable, if the informer wants a reward, to fill out Form 211 immediately.

(9) Through information obtained by government investigations, e.g., Congressional Crime Investigations, war profiteering contracts, etc.

The continuous changing of the provisions of the Internal Revenue Code, the closing of loopholes and increasing tax rates create the incentive for tax evasion. This has caused an increase in the number of pending fraud cases in the Bureau of Internal Revenue and the Tax Court of the United States—so that we now have more fraud cases reaching the litigation stage. The drive against

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1 For a full discussion see Berman, "Civil Penalties of Income Tax Evasion;" KENTUCKY STATE BAR JOURNAL (December, 1951); MONTHLY TAX DIGEST (March, 1952).
gamblers, racketeers and other tax evaders leads to more criminal fraud prosecutions and increases civil fraud litigations.

The civil fraud penalty of fifty per cent and criminal penalties incurred by filing a fraudulent return are in addition to delinquency and interest and other penalties imposed. Penalties attach to the entire deficiency in income tax cases, even though only a part is tainted by fraud. In estate tax cases it attaches to the entire tax liability. There is no statute of limitations in cases of fraud. Civil penalties for filing fraudulent returns, therefore, can be severe and disastrous to the taxpayer.

The taxpayer may be free of criminal prosecution for tax evasion where the violation falls short of proof "beyond a reasonable doubt;" yet, he may not be able to avoid civil penalties attaching to the charges. Therefore, the client must be well represented. He should not in such cases be represented by an accountant or an attorney inexperienced in trial procedure.

In a criminal tax fraud investigation the special agent of the Intelligence Unit, in addition to determining the dollar amount of the tax liability evasion involved, also must determine whether the taxpayer responsible for the return under examination also shall be prosecuted for wilful tax evasion.

The agent's primary purpose in a criminal fraud investigation is fundamentally different than that in an ordinary civil tax case. Lawyers and accountants who do not realize this difference in attitude are instrumental in getting their clients into jail.

The taxpayer is not obliged to supply the agent with the necessary evidence that would convict him. The Fifth Amendment of the Constitution of the United States protects him to the extent that the taxpayer cannot be compelled "to be a witness against himself" in a criminal prosecution. The taxpayer can stand on his constitutional rights and refuse to be questioned by investigating government agents and refuse them his books, records and writings in his possession. His right to refuse to give agents his books and records is in doubt now since the Supreme Court decided the case of Shapiro v. United States which held that records required to be kept under Office of Price Administration regulations are not privileged.

The privilege against self-incrimination protects taxpayers' books and records including those of a partnership which are presumed to be owned by the individual partners. It does not apply to corporate books and records. A corporation's books and records belong to the corporation and not to its officers. Its

1 See n. 1, supra.
2 For a full discussion see Berman, "Are Taxpayer's Safe in Relying upon the Advice of Their Accountants and Attorneys in Federal Tax Cases," 56 DICK. L. REV. 229 (January, 1952).
3 See n. 1, supra.
4 335 U. S. 1 (1949).
records may disclose fraud on the part of its officers, the individuals who signed the corporate returns. These officers are not protected by the Fifth Amendment of the Constitution even though its books and records may incriminate them. This privilege does not protect documentary evidence in the possession of third parties even though belonging to an individual taxpayer.

The taxpayer's possession extends to his own office and to his premises. His books are safe even if they are in the custody of his bookkeeper or other employee. They are safe in his attorney's hands, because of the privilege existing between attorney and client. However, they are not safe in the taxpayer's accountant's hands, unless the accountant is employed by his attorney in the matter. Documents in a safety deposit box at a bank would most likely be considered as being in the taxpayer's possession and therefore fully protected. There are no decisions on this.

The taxpayer can waive his constitutional privilege any time he desires by ignoring all the safeguards previously mentioned—but he does not have to do it. His waiver must be voluntary. Otherwise, evidence obtained from him can be suppressed. This rule applies in cases where he was induced by a promise of immunity to turn over his records, or where incriminating documents were obtained by agents through a furtive search of the taxpayer's premises. The agents are usually well-informed and careful in their actions in such instances.

