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Parallel Criminal and Civil Investigations Require Caution, Practitioners Say

by Shamik Trivedi

Summary by **taxanalysts**

Increased litigation over purported tax shelters and expanded reporting requirements for foreign bank accounts will require taxpayers and their counsel to be aware of complications that may arise in parallel civil and criminal tax proceedings, practitioners said February 17.

Full Text Published by **taxanalysts**

Increased litigation over purported tax shelters and expanded reporting requirements for foreign bank accounts will require taxpayers and their counsel to be aware of complications that may arise in parallel civil and criminal tax proceedings, practitioners said February 17.

IRS Policy Statement 4-26 says that concurrent civil and criminal investigations involving the same taxes and years could imperil criminal proceedings and that as a result, criminal proceedings should generally take precedence over civil proceedings, said Bruce Meneely, deputy area counsel (Kansas City), IRS Small Business/Self-Employed Division. He spoke on his own behalf at a Court Practice and Procedure session of the American Bar Association Section of Taxation meeting in San Diego.

The prior IRS Policy Statement, 4-83, was effectively a "thou shalt not" rule, under which civil prosecution would stop as soon as the Justice Department began a criminal investigation, Meneely said. The new policy statement resulted from a coordinated effort between the Justice Department and the IRS to ensure a balance between civil and criminal prosecution, particularly as a way to curtail tax shelters and pursue return preparation fraud, he said.

In a typical tax shelter investigation, involving both the shelter promoter and the shelter participants, investigations can proceed on a parallel basis, said Mark D. Allison of Caplin & Drysdale. Meneely agreed that Policy Statement 4-26 does not apply to civil proceedings against taxpayers and criminal proceedings against tax shelter promoters, adding that if information "can be shared from civil to criminal and criminal to civil, that is done."

Walking on Eggshells

Bryan C. Skarlatos, a partner with Kostelanez & Fink LLP in New York, said he has seen an increase in parallel investigations by the IRS and the DOJ over the past few years. A parallel investigation is "really just another version of an eggshell audit," and "similar considerations apply," he said.

Meneely said that section 4 of the Internal Revenue Manual instructs examination agents to inform a taxpayer if there is an ongoing criminal investigation. But although the civil examiner "cannot mislead the taxpayer," whether that obligation is affirmative or applies only upon inquiry by the taxpayer seems unclear, he said.

"Usually I'm not going to wait around," Skarlatos said. "I'll ask whether there is a fraud technical adviser in the background, or is there anything even more going on." Meneely said that if there is a parallel investigation occurring, "there are a host of people in the background."

The lead development center will check whether the Criminal Investigation division is involved before sending a case to the field, Meneely said. If CI is performing an investigation or considering one, the IRS holds a joint conference with the revenue agent, the agent's group manager, a counsel attorney from the appropriate IRS business division, the CI agent and supervisory agent, a criminal tax counsel attorney, and attorneys from the DOJ, he said.

"Is the taxpayer notified of that meeting? The answer is no," Meneely said.

Fifth Amendment Privilege

Skarlatos said that if a taxpayer has reason to believe there is or might be a criminal investigation pending against him or her and has received a stat notice and filed a petition in the Tax Court, the taxpayer could assert a Fifth Amendment privilege against self-incrimination.

"You have to slow down and figure out how the case is going to play out," he said, adding that a practitioner must determine whether the client has jeopardy and what the consequences of asserting the privilege might be.

"The consequences can be pretty bad. You could get an adverse inference for asserting the Fifth," Skarlatos said. Citing *Zackim v. Commissioner*, he added that in that situation, he would have a client assert a Fifth Amendment privilege and then request the Tax Court for a stay, to see how the criminal proceedings play out. (For *Zackim v. Commissioner*, 91 T.C. 1001 (1988), see *Doc 88-9507* or *88 TNT 245-22* )

Zackim stands for the proposition that the respondent in a Tax Court proceeding should stay its case during a parallel proceeding. The new IRS policy statement may not convince the court to follow *Zackim*, but the hope is that a practitioner can slow down the civil proceeding, Skarlatos said.

Chief Special Trial Judge Peter Panuthos, U.S. Tax Court, said that in most Tax Court cases, when the possibility of criminal prosecution is remote or unlikely, a taxpayer-petitioner may not assert a Fifth Amendment privilege. If there is real and appreciable danger of self-incrimination, the assertion is acceptable, he added.

"It's a very difficult and sensitive decision for the judge," Panuthos said. If the judge grants the request for privilege, "the taxpayer might well be prohibited from presenting information later, surrounding that topic," he said.

The "real likelihood of prosecution" standard puts practitioners in a difficult position, Skarlatos said. "I'm in the position of having to argue that my client is going to get prosecuted and that there really is a good case against [him]," he said.

Panuthos said that if it is important to convince the judge that a Fifth Amendment privilege is necessary, the taxpayer should request an in camera review. "You could let [that other] judge make the call on it," he said.

Skarlatos suggested working with the criminal prosecutors to strengthen the taxpayer's case. "If this whole policy is that the IRS will go forward with the civil proceeding as long as it doesn't imperil the criminal case, then maybe you want to talk to the prosecutor about how if we go forward with Tax Court discovery, it is going to imperil the criminal case," he said.

"Try to get the prosecutor on your side to join you and get a motion to stay the proceedings," he said. Panuthos agreed, saying the court would be much more inclined to grant a stay if both parties made that request.

The taxpayer could argue that although there is no harm to the government in granting the stay, the taxpayer could be greatly harmed if a stay isn't granted, Skarlatos said.

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