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# Follow That Lead! Obtaining and Using Tax Information in a Non-Tax Case

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## Introduction

In any criminal case where financial gain is the prominent motive, tax returns and return information can provide some of the most significant leads, corroborative evidence, and cross-examination material obtainable from any source. Title 26, United States Code, Section 6103, enacted by Congress after the abuses of Watergate, continues to be the principal instrument to protect the confidentiality of tax returns and return information. The statute recognizes, however, that tax information, properly obtained and used, can play an important role in criminal investigations of non-tax crimes.

Assistant United States Attorneys (AUSAs) and Federal agents must carefully follow Section 6103 if they want to avoid exposure to criminal and disciplinary sanctions.<sup>\*</sup> This article discusses some of the reasons for seeking disclosure of tax information and the proper procedures for obtaining and using tax information for investigations, at trial, and in ancillary proceedings. It also discusses some strategic considerations in adding tax charges to non-tax cases, and the procedures for doing so. Although this article summarizes relevant provisions of Section 6103(b), (c), (e), (h), (i), and (p), the reader should become familiar with these provisions and with the Department of Justice (DOJ) publications<sup>†</sup> and policies on maintaining the confidentiality of tax records.

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<sup>\*</sup>Willful, unauthorized disclosure of tax return information is a felony, carrying a maximum statutory penalty of five years of incarceration, a \$250,000 fine, and termination of employment. 26 U.S.C. §7213(a) (1994). Section 7431 provides that the United States may be sued for civil damages for unauthorized disclosure of tax returns and return information by a Federal employee.

## Why Obtain Taxpayer Return Information?

A review of the Section 6103(b) definitions of "return," "return information," and "taxpayer return information" makes clear that, except as expressly provided under the disclosure provisions, all information filed with or provided by the taxpayer to the Internal Revenue Service (IRS) is protected from disclosure by Section 6103.<sup>\*\*</sup> This includes all information relating to the taxpayer received by the IRS from third parties (including informants) and all information derived from those submissions, including the work product of the IRS in determining, assessing, and collecting taxes or investigating the taxpayer criminally. "Disclosure" means "the making known to any person in any manner whatever a return or return information." 26 U.S.C. § 6103(b)(4)(8).

Section 6103(i)(1)(A), in relevant part, permits the IRS, upon the entry of an *ex parte* order by a Federal district court judge or magistrate judge, to disclose tax returns and return information to employees of

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<sup>\*\*</sup>Section 6103(b)(1) defines "return" as "any tax or information return, declaration of estimated tax, or claim for refund . . . which is filed with the [IRS] . . . and any amendment thereto, including supporting schedules, attachments" . . . which are made a part of the return. Subsection (b)(2) defines "return information" to include all the information on the return, any information regarding the examination or processing or investigation of the return, and any data collected or received by the IRS from any source with respect to "the determination of the existence, or possible existence, of liability (or amount thereof) of any person . . . for any tax, penalty, interest, fine, forfeiture, or other imposition or offense," and background files "relating to such determination." Subsection (b)(3) defines "taxpayer return information" as taxpayer information "filed with or furnished to the [IRS] by or on behalf of the taxpayer to whom such return information relates."

any Federal agency personally and directly engaged in—

- (i) preparation for any judicial . . . proceeding pertaining to the enforcement of a specifically designated Federal criminal statute (not involving tax administration) . . . to which the United States . . . is or may be a party.
- (ii) any investigation which may result in such a proceeding, or
- (iii) any Federal grand jury proceeding pertaining to enforcement of such criminal statute to which the United States or such agency may be a party,

solely for the use of such officers and employees in such preparation, investigation, or grand jury proceeding.

26 U.S.C. § 6103(i)(1)(A).

In even the most straightforward fraud case, the usefulness of tax returns should be apparent. For example, in a false bank loan application prosecution under 18 U.S.C. § 1014, examination of the target's filed individual, partnership, or corporate tax returns may reveal a sharply different picture of the target than the one he or she has painted in the loan application. In this instance, the tax return information provides a statement under penalty of perjury which may either serve as circumstantial evidence of the target's misrepresentations of his economic status or as helpful cross-examination material. If the target submitted purported tax returns with the loan application that do not match the filed returns, the filed returns are direct evidence of the fraud.

Just as loan applications often exaggerate assets, bankruptcy petitions often conceal them. An examination of filed returns from several prior years may reveal substantial leads to concealed assets or to assets recently transferred. Tax disclosure may uncover interest income on concealed bank accounts or depreciation schedules for concealed or transferred equipment or rental property. Disclosed transfers of property for the exact amount of the depreciated basis may lead to discovery of assets siphoned off to other companies controlled by the defendant. As is the case with bank loan applications, purportedly filed tax returns submitted to

the bankruptcy court may turn out to be different from those actually filed with the IRS. Tax disclosure should, therefore, be an early part of every bankruptcy fraud investigation.

It is common for the target of a financial, political corruption, or even a narcotics investigation to argue that excess cash discovered during the investigation is the "proceeds" of legitimate activity. For example, a target may argue that kickbacks are "commissions," political bribes are "consulting fees," or drug proceeds are profit from "jewelry sales." The failure to report the fact and purported source of those moneys on the filed return will seriously undermine the defense. If the target is so law-abiding and the source of funds so innocent, why wasn't the income declared on the appropriate returns and schedules?

Disclosure of tax returns may also provide critical leads and impeachment material in a political corruption investigation. For example, a public employee's tax returns may show mounting yearly interest from an increasing number of certificates of deposit (CDS), the purchase of which is inconsistent with his or her slowly-rising salary and other declared income. Consider obtaining the requisite disclosure orders to pursue whether the undeclared source of funds for the purchase of the CDS was taxable and illegitimate. Similarly, if you have evidence of cash payments to a public official, a tax return showing only Form W-2 income and small amounts of interest may be used as evidence of cover-up and guilty knowledge of the illicit source of the cash income. As a final example, a tax return showing below market interest on claimed "loans" to a public official may support the inference and corroborate the proof that the "loans" were extorted under color of official right in violation of 18 U.S.C. § 1951(b)(2).

Sometimes, even when a potential defendant has declared substantial income on the tax return to keep the IRS at bay, he or she will have misdescribed the income source on the filed return. For instance, a drug dealer may report a jewelry business to explain the presence of large amounts of cash. The Schedule C or corporate tax returns, however, may show the business operated over a substantial period without significant profit, without a large cost of goods sold, or without a substantial business expense for insurance or other normal expenses of the type of business claimed. Consider, for example, a politician on the take who decides to declare his bribes as "commissions" on his real estate sales, but shows little expense for advertising and no expense for