THE POWER OF THE BUREAU OF INTERNAL REVENUE TO SUBPOENA BOOKS AND RECORDS IN TAX INVESTIGATIONS

A Bureau of Internal Revenue agent was investigating the tax returns of a union president. The agent subpoenaed all union records relating to any transactions between the union and its president.[1] The union failed to comply, and upon complaint being filed, the district court ordered the subpoena enforced.[2] The court of appeals reversed and remanded the cause for further proceedings, holding that it was necessary to show that the records sought were related to the tax liability of the union officer under investigation.[3]

The court's requirement of proof of a relationship between the records sought and the union president's tax liability raises the question of how broadly the Internal Revenue Bureau can frame a subpoena duces tecum. In considering this problem two classes of cases will be discussed: (1) those which will be referred to as "two party" cases in which the party whose records are subpoenaed is under investigation; (2) and "third party" situations, such as the principal case, in which the party whose records are subpoenaed is not directly under investigation.[4] The courts have not treated these two situations in the same manner and unless this distinction is kept in mind, one may easily fall prey to the mistaken belief that a hopeless maze of contradictory cases exists.

The fourth and fifth amendments have long been held to be limita-

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1. See Int. Rev. Code of 1954, § 7602(2). This section gives the Bureau of Internal Revenue power to subpoena the books and records of one whose tax liability is under investigation, or "any other person" who may have pertinent data.

2. See Int. Rev. Code of 1954, § 7604(a). This section gives a United States district court jurisdiction to enforce a subpoena issued pursuant to § 7602(2) of the Code. In Local 174, International Brotherhood of Teamsters v. United States, 240 F.2d 387 (9th Cir. 1956) the complaint was supported by an affidavit which stated that the union president had received money from the union as "loans," which were unsecured, and it was argued that these "loans" should be investigated because his returns showed no interest payments.

3. Local 174, International Brotherhood of Teamsters v. United States, supra note 2.

4. The law is well established that a "third person" who is not under immediate investigation may be subpoenaed under § 7602(2). E.g., In re Albert Lindley Lee Memorial Hospital, 209 F.2d 122 (2d Cir. 1953); First Nat'l Bank v. United States, 160 F.2d 532 (5th Cir. 1947).

tions on the subpoena power of administrative agencies.[5] Because the fifth amendment is personal in nature it normally can be raised as a defense only in the "two party" cases; usually only the person under investigation can refuse to answer on grounds that he may incriminate himself.[6] Thus accountants,[7] banks,[8] and stockbrokers,[9] who are "third parties," cannot invoke the amendment on behalf of a taxpayer under investigation. Also corporations[10] and unions[11] are not privileged from furnishing self-incriminating evidence, even when they are directly under investigation, because their structure is public in nature.[12] However, the availability of the fifth amendment as a defense in the conventional "two party" cases has recently been

5. See Boyd v. United States, 116 U.S. 616 (1886). This is the leading case holding that the fourth and fifth amendments are limitations on the government's subpoena power. The pertinent sections of these amendments which restrict the government's subpoena power are the "search and seizure" clause of the fourth and the "self-incrimination" clause of the fifth. Prior to this case an illegal search and seizure was confined primarily to situations in which officers "actually" encroached on one's property or person and by force took the evidence they desired. See Davis, Administrative Law § 32 (1951). But the Court here reasoned that to force one, by issuance of a subpoena, to produce his private books and records was equivalent to an "actual" search and seizure. The Court considered a subpoena in the nature of a "constructive" search and seizure and thus a violation of the fourth amendment when improperly framed.

But see Oklahoma Press Publishing Co. v. Walling, 327 U.S. 186, 202 (1946) where the Court stated, "The primary source of misconception concerning the Fourth Amendment's function lies perhaps in the identification of cases involving so-called . . . 'constructive' search with cases of actual search and seizure." See also Davis, op. cit. supra, at § 32 which states, "The Amendment's prohibition of unreasonable searches and seizures might well have been limited to what the words cover—searches and seizures." With regard to the production of one's records the Court in the Boyd case said that the fourth and fifth amendments ". . . run almost into each other." 116 U.S. at 630. This indicates that when a subpoena is issued one may have both amendments available to justify noncompliance.