Corporations formed or used for the purpose of avoiding the payment of taxes or which have no business purpose have been disregarded by the government and courts for tax purposes. The organization of subsidiaries for the purpose of avoiding taxes has been ignored by the courts.

In order to avoid excess profits taxes taxpayers have purchased corporations on their death bed which had large, unused excess profit credits, in order to use them for the buyer's own profitable taxwise advantage. Congress by the Revenue Act of 1943 closed this loophole, which is now accomplished by Section 129 of the code. (Section 29.129.3.)

All transactions between organizations controlled by the same interests will be carefully scrutinized for indications of attempts to evade, reduce or escape taxation. (Section 29.45-1 (a), (b), (c) and (i).)

The Internal Revenue Code reflects the desire of Congress to prevent avoidance and evasion of federal taxation by means of business transactions with foreign corporations.

6 See n. 2, supra.
7 In re Liebster, 91 F. Supp. 814 (E. Dist., Pa., 1950).
7c Texas-Canadian Oil Corp. Ltd., 44 B. T. A. 913; §§ 112 (1); 29.112 (i) 1 and 29.112 (1) 1.
The problem of whether salaries granted certain top-notch entertainers individually or as partners as Jack Benny, Gosden and Correll (the well-known team of Amos & Andy), Milton Berle, etc., were salaries or a disguised purchase price for their programs was given a good deal of publicity in our press. The answer will depend in all cases on the facts of the case, whether they ever get into court and whether they are tax avoiding and evasion cases.

Compensation payments are deductible only if they are reasonable in amount. A reasonable amount that is such an amount as ordinarily would be paid for similar services by similar businesses under similar circumstances.\(^7\)

A deficiency due to fraud cannot be reduced by filing an amended return showing a higher tax liability than in the original return. The fifty per cent fraud penalty is based on the difference between the final tax liability and the amount shown on the original return. Otherwise a fraud-committing taxpayer could cover himself by, filing an amended return, and paying the additional tax as soon as he found out that he was under investigation. He would thereby escape the fraud penalty.\(^7\)

In *Gutterman Strauss Co.* case,\(^7\) the Tax Court held that it had jurisdiction to determine whether there was a false and fraudulent understatement filed with the intent to evade taxes and whether the penalty found by the commissioner should be assessed and collected. The court also can impose a fraud penalty on its own motion if a fraudulent intent was proved, according to the case of *Peterson and Pegan Baking Co.* (2 B.T.A. 637). And certainly the commissioner can, during a hearing, move to amend his answer to include the charge of fraud where such are the facts in the case, according to the ruling of the court in the *B. P. Wickham v. Comm.* case, 65 F.2d 527.

Constitutional privileges previously discussed do not apply to civil tax cases. Evidence tending to prove fraud barred by the six-year statute of limitations cannot be withheld from the agents. Nevertheless, such books and records dealing with financial transactions of barred years may have a bearing on subsequent years' returns and may help in establishing a pattern of fraudulent conduct or give the government a starting point for the computation of net worth increases in the years of prosecution.

Communications of a client to his attorney are privileged and the law protects them. The attorney cannot be compelled to reveal it in court. It would be unethical and disloyal for him to do so at any time without his client's permission. This rule does not apply if the communications are made in the presence of a third party, other than the attorney's secretary or clerk. The client's accountant should not be present when his attorney questions him since the client's admission


\(^{7e}\) Maitland A. Wilson, 7 T. C. 49.

\(^{7f}\) *Gutterman Strauss Co.*, 1 B. T. A. 243 (A).
of fraud in the accountant’s presence may lead to an examination of the accountant by agents. The federal investigators can in this way obtain the client’s admission of fraud.

Documentary evidence in the attorney’s possession is treated as if it were in client’s hands. If it was protected in the client’s possession, it cannot be taken from the attorney. On the other hand a document is not given added protection or privilege by turning it over to the taxpayer’s attorney. Corporate books and records are not privileged in its attorney’s hands any more than they are in its office.

An accountant’s status must be distinguished from that of an attorney. In the hands of the taxpayer’s accountant his books and records and other private papers are vulnerable. In most cases an accountant’s analysis may be vital to the taxpayer’s defense, and in order to protect it the accountant should do his work in the taxpayer’s office or in that of his attorney. Otherwise, agents may get the data from the accountant by subpoena.

