



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
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MEMORANDUM FOR DIRECTOR (FRAUD/BSA)

FROM:

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SUBJECT:

United States v. Tweel

As a follow-up to our meeting on August 19th, we have assembled this guidance to increase the awareness of and attempt to minimize the potential harm from Tweel-type challenges. Given the recent increase in the number of parallel civil and criminal investigations, it is possible we could experience a rise in the number of Tweel motions filed by defendants. A Tweel challenge focuses on fraud, deceit and trickery on the part of the government.

While courts have recognized the government's use of "trickery" in the context of undercover operations¹, courts have generally limited the government's ability to deceive individuals in certain contexts. For example, a revenue agent can not be a "stalking horse" for CI. In this regard, the IRS may not gather evidence for criminal prosecution through the consensual audit process by affirmatively misrepresenting its intentions. While a revenue agent has no affirmative duty to warn a taxpayer that the information may be shared with CI, the revenue agent must not in anyway conceal the involvement of CI, if asked by the taxpayer. A violation of this policy may be considered an illegal search within the context of the Fourth Amendment.

The memorandum starts off with a discussion of the Tweel case and progresses into an analysis of two related arguments. Also included is an analysis of several common scenarios and a suggested protocol to apply when questions arise. A summary of cases addressing Tweel-type arguments is also included in an Appendix.

¹ See Jones v. Berry, 722 F.2d 443 (9th Cir. 1983)(When undercover agents gain the confidence of one suspected of criminal activity, and the suspect later voluntarily reveals to the agents evidence of crimes, he or she can have no expectation of privacy in the information so revealed)

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BACKGROUND

In United States v. Tweel, 550 F.2d 297 (5th Cir. 1977), the Fifth Circuit held that the government cannot affirmatively mislead a taxpayer into consenting to a search by agreeing to provide information during a civil audit by engaging in fraud, trickery or deceit. If the government does so, the consent will not be valid and the "search" will violate the Fourth Amendment and the Court will exclude the evidence that had been gathered during the civil audit, from the criminal case. The Fifth Circuit emphasized that "[o]ur revenue system is based upon the good faith of the taxpayers and the taxpayers should be able to expect the same from the government in its enforcement and collection activities." Tweel, 550 F.2d at 300.

In Tweel, a civil audit of the defendant was requested by the Organized Crime and Racketeering Section of the Department of Justice. During a telephone conversation between the agent conducting the audit and the defendant's accountant, the accountant asked the agent whether a special agent (denoting the criminal nature of the inquiry) was involved in the case. The agent responded that no special agent was involved. The accountant took the answer to mean that the audit would be a routine civil audit. The court found that the agent's failure to advise the attorney of the "obvious criminal nature" of the audit was a "sneaky deliberate deception" and a "flagrant disregard" for the defendant's rights.

Notwithstanding the result in Tweel, the Fifth Circuit stated:

We conclude that the mere failure of a revenue agent (be he regular or special) to warn the taxpayer that the investigation may result in criminal charges, absent any acts by the agent which materially misrepresent the nature of the inquiry does not constitute fraud, deceit, and trickery. Therefore, the record here must disclose some affirmative misrepresentation to establish the existence of fraud, and the showing must be clear and convincing.

Tweel, 550 F.2d at 299, citing United States v. Prudden, 424 F.2d 1021, 1033 (5th Cir.), cert. denied, 400 U.S. 831 (1970).

Traditionally, Tweel arguments fall into two distinct categories:

- (1) Did the IRS conduct a criminal investigation under the guise of a civil audit?
- (2) Did the revenue agent violate the Internal Revenue Manual by not referring the case to CI at an earlier time?

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Since the Tweel ruling, criminal defendants have alleged that civil agents have made affirmative misrepresentations because of what they said or didn't say. They sometimes claim that the agents violated Tweel because they allegedly continue civil audits even if they have sufficient indicia of fraud to warrant referring the case to CI. This defense centers on whether the revenue agent violated IRS policy by not referring the case to CI upon the finding of fraud. Often times, the defendant's policy argument merges into a traditional Tweel violation involving fraud, deceit and trickery.

IRS POLICY

25.1.10.1 Referrals to CI

(1) When firm indications of fraud are present, a referral to CI will be prepared using Form 2797. Refer to IRM 25.1.3.2 for information in preparing Form 2797. All criminal referrals must be routed through the FRS Group Manager for review, concurrence and forwarding to the new Criminal Investigation Lead Development Center (LDC).