6. A third party may invoke the privilege only when he is the one who will be incriminated. In re Friedman, 104 F. Supp. 419 (S.D.N.Y. 1952).

7. E.g., Falsone v. United States, 205 F.2d 734 (5th Cir.), cert. denied, 346 U.S. 864 (1953).

8. E.g., First Nat'l Bank v. United States, 160 F.2d 532 (5th Cir. 1947); United States v. First Nat'l Bank, 295 Fed. 142 (S.D. Ala. 1924).

9. McMann v. SEC, 87 F.2d 377 (2d Cir. 1937). Contra, Zimmermann v. Wilson, 81 F.2d 847 (3d Cir. 1936), overruled, 105 F.2d 583 (3d Cir. 1939).

10. See e.g., Grant v. United States, 227 U.S. 74 (1913); Wheeler v. United States, 226 U.S. 478 (1913); United States v. Cooper, 288 Fed. 604 (N.D. Iowa 1923).

11. E.g., United States v. White, 322 U.S. 694 (1944).

12. This stems from the personal nature of the fifth amendment. See McCormick, Evidence § 125 (1954).

subjected to severe limitations.[13] The courts have reasoned that because the law requires a taxpayer to keep records for tax purposes, the Bureau of Internal Revenue can inspect them at any time to determine tax liability. Nevertheless, since there has been no Supreme Court decision on this matter, one should continue to raise the privilege against self-incrimination as a defense.

For a subpoena to be valid within the bounds of the illegal search and seizure clause of the fourth amendment, the courts have required proof that the information sought be relevant and of reasonable breadth.[14] In the "two party" cases courts have been hesitant to put any limitation on the administrative order. The attitude seems to be that individuals suspected of violations should not be allowed to use the fourth amendment as a subterfuge to hinder the efficiency of the Internal Revenue Bureau and, therefore, taxpayers must cooperate fully by producing all requested records.[15] This attitude has led some

13. Shapiro v. United States, 335 U.S. 1 (1948), severely impinged upon the long line of precedent (see note 4 supra) which supported the applicability of the fifth amendment as a limitation on the subpoena power of administrative agencies. The Court held that records which the OPA required a fruit and produce wholesaler to keep could not be withheld under a claim of the privilege against self-incrimination. It had long been held that public records were not within this privilege. E.g., State v. Donovan, 10 N.D. 203, 86 N.W. 709 (1901); People v. Coombs, 158 N.Y. 532, 53 N.E. 527 (1899). But the Shapiro case seems to make all required records public records. An important question is what effect the Shapiro case will have on § 6001 of the Internal Revenue Code of 1954, which gives the Bureau authority to require taxpayers to keep records. The first appearance of the Shapiro doctrine in a tax case was in Falsone v. United States, 205 F.2d 734 (5th Cir.), cert. denied, 346 U.S. 864 (1953), where the court said that the taxpayer could not raise the privilege against self-incrimination because he was required by law to keep records for tax purposes. 205 F.2d at 739. For other tax cases which have reasoned similarly, see Smith v. United States, 236 F.2d 260 (8th Cir.), cert. denied, 352 U.S. 909 (1956); Beard v. United States, 222 F.2d 84 (4th Cir.), cert. denied, 350 U.S. 846 (1955); United States v. Willis, 145 F. Supp. 365 (M.D. Ga. 1955).

14. See Oklahoma Press Publishing Co. v. Walling, 327 U.S. 186, 208 (1946), where the Court stated: "[In cases involving] . . . production of corporate records and papers in response to a subpoena . . . the Fourth [amendment], if applicable, at the most guards against abuse only by way of too much indefiniteness or breadth . . . ." See also Davis, op. cit. supra note 4, at 106 which states: "Except for limitations concerning breadth and relevancy, the Fourth Amendment does not now restrict an administrative subpoena for records or an administrative requirement of reports."