Section 3611 of the Internal Revenue Code allows one examination as to a particular year, unless the commissioner decides otherwise. The taxpayer must receive notice of the commissioner’s decision.

The statute of limitations (Section 275 of the Internal Revenue Code) may be the basis for requiring the agents to show grounds for suspecting fraud. In the absence of such grounds they may be enjoined from examining books and records of a pertinent year.

This weapon can be invoked by a corporation or in respect to third-party records. It depends on the code and not on the Fifth Amendment previously discussed. Only records pertinent to the determination of tax liability can be examined. If the year is barred, the records are not considered pertinent.

The attorney’s decision as to cooperation with the bureau should be made early in the investigation and must be carefully considered before it is granted. All the pros and cons should be weighed by the attorney with an eye to the probable benefit his client might receive in so doing. Tardy cooperation, after the agents have built up their case, does not count and is of no avail.

It often is difficult to realize whether an examination is in ordinary routine one or a fraud investigation. A special agent’s investigation is usually a fraud investigation. An ordinary revenue agent’s investigation, however, may in some cases where warranted lead to a criminal fraud investigation and the taxpayer’s indictment on a felonious charge. At such point, accountants are derelict if they do not advise their clients to retain an attorney; and attorneys are open to criticism if they do not exercise care in deciding as to cooperation and see to it that their clients act with full knowledge of their constitutional rights in the matter. An accountant must advise cooperation, being answerable to the Treasury Department; whereas an attorney’s decision of non-cooperation will be respected.

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8 See n. 2, supra.
The attorney in making his decision should have full knowledge of the facts. He should go over the case thoroughly with his client before he advises him in the matter. He also should examine thoroughly his client's books, records and other documents before he gives his decision in the matter as to cooperation. He should ask the agents for time to consider the matter. If refused he should advise his client to stand on his constitutional rights in order to safeguard the latter's interests in the matter. The agents should be informed by the attorney as to his tentative position and the reasons for the position he takes in the matter until such time as he goes into the facts and learns what the case is all about.

The attorney's decision requires (a) an analysis of the facts of the case; (b) an analysis of the client's books, documents and records; (c) probability of the client making damaging admissions; (d) feasibility of client's explanations; (e) consistency of client's position with accounting data or ability of agents to prove it false by third-party records or witnesses.

The attorney should examine and cross-examine the taxpayer, confronting him with any documentary or other evidence inconsistent with his statements. Other factors the attorney must consider are as follows:

(f) What will the books reveal to the agents on their surrender?; (g) do they indicate alterations and manipulations?; (h) do they support the returns?; (i) what evidence is available to agents from other sources?; (j) what have agents learned and what can they learn from examining the taxpayer's employees?

The attorney should carefully study any available question-and-answer statements taken by agents from the bookkeeper, secretary, office manager, etc. If not questioned, the attorney should ascertain what their testimony will be. Agents will have access to third-party records of suppliers, customers, banks, brokers, insurance companies, etc. If agents can prosecute from such records, cooperation may not hurt the client.

The above-mentioned analysis and weighing of the evidence is an important function that must be performed by an attorney in handling a tax fraud case in its administrative stages.

1. Can the Government make out a case without the taxpayer's aid?

2. Can the prosecution prove beyond a reasonable doubt that (a) the client's return substantially understated his tax and (b) that the understatement was intentional and not due to negligence?

If the attorney decides that the government's case is defective, and can only be cured by the client's testimony or use of his books, non-cooperation is advisable. On the other hand, if the client's explanations are consistent and persuasive and his records are not going to damage him and do not show fraud, a policy of cooperation can save the day by casting doubt on circumstantial evidence of fraud obtained from other sources.
I. R. B. FRAUD POLICY

It is advisable that the attorney move slowly in the direction of cooperation since it is an important and decisive step. Cooperation may otherwise prove dangerous since evidence disclosed can not be recalled.