25.1.3.2 Preparation of Form 2797

(1) If after consultation with the fraud referral specialist (FRS), it is determined a potential fraud case has firm indications (affirmative acts) of fraud and meets criminal criteria, the compliance employee will suspend the examination or collection efforts without disclosing to the taxpayer or representative the reason for the suspension. A referral to CI will be prepared using Form 2797.

(2) The referral will be a detailed factual presentation of those factors used to establish firm indications of fraud, including, but not limited to:

- Affirmative act(s) of fraud
- Taxpayer's explanation of the affirmative act(s)
- Estimated criminal tax liability
- Method of proof used for income verification

A common argument amongst defendants is that the revenue agent prolonged his/her investigation of the defendant beyond the point of firm indications of fraud resulting in the building of the criminal case under the guise of conducting a civil audit. An example of a case, albeit a district court holding, applying the firm indication of fraud concept to the detriment of the government is United States v. Toussaint, 456 F.Supp.1069 (S.D. Texas, 1978). In Toussaint, the district court held where a revenue agent, after having

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a firm indication of fraud, continued his investigation for a considerable period of time without advising the taxpayer that the information being collected could be used for criminal prosecution, violated the taxpayer's Fourth and Fourteenth Amendment rights. As such, suppression of evidence of admissions or statements made by the taxpayer during interviews held by the revenue after the finding of firm indications of fraud was required.

A firm indication of fraud must be distinguished from a first indication of fraud. A first indication of fraud can be described as a mere suspicion of fraud. Courts have recognized that revenue agents enjoy latitude in making the difficult referral decision. See, United States v. Groder, 816 F.2d 139, 142 (4th Cir. 1987).

The procedures surrounding parallel proceedings are all directed at avoiding a situation where a promoter, preparer or taxpayer can accuse the Service of violating his or her constitutional rights by affirmatively misleading him or her about the "true" purpose of the contact or interview; how the information could be used; or whether she or he was the subject of a criminal investigation.

PROTOCOLS

[REDACTED]

DP

[REDACTED]

[REDACTED]

[REDACTED]

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Deliberative process privilege

APPENDIX

Affirmative Misrepresentation Cases:

United States v. Irvine, 699 F.2d 43 (1st Cir. 1983) – IRS agent's violation of IRS regulation in failing to specifically tell defendants that he was conducting "criminal" investigation did not require suppression of records obtained by agent during the interview. IRS agent breaches no constitutional duty when he obtains information merely by failing to state specifically that he is conducting criminal investigation.

Jones v. Berry, 722 F.2d 443 (9th Cir. 1983) – When an undercover agent gains the confidence of one suspected of criminal activity, and that suspect later voluntarily reveals to agents evidence of crimes, he or she can have no expectation of privacy in information so revealed.

United States v. Skulsky, 786 F.2d 558 (3rd Cir. 1986) – The IRS may not gather evidence for criminal prosecution through consensual civil audit process by affirmatively misrepresenting its intentions. CI had not used the civil audit process as a stalking horse for the grand jury investigation.

United States v. Kaatz, 705 F.2d 1237 (10th Cir. 1983) – Evidence obtained by IRS agent during a civil audit of defendants was not subject to suppression in later criminal prosecution, since nothing in the record showed that defendants were misled by anything the agent did or said, and since failure to warn that a criminal investigation may ensue is not fraud, deceit, or trickery. Further, violation by an IRS agent of the "Audit Technique Handbook for Internal Revenue Agents" does not prove a violation of any constitutional right of audited individual. See *United States v. Caceres*, 440 U.S. 741, 744-745 (1979).

United States v. Wuagneux, 683 F.2d 1343 (11th Cir. 1982) – Internal revenue agent's disclosure that he was from the IRS and intended to conduct a tax audit of defendant's corporation was adequate, for Fourth Amendment purposes, to sustain defendant's consent to the audit. Further, revenue agents need not expressly advise taxpayers that a routine civil audit may lead to criminal proceedings if discrepancies are uncovered, as all taxpayers, especially businessmen, are presumed to be aware of this possibility.

Spahr v. United States, 409 F.2d 1303 (9th Cir. 1969) – If federal agents procured their invitation through guile or fraud, subsequent examination of corporation's records would constitute an "unreasonable search." However, federal agents who desired to examine tax records of corporation could not be held to have concealed their true purpose of investigation so as to constitute the examination of the records as an "unreasonable search" where one agent identified himself as a special agent for the Intelligence Division of the Internal Revenue Service, and second agent identified himself as a revenue agent from the Audit Division.