15. See e.g., Endicott Johnson Corp. v. Perkins, 317 U.S. 501 (1943); Westside Ford Inc. v. United States, 206 F.2d 627 (9th Cir. 1953), where the court said that in an ex parte inquiry, the standards of relevancy and materiality are not as rigid as in a trial; United States v. United Distillers Product Corp., 156 F.2d 872 (2d Cir. 1946); In the Matter of Carroll, 149 F. Supp. 634 (S.D.N.Y. 1957) (only when a "third party" is requested to produce books or records need there be shown a relation between the papers sought and a taxpayer's liability).

courts to very broad statements concerning the scope of the Internal Revenue's subpoena power in the "two party" cases.[16] Thus, in *In re International Corp.*[17] the court reasoned that if pertinent records of third parties can be subpoenaed in an investigation of the tax liability of a specific taxpayer, then all of the financial records of the taxpayer are subject to scrutiny.[18]

Although "third parties," as noted earlier, cannot raise the defense of the privilege against self-incrimination for the party under investigation, they can defend on grounds of an unreasonable search and seizure.[19] The liberal statements of the restrictive effect of the fourth amendment in many "two party" cases, such as the *In re International Corp.* case, might appear to apply to the "third party" cases, but the courts in most instances have been unwilling to make this extension.[20] They still require proof that the records subpoenaed are "actually needed."[21] A merely exploratory search will be held to violate one's fourth amendment rights.[22] A trend established by many courts, however, has been to almost completely disregard the breadth

16. See note 14 supra.

17. 5 F. Supp. 608 (S.D.N.Y. 1934).

18. Id. at 611.

19. E.g., Bowles v. Joseph Denunzio Fruit Co., 55 F. Supp. 9 (W.D. Ky. 1944). Judge Pope in the dissenting opinion of the principal case states that unions cannot resist an administrative subpoena on grounds of an unreasonable search and seizure. He relies on the case of United States v. White, 322 U.S. 694 (1944). But it is very doubtful that the Court in that case so held. The Court there stated: ". . . that neither the Fourth nor the Fifth Amendment, both of which are directed primarily to the protection of individual and personal rights, requires the recognition of a privilege against self-incrimination under the circumstances of this case." 322 U.S. at 698. The Court was speaking of the right of the union to raise these amendments as a defense to an administrative subpoena, but it was *peculiarly* considering the fourth amendment in reference to the privilege against self-incrimination and failed to mention the possibility of the illegal search and seizure clause as a defense. The majority opinion in the principal case completely ignored United States v. White and based its holding on illegal search and seizure grounds. 240 F.2d at 390.

20. See e.g., Chapman v. Goodman, 219 F.2d 802 (9th Cir. 1955), where a court's order to an attorney to produce the records of his client was held to require only that the attorney bring the records to court for the judge to determine which ones the agency could properly subpoena; First Nat'l Bank v. United States, 160 F.2d 532 (5th Cir. 1947), where the court held that in "third party" cases it must be shown that the records desired bear upon matters under investigation; Redlich, Searches, Seizures, and Self-Incrimination in Tax Cases, 10 Tax L. Rev. 191, 203 (1954): "When third parties are directed to produce records . . . there is a greater likelihood that the 'fishing expedition' defense will prevail."

21. Martin v. Chandis Securities Co., 33 F. Supp. 478 (S.D. Cal. 1940), aff'd, 128 F.2d 731 (9th Cir. 1942).

22. Mays v. Davis, 7 F. Supp. 596 (W.D. Pa. 1934).

and relevancy limitations formerly imposed under the fourth amendment, even in "third party" cases.[23] This trend is based upon the premise that public necessity is paramount to private civil liberties, and is especially prominent in recent cases. The reasoning behind it is that the agency, in order to fulfill the purposes for which it was organized, must be permitted to engage in "some fishing."[24] Although it is still required that there be reasonable grounds for suspicion,[25] this trend represents quite an extension of the "actually needed" test.[26]

Certain factors, in addition to whether a "two party" or "third party" case is involved, appear to have influenced the determination of how broadly a subpoena may be framed. For example, the dissent in the principal case suggested that the degree of possible guilt or innocence of the "third party" should also be considered.[27] Thus, in the principal case, where there was a good chance that the union was as guilty as its president, the dissent would have treated the union as if it were under immediate investigation.[28] Although courts have not expressly considered the possible innocence or guilt of the "third party," the cases in which limitations of breadth have been imposed