Proper timing is important in these cases. If the agent has made up his mind, it may be advisable to wait until the case reaches the Penal Division or even the Department of Justice before submitting additional evidence or revealing the taxpayer's explanation. A defense may be a lot more effective if revealed for the first time at the trial. Therefore, if the case is going to be prosecuted, it may be better to show your hand in the courtroom. The prosecution gains with each disclosure. A weak or unconvincing explanation, which commits the taxpayer to a certain defense, is sometimes worse than no explanation.

The agent's recommendations are based on the evidence in his file. If the evidence shows guilt that can be proven beyond a reasonable doubt, he will recommend prosecution no matter how nice the taxpayer and his advisers were in the matter. If the case is defective, he will recommend nonprosecution. Under all circumstances his recommendations will be reviewed by the Penal Division and the Department of Justice. The lawyers reviewing the case base their recommendations on the sufficiency of the evidence that accompanies the agent's report. Reviewing lawyers are not influenced by the agent's resentment and most agents are cognizant of the taxpayer's rights and his attorney's duties in these matters. An attorney who, in proper cases, advises his client to stand on his constitutional rights is respected by all concerned.

Where cooperation is advisable, the agent will appreciate it. He will be reluctant to advise prosecution in doubtful cases, where the taxpayer and his attorney helped him in the case.

Cooperation is advisable where the taxpayer has a consistent and convincing explanation, especially where he will effectively testify in his own behalf. If his books, documents and records are favorable to him, it should be shown to the agent.

In a bad case, full cooperation is advisable since it may have a favorable effect on the judge on sentence day. However, cooperation is not advisable on this basis alone. In a case where they taxpayer has confessed to wilful tax evasion before he employs his attorney, cooperation on the above ground is advisable.

In most instances, books and records are made available to agents unless they contain evidence of alterations and fraudulent manipulations. Correspondence, memoranda and private papers are not part of the business records.

Cooperation in showing the taxpayer's accounting records should not be extended to permitting him to be questioned under oath in the presence of a stenographer or even to allowing the agent to talk to him. Such stenographic record would make an important exhibit and would be carefully considered by reviewers in the Penal Division and the Department of Justice. If he can testify convincingly he should be encouraged to do it. Otherwise he should not speak. In such cases,
if necessary to bring in his testimony, an affidavit should be carefully prepared by his attorney. Or answers to a series of written questions presented by the agent should be prepared.

The taxpayer cannot lie or file an untrue affidavit. He can be silent and stand on his constitutional rights. If he admits wilfulness to his attorney, it will involve either a confession or perjury.

Net worth statements built up in all these cases should be avoided. Agents usually attempt to get a commitment by the taxpayer as to an opening balance sheet. It will be used as a starting point in analyzing net worth increases in future years. An important item in a balance sheet is "cash." What was the taxpayer's and his family's maximum cash position at a certain date? Agents like to establish the taxpayer's cash start so as to attribute future investments and expenses to current unreported income.

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After a decision as to non-cooperation is reached the attorney and his accountant should jointly investigate the facts in the case. Sometimes it may lead to a technical adjustment which may change the whole complexion of the case. The accountant must determine how much money, if any, the taxpayer owes, since under all circumstances the civil tax liability remains to be settled.

The attorney should follow up the trail of the agents and if possible obtain copies of testimony of all interviewed. He should keep in contact with the agents and assure them of cooperation if criminal prosecution is abandoned. They should be given every assistance consistent with full protection of the taxpayer's interests. For example, the furnishing of easily-obtainable data as: bank statements, brokers statements, statements of real estate transactions, etc. These are obtainable by the agents anyhow.

The attorney cannot influence or interfere with third-party testimony. He can question the taxpayer's employees and others acquainted with the facts as to the case and their testimony given to agents. He can ask to see copies of sworn questions and answers, statements given by any previously-mentioned witnesses, since any witness who signs a transcript of his statement is entitled to receive a copy under Treasury practice. But the attorney must avoid influencing testimony or preventing its rendition. The government can take testimony of above-mentioned witnesses, subject to their privileges against self-incrimination.

The attorney's first duty is to his client, the taxpayer. The client has certain constitutional rights which under all circumstances must be protected and he should be fully informed as to it. He cannot be permitted to give false testimony.