United States v. Robson, 477 F.2d 13 (9th Cir. 1973) – Where agent made same type of civil audit that he conducted in all cases, regardless of initial impetus for the audit, and he had no instructions from the intelligence division, had no interim conferences with its representatives and was under no obligation to report it unless his audit uncovered an indication of fraud, fact that informant's tip which led to audit originally came from intelligence division did not mean that agent was an agent of the intelligence division and there was no violation of due process in agent's failure to give warnings required of special agents of the intelligence division. Also, where agent did not represent his audit to be simply "civil" in nature and did not indicate to taxpayer that he intended to conduct a "civil" audit but told him that his tax returns had been assigned to agent for examination and agent was under no duty to mention possible criminal consequences of his audit and record disclosed no intimation that agent was ever queried as to scope of his investigation, taxpayer's consent to search of his records was not induced by agent's deceit, trickery or misrepresentations and exhibits could not be suppressed on that ground.

Firm Indication of Fraud Cases:

United States v. Peters, 153 F.3d 445 (7th Cir. 1998) – In case which began when CI received "information item" from defendant's ex-husband, was then referred to Examination Division and ultimately referred to CI for criminal investigation, IRS did not use civil audit as covert means to obtain evidence for criminal prosecution, in violation of Fourth and Fifth Amendments. The court noted that the IRS had not developed "firm indication of fraud" at time special agent referred case to Examination Division, revenue agent who audited returns believed audit was routine, her supervisor's decision to develop further was consistent with directives in Internal Revenue Manual and not part of effort to conduct covert criminal investigation, and revenue agents who were reassigned the case did not develop firm indications of fraud prior to their fraud referral of matter to CI.

United States v. Caldwell, 820 F.2d 1395 (5th Cir. 1987) – Revenue agent did not make material misrepresentation by asking taxpayer to meet with him to discuss 1979 to 1980 audit on ground that real purpose of meeting was to conduct criminal investigation of 1978 tax year, so that taxpayer was not entitled to suppression of statements taxpayer made at interview on ground that statements were obtained by IRS through fraud, trickery, and deceit. Revenue agent had only "first indication," not "firm indication," of fraud prior to interview with taxpayer, so that there was no violation of Internal Revenue Service procedures requiring revenue agent to refer firm indication of fraud to criminal investigations division; thus, even if defendant had Fifth Amendment right to rely on Internal Revenue Service Regulations, that right was not violated.

United States v. Grunewald, 987 F.2d 531 (8th Cir. 1993) – Defendant charged with tax evasion was not entitled to suppression of evidence discovered during civil audit where IRS agent did not have firm indications of fraud prior to his initial meeting with defendant. There were no firm indications of fraud until after agent's analysis of checks, which provided basis for concluding that defendant had substantial income deficiency and pattern of underreporting. Also, subsequent to agent's last meeting with defendant, agent did not mislead defendant as to true nature of audit, and agent did not fail to refer investigation to CI in violation of IRS internal regulations. Mere failure of IRS agent to inform defendant that information developed in audit may result in further criminal investigation does not indicate affirmative and intentional deceit by IRS as required for suppression of evidence discovered during course of audit.

United States v. Knight, 898 F.2d 436 (5th Cir. 1990) – Failure of IRS agent to disclose his tentative fraud determination at time he talked to taxpayer who was subject of investigation did not amount to fraud, trickery, and deceit requiring suppression of oral statements which taxpayer made to the agent, where agent made no affirmative misrepresentation and left no inquiry of taxpayer unanswered.

United States v. Michaud, 860 F.2d 495 (1st Cir. 1988) – Internal Revenue agent's notes to herself during investigation of taxpayer, about whether investigation warranted referral to fraud division, was not sufficiently firm to warrant referral and cessation of her investigation pursuant to agency regulations; thus, agent's continued investigation of taxpayer was not government misconduct sufficient to warrant dismissal of criminal tax charges against defendant particularly since agent only potentially violated agency regulations.

Groder v. United States, 816 F.2d 139 (4th Cir. 1987) – IRS manual which requires agents to suspend civil investigations when they detect "firm indication of fraud" and refer such cases for evaluation by criminal investigation division requires that agents have more than first indication or mere suspicion that intentional fraud exists prior to making referral; mere understatement of income by taxpayer on original return does not constitute "firm indication of fraud" as failure to report income correctly may be due to mistake, inadvertence, negligence or carelessness or reliance on professional advice. Also, abuse of judicial process that would lead courts to deny enforcement of summons by Internal Revenue Service is tied to showing of governmental bad faith; burden to prove bad faith rests with taxpayer, and violation of its own regulations by IRS is not proof by itself of bad faith in tax investigation nor is failure to warn that criminal investigation may ensue; rather, bad faith involves broader deceit on part of Government.