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23. One of the first "third party" cases to disregard the fourth amendment's limitations of breadth and relevancy (see note 13 supra) was Miles v. United Founders Corp., 5 F. Supp. 413 (D. N.J. 1933). In this case the government was allowed to order a corporation to produce the names of each shareholder who had transferred his stock, so that each individual shareholder's income might be assessed. See also Peoples Deposit Bank and Trust Co. v. United States, 212 F.2d 86 (6th Cir. 1954), where the court was satisfied with testimony of a special agent that he had a strong suspicion of a false or fraudulent tax return, and did not require any other proof that the return was false or fraudulent; In re Albert Lindley Lee Memorial Hospital, 209 F.2d 122 (2d Cir. 1953) (emphasized the necessity of public interest over private interest); Stone v. Frandle, 89 F. Supp. 222 (D. Minn. 1950) where the internal revenue agent ordered a stenographer, whose tax liability was not directly under investigation, to produce notes taken at an arbitration hearing. The court held that she should produce such notes whether or not they were related to any books of account of the taxpayer or others.

24. See United States ex rel. Sathre v. Third Northwestern Nat'l Bank, 102 F. Supp. 879, 881 (D. Minn.), appeal dismissed on stipulation of parties, 196 F.2d 501 (8th Cir. 1952).

25. Ibid.

26. See text supported by note 20 supra.

27. 240 F.2d at 395.

28. Judge Pope in the dissenting opinion said that to treat the union as an innocent third party, which is subject to greater protection under the fourth amendment, would be the same as saying that in the investigation of one suspected of stealing, a receiver of the stolen goods would be a "third party" with rights of privacy. 240 F.2d at 395 n.1.

on the subpoena power are those where the "third party" was relatively free from suspicion of guilt.[29]

The nature of what the agent is trying to prove may also influence a court. In the principal case the Bureau of Internal Revenue sought to prove that the union president never repaid certain "loans" he had received from the union. Therefore, it is difficult to see how the subpoena could have been drafted without including all records in any way related to transactions between the union and its president.[30] It would be necessary to examine all such records to see whether or not the loans in question had been repaid. The information sought in many of the "third party" cases where the breadth of the administrative subpoena power was limited was not of this negative character, and thus could have been obtained through a less comprehensive inspection of the books.[31] Therefore, it is submitted that the decision in the principal case is significant for its restrictive view of breadth and relevancy, especially in view of the modern trend in "third party" cases, the possible guilt of the union, and the nature of the information sought.

In the past, courts have been more conscious of private civil liberties. However, as our society becomes more complex, there has been a growing tendency to increase administrative agencies' subpoena power. This is well illustrated by the cases which have limited the availability of the privilege against self-incrimination even when the party is under immediate investigation. The cases restricting the limiting effects of the fourth amendment in "third party" situations are also illustrative. Taxation problems have increased in proportion to the complexity of society. It is submitted that the Bureau of Internal Revenue must necessarily have access to a great many records if it is to be an effective agency of the government. It is further submitted that in the future the courts, in an effort to prevent tax frauds, will continue to provide the Bureau of Internal Revenue with a more extensive subpoena power than is granted to other administrative agencies of the federal government.

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29. See notes 19-21 supra.

30. Judge Pope in the dissenting opinion recognized the necessity of permitting the Internal Revenue Bureau to inspect all of the union's records when he said: "Do my associates suggest that these books must be brought into Judge Bowen's court and that Judge Bowen should read them all for the purpose of satisfying himself that they contained no entry showing repayment of these loans?" 240 F.2d at 398. This statement accurately indicates the impracticability in many instances of having the court determine whether the records sought are relevant and therefore subject to administrative investigation.

31. See e.g., First Nat'l Bank v. United States, 160 F.2d 532 (5th Cir. 1947); Mays v. Davis, 7 F. Supp. 596 (W.D. Pa. 1934).