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The majority of fraud cases are tried in the Tax Court of the United States since the taxpayer seldom desires to pay the tax and penalty and bring suit for recovery in the Federal District Court or in the Court of Claims.
The Tax Court cannot mitigate a fraudulent penalty if fraud is alleged and proved. The penalty must be imposed in spite of prior voluntary submission of corrected returns and the payment of additional taxes.\(^8\)a The penalty imposed for fraud can be asserted after the collection of the tax and delinquency penalties.\(^8\)b It is measured by the entire deficiency and not by the unpaid portion, where a part has been assessed and paid.\(^8\)e The fifty per cent penalty attaches to the entire deficiency, even though some of it is based on income, the failure of which to report was not due to fraud with intent to evade taxes, where at least a part of it is due to fraud in attempting to evade taxes.\(^8\)d In a case where a taxpayer was acquitted in a criminal prosecution for wilful attempt to evade taxes the imposition of the fraud penalty was not barred.\(^8\)e If an acquittal is the result of the filing of amended returns and relates thereto, the fraud penalty can be imposed on the ground of fraud in the original returns.\(^8\)f

It is fraudulent to omit or understate income.\(^8\)g In order that the taxpayer be liable for the fraud penalty, there must be present the element of bad faith and the intent of defraud.\(^8\)h The fictitious sale of stock or other assets to create a loss for income tax purposes, claiming falsely that a partnership or a trust existed in order to evade taxes and keeping a bank account or other assets under an assumed name are grounds for imposing the fraud penalty. The failure to report income from an illegal liquor or other business, the keeping of false records and deducting items never paid out are all elements which may be the basis of a fraud penalty.

The burden of proof in fraud cases rests on the commissioner. To sustain it, he must show that in making the return the taxpayer knew it was false and intended to evade taxes.\(^8\)i Such intention to evade taxes may be evidenced by the disparity in taxpayer's return and the records of his stockbroker, or that of large bank deposits and small gross income as shown by his return. The existence of large unexplained bank deposits not reported as income for tax purposes sustain the commissioner in his burden of proof.\(^8\)j

\(^8\)a Garden City Feeder Co., 27 B. T. A. 1132, reversed on other issues in 75 F. 2d 804.
\(^8\)b Thomas J. McLaughlin, 29 B. T. A. 247.
\(^8\)c J. S. McDonnell, 6 B. T. A. 685 (A).
\(^8\)d Ollie Kessler, 39 B. T. A. 646.
\(^8\)e Helvering v. Chas. E. Mitchell, 303 U. S. 391.
\(^8\)f John R. Hanby v. Comm., 67 F. 2d 125.
\(^8\)g See n. 8c, supra.
\(^8\)j J. J. Hoeffle v. Comm., 114 F. 2d 713; Leota Meyers, T. C. Memo Dkt. 107058 (March 21, 1946); William H. Malone, T. C. Memo Dkt. 76350 (December 17, 1945).
In fraud cases taxpayers can be examined in connection with taxable years barred by the statute of limitations.\textsuperscript{8k} The code provides certain penalties in criminal fraud cases. In these cases the penalties cannot be collected by assessment but only on conviction by civil or criminal action. (Section 145.) The wilful failure to pay any tax, make a return, keep records or supply any information for the purpose of assessing, collecting or computing any tax required by law on the part of any one is a misdemeanor punishable by a fine of not more than $10,000 or imprisonment for one year or both, and the costs of the prosecution. (Section 145a.)

The filing of a false and fraudulent return and/or the wilful failure to collect or truthfully account for and pay over to the government any tax imposed by law is a felony punishable by a fine of not over $10,000, imprisonment for not more than five years or both, together with the costs of the prosecution. (Section 145b.)

In addition the taxpayer is guilty of perjury if he wilfully lies about his return. (Section 145c.) It is a felony to wilfully aid or assist, procure, counsel or advise in the preparation or presentation of a false or fraudulent return, affidavit, claim or document in connection with matters arising under the internal revenue laws. This is punishable by a fine of not more than $10,000 or five years imprisonment, or both, and the taxpayer can also be charged with the costs of prosecution. (Section 3793(b) (1).)

The following are subject to criminal penalties:

(a) An officer or employee of a corporation, (b) a member or employee of a partnership, (c) a nonresident alien.\textsuperscript{8k}

The statute of limitations for prosecutions under the internal revenue laws is three years, except in cases involving the defrauding or attempted defrauding of the United States by conspiracy or otherwise. For the latter, it is six years. This limitation period is inapplicable during any period when defendant is absent from the district in which the offense was committed.\textsuperscript{81}

The period runs from the time the crime is committed. It does not begin until there is a wilful failure to file a return.\textsuperscript{8m} The filing of a complaint before expiration of the period is good and it is immaterial that an indictment was not found until after the expiration of the period.\textsuperscript{8n}

The constitutional privilege against self-incrimination is not infringed upon by the statutory requirement to file a return for income derived from the crime.


\textsuperscript{81} § 3748 (a); U. S. v. Anthracite Brewing Co., 11 F. Supp. 1019.

\textsuperscript{8m} Ralph Capone v. U. S., 51 F. 2d 609, cert. denied 284 U. S. 669.

The taxpayer in such a case may refuse to answer specific incriminating questions, but cannot refuse to answer all questions or file a return. He must state the amount of his income. (Section 29.145.1.) Failure to report income derived from bootlegging, graft on public contracts and bribery have been held convictable offenses.

The privilege is the defendant's and he may waive it. If he does not claim it when the agent examines his books, he cannot assert it on trial.

Immunity will not be granted in a federal case on the ground that in testifying a witness will incriminate himself under state law. The constitutional provision against double jeopardy is not a defense in an action for filing a false income tax return and perjury, where the facts alleged in each count arise from the same transaction. Paying a civil penalty to the Internal Revenue Bureau does not bar criminal prosecution for the failure to include all of the taxpayer's income in his return. Nor does the failure to assess a tax preclude indictment for willful failure to file a return or pay tax due. The fact that, by an illegal search in another tax evasion case, information is obtained which is the basis of an indictment against the taxpayer, does not immunize him from prosecution. His conviction for income tax evasion cannot be set aside if it is sustained by evidence obtained from independent sources and if no illegally-obtained evidence was used against him.

The preparation of such a case involves (a) the preparation and filing of the petition and all other pleadings involved, (b) the preparation for trial, (c) the stipulation of facts, (d) the opening statement to the court, (e) the introduction of exhibits, (f) the examination of witnesses, and (g) the filing of briefs.

The Tax Court has jurisdiction to determine the following:

(a) If the fraud penalty is due, whether or not a deficiency in tax also has been asserted in the statutory notice; (b) that the fraud penalty can be asserted for the first time in the answer to the petition or at the hearing; (c) that the fraud penalty attaches to the entire deficiency in income, excess profits and gift tax cases if any part of the deficiency is due to fraud; (d) that the fraud penalty attaches to the entire tax liability in estate tax cases, if any part of the understatement of such taxes is due to fraud; (e) that there is no statute of limitations when a return is fraudulent; (f) that the commissioner has the burden of proof

8r U. S. v. Harry Murdock, n. 8q, supra.
8s Joseph Levin et al. v. U. S., 5 F. 2d 598.
8t Slick v. U.S., 1 F.2d 897.
8u U. S. v. Commerford, 64 F. 2d 28, cert. denied 289 U. S. 759.
8v Bennetti v. U. S., 97 F. 2d 263.
9 See Berman, "Statute of Limitations—A Trap in Tax Criminal Penalty Cases," n. 8n, supra.
with respect to the fraud penalty, but the taxpayer has the burden of proof as to the tax deficiency; (g) that in proof in fraud cases the element of intent to evade tax is important; (h) that fraud is not presumed, but must be established by "clear and convincing evidence," as distinguished from "a mere preponderance of the evidence" in an ordinary case and proof "beyond a reasonable doubt" in criminal fraud prosecutions.\(^1\)

The petition should contain an assignment of error as to the fraud penalty along with such other assignments the attorney desires to make regarding the deficiency in tax. Facts supporting it need not be alleged since the respondent has the burden of proof on that issue. The petition should be complete and should set forth facts supporting the assignments of error raised regarding the tax deficiency. The petition should set forth the ultimate facts relied on rather than arguments or citations of authorities. No reference shall be made as to what happened in the bureau since it has no bearing on the merits of the issues the court is asked to consider.

The respondent in a fraud case must plead affirmatively in the answer facts supporting the determination of a fraud penalty. The petitioner must file a reply to the affirmative allegations or respondent either admitting, denying or answering the allegations. Failure to do so will invite a motion by respondent (under rules) to have the fraud allegations deemed to be admitted. Such a motion, if granted, will remove the necessity of proof by respondent to support his allegations of fraud at the trial.

If fraud allegation in the answer is insufficient to acquaint counsel with the basis of the fraud charges, he should either file a motion to have the allegations made more definite and specific or contact the opposing counsel who can give the information thereby avoiding dispute as to pleadings in Tax Court. The respondent is required to plead ultimate facts only and the court will not compel him to disclose his detailed underlying evidentiary facts. If intended merely as a "fishing expedition," such a motion will not be successful.

In most cases settlement may be advisable thereby avoiding a trial. If there is little doubt as to tax liability, the attorney should try only the fraud issue. He should be frank with the court. The court will be more impressed by testimony in such a case if adduced to disprove fraudulent intent and purpose. It does a great deal of harm to take unsound positions and advance fallacious arguments.\(^1\)

If the case cannot be settled, the attorney should try to enter into a stipulation of facts not in dispute as soon as the case is on the hearing calendar. The court does not like to have its time wasted. If another attorney is to take the case into court, he should be engaged far ahead of the trial date to permit him adequate

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10 For a full discussion see Berman, "Proper Procedure Followed in Matters before the Tax Court of the United States."
11 For a full discussion see Berman, "The Advisability of Entering into Closing Agreements and Compromises in Federal Tax Cases."
time for preparation for trial and to prevent him from asking for a continuance of the hearing.

Proper and thorough preparation for trial is important. The counsel for the taxpayer charged with fraud is fortunate if his client is in possession of all the facts concerning his returns and business transactions carried. As mentioned above, the books and records should be carefully examined and counsel should be familiar with their contents. Pertinent facts should be assembled from every available source. All witnesses having information of transactions involved should be interviewed and all pertinent records should be inspected. These can be of greater weight than the taxpayer's sole testimony as to his intent.

A trial brief or memorandum should be prepared since some important point in counsel's favor may be overlooked in court. Evidence to be introduced should be outlined and a list of things to be proved or disproved at the trial should be made. All the evidence which tends to disprove the inference of fraudulent intent should be assembled and put in proper form for presentation to the court.

The government usually uses the following approach:

(a) Introduction of books and records of taxpayer; (b) books and records and corroborative statements of third persons engaged in transactions with taxpayer; (c) bank deposits and brokerage accounts; (d) increase in net worth; (e) an analysis of expenditures.

This is done to establish taxable unreported income. The government approach must be met by showing that all transactions were correctly recorded or by explaining away any false entries or omissions. Inconsistent records of third persons may be reconciled and different treatment explained.

Preparation should be made in case of bank deposits involved to show what deposits represent capital or income from gifts or nontaxable transactions and what portion represents transfers, redeposits or business expense withdrawals.

Increase-in-net-worth method can be relied upon where no books or records exist or inadequate records are kept. It is important that the list of assets at the beginning of the year be complete.

Prior accumulations should be established by best available evidence. If part of the client's living expenses are traceable to gifts or other nontaxable items, it should be proved.

Fraud should be disproved by showing that no additional tax is due. A thorough search of all evidence of transactions covering the period involved should be made since additional deductions or other adjustments in taxpayer's favor may be found which may offset additional income on which the fraud penalty is based or thereby reduce the tax to which the penalty attaches.

The taxpayer as a rule cannot escape responsibility by delegating to another the preparation of his return. If the individual preparing the return was sufficiently qualified and was furnished with all the pertinent facts, his testimony
may disprove fraudulent intent on the part of the taxpayer.\textsuperscript{12} Such testimony is ineffective if the reputation of the party preparing the return is questionable and can be discredited.\textsuperscript{18} This defense will fail if it appears that the taxpayer did not reveal all the facts to his advisor. It should not be greatly relied upon. The attorney should be prepared to prove the authenticity of documents and records when questioned.\textsuperscript{14}

There is no standard test for fraud since courts refuse to define it and limit themselves in these cases\textsuperscript{15} because of the many ways in which taxpayers can evade income tax payments.

The attorney in his opening statement to the court should briefly explain the issues and state the petitioner's case so that it can be understood without going into the detailed facts and evidence to be produced. He may refrain from making any statements regarding the issue of fraud until the respondent makes his statement in support of the charge of fraud. The statement should not be too elaborate. The attorney should proceed with the introduction of evidence. It is important.

Time may be saved in introducing exhibits by letting the adversary examine them and by giving him an opportunity to agree to their introduction. Direct examination should be planned, in orderly fashion and developed along well-defined lines so that it shall be easy for the court to follow. The attorney should not ask his witnesses leading questions except in preliminary matters to save time. The witness should testify if he is to be effective. The attorney should produce all the evidence supporting his position. He should put in all the facts supporting his theory, since no amount of argument in his brief will make up for the failure to produce evidence of essential facts.

The attorney should be careful in cross-examination since more harm than good can result from it. It is better to leave a matter unexplained than to receive an unsatisfactory explanation. The chief purposes of it are as follow: (a) To bring out some suppressed or undeveloped facts; (b) to enable the witness to modify his statements made on direct examination by developing additional and qualifying circumstances, and (c) to discredit the direct testimony by showing that the witness was mistaken or that he misrepresented the facts.

The attorney should not stumble through cross-examination nor should he take too many chances in fraud cases. The witnesses' bias or impartiality in the case should be considered before cross-examination is undertaken. Evidence should not be objected to unless the attorney has a valid legal objection. The attorney should avoid giving the impression that he is trying to hide something. The court wants to know all the facts and takes a liberal view as the admissibility of evidence in fraud cases.

\textsuperscript{12} Portland Oil Co., 38 B. T. A. 757, aff'd 109 F. 2d 479.
\textsuperscript{13} Joseph H. Imeson, 14 T. C. 1151.
\textsuperscript{14} Rialto Mining Corp., Docket 4254, B. T. A. Memo Op. (October 9, 1945).
\textsuperscript{15} M. Rea Gano, 19 B. T. A. 518, 533.
Unreported income has led to convictions in a long line of cases. There have been a great many fantastic and unbelievable stories told, regarding sources of unaccounted accumulations of wealth.\textsuperscript{16}

When the trial is concluded the attorney should prepare his brief. In it he should carefully review the evidence and outline his theory and approach. Such theory should be affirmative rather than negative.

His request for finding facts should be carefully drawn and appropriate references should be made to the transcript and exhibits. All essential facts should be set forth in declarative form. It should be in language that the court can adopt verbatim. In the case of facts disclosed by exhibits, the pertinent parts should be picked out or summarized and findings accordingly requested.

His argument following a request for findings should be direct, positive and specific. It should carefully analyze the facts and should contain sound, logical reasoning as to why the facts do not support the charge of fraud. His argument should be based on the record made at the trial and should be strictly on the merits of the issue of fraud. Positive and direct statements should be followed by logical, persuasive and sound reasoning.

The bureau does not lightly or arbitrarily impose the fraud penalty and the court is reluctant to sustain such a penalty unless there is disregard of the nation's revenue problems and clear evasion. This is true now in cases of gains from gambling, bookmaking, racketeering and other illegal activities from which no income or only a small portion thereof has been reported.

It is not always easy for the court to make decisions in fraud cases, especially where the taxpayer has no criminal record, is not engaged in illegal activities, is of seemingly unimpeachable character and testifies as to the purity of his motives and the absence of fraudulent intent.\textsuperscript{17}

Accountants and attorneys can be of assistance not only to the government but also to the taxpayers by seeing to it that their clients keep adequate books and records and file complete and proper returns, disclosing all transactions taxable or otherwise. If the client is innocent of fraud charges, a proper explanation may be advisable and may clear the matter up. Voluntary disclosures properly made are a bar to criminal prosecution. In civil fraud penalty cases, an admission of dereliction may in some instances lead to a stronger position on the client's part.


\textsuperscript{17} Charles E. Mitchell, 32 B.T.A. 1095; 89 F.2d 873; 303 U.S. 391; 340 U.S. 45.