THE MIRANDA WARNING AND THE TAX FRAUD INVESTIGATION

I. INTRODUCTION

In 1966 the United States Supreme Court decided the case of *Miranda v. Arizona*,[1] holding that prior to custodial interrogation, the police must warn a suspect of his right to remain silent, that if he does speak anything he says may be used against him, that he has a right to consult an attorney, and that if he cannot afford an attorney one will be appointed for him. The effect of the *Miranda* decision has been a shift in the conceptual basis of the fourth,[2] fifth,[3] and sixth[4] amendments by creating a conclusive presumption against voluntariness when a person divulges self-incriminating information while subject to custodial interrogation if he is not warned of his fourth, fifth, and sixth amendment rights prior to questioning.

The purpose of this article is to question the broad application of *Miranda* and its nontax progeny to initial tax fraud investigations in a taxpayer's home or office. The thesis of the article is that in view of the noncustodial, nonaccusatory nature of the tax fraud investigation prior to the taxpayer's arrest and in view of the safeguards provided by the Internal Revenue Service (IRS) to protect the taxpayer's constitutional rights, there should be no broad application of *Miranda* and its nontax progeny to pre-arrest tax fraud investigations. To apply *Miranda* to these cases would be to use *Miranda* beyond its factual limitations and would be contrary to the theory of our self-assessment income tax system which requires a fairly free exchange of information between the taxpayer and the IRS. A brief discussion of the IRS investigative procedure will illuminate some of the differences between the tax fraud investigation and the typical criminal investigation.

II. IRS TAX FRAUD INVESTIGATION PROCEDURE[5]

The IRS has two division which deal in tax investigations, the Audit Division and the Intelligence Division. The Audit Division, whose investigators are called Internal Revenue Agents, investigates the possible civil

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[1] 384 U.S. 436 (1966).

[2] "The rights of people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated . . . ."

[3] "No person . . . shall be compelled in any criminal case to be a witness against himself . . . ."

[4] "In all criminal prosecutions, the accused shall enjoy the right . . . to have Assistance of Counsel for his defense."

[5] I would like to express appreciation for the information on IRS tax fraud investigation procedure received from Mr. William D. Howard, Executive Asssitant, Area Regional Assistant, Intelligence, and Mr. Thomas J. Clancy, Senior Regional Analyst, Area Regional Assistant, Intelligence, Internal Revenue Service, Cincinnati, Ohio. I would also like to thank Mr. Clarence E. Price, Regional Counsel, and Mr. Clarence E. Barnes, senior trial attorney, for arranging interviews, the information from which was used as background for this article.

liability of taxpayers. The Intelligence Division, whose investigators are called special agents, investigates the possible criminal liability of taxpayers. The audit agent's initial function is basically to review tax returns. When misstatements of tax liability appear in the returns or in evaluation of other information the IRS receives, the agent ascertains the proper liability and the IRS assesses a deficiency. Though the agents interview taxpayers, they do not deal in the criminal area to any great extent. Thus, this article will focus almost exclusively on the Intelligence Division, whose function, as earlier stated, is criminal in nature.[6]

There are four sources from which the Intelligence Division draws information of possible tax fraud: the Audit Division, independent initiative of special agents, other government agencies, and the public. The Audit Division furnishes approximately fifty percent of the leads for the Intelligence Division. If, in his audit to determine the existence of civil liability, an agent discovers what appears to be fraud, he notifies his superior, who contacts the Intelligence Division and informs them of the discovery. The agent makes no further inquiry into the possible fraud until the Intelligence Division becomes involved with the investigation. At this point the special agent assigned to the case may or may not enlist the agent's assistance in the criminal investigation. Independent initiative of special agents produces approximately twenty-five percent of the leads. Independent initiative involves evaluation of information obtained from newspapers and from surveys of particular occupations, income brackets, etc.[7] Other government agencies are the source of fifteen percent of the leads. These tips are derived from government investigation in nontax areas, such as investigations in the illegal liquor and narcotics trades. The final source of information is the public, which contributes ten percent of the leads. This information is derived from public-minded citizens, frustrated business competitors, and a small minority of persons aware of the reward authorized for information which leads to tax fraud convictions.

The Intelligence Division investigates the above information in a three-step process which operates much like a series of screens filtering out cases which do not meet the criteria of the IRS for criminal prosecution. At each step the possible success of the case, the limited availability of per-

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[6] In view of the fact that many of the leads in tax fraud investigations are derived from audit investigations, it may be questioned whether or not *Miranda* might attach when agents interview taxpayers in civil investigations. No court has gone so far as to hold that *Miranda* applies this early. The fact that agents have responsibility in the civil area only and that the need for fair collection of revenues by the government outweighs the taxpayers' need for protection from self-incrimination at this stage are probably the basic reasons for not applying *Miranda* safeguards at this stage. In any event, this question is beyond the scope of this article.

[7] A special agent may notice the reporting of a large wedding in a local newspaper, for example. He will then review the party's tex records on file with the IRS to determine if the expense of the wedding is in line with the taxpayer's reported income.

sonnel, the enforcement coverage,[8] the flagrancy of the violation, the need for emphasis in a particular area to deter other violations in that area, the dollar value of the violation, and the presence of organized crime are considered before forwarding the investigation to the next step. Each step requires a more detailed investigation and thus is more time consuming.

The first step in the investigative process is the evaluation of information items to determine prosecution potential. At this point the Intelligence Division scrutinizes returns and IRS files, discusses the case with the audit agent or government official who referred the case, interviews the informant, and makes inquiries without disclosing the taxpayer's identity (*i.e.*, inspection of public records). Since 91.4 percent of the investigations come to an end at this stage, protection of the taxpayer's name and reputation are of a high priority.

A preliminary investigation, which takes approximately two weeks, is the second step in an Intelligence investigation. At this point the taxpayer may be first contacted by a special agent. The special agent's objective at this stage is to interview the taxpayer and inspect his records, if possible, and, if necessary, to contact third parties who have information pertaining to the taxpayer's liability. Only 2.5 percent of the original cases are investigated beyond this second step.

The final step of the investigation is the full-scale investigation of the taxpayer. Here a two-year investigation is not uncommon. The special agent's objective at this stage is to collect detailed evidence of tax fraud which may be used against the taxpayer in criminal prosecution. The taxpayer may also be interviewed at this stage in the investigation.

Following the full-scale investigation, the special agent submits a complete report to his supervisor along with a recommendation for or against prosecution. Regardless of his recommendation for further action on the case, his supervisor reviews the information. When the supervisor feels prosecution seems feasible, he sends the report to a review group in the Intelligence Division which evaluates the case and if they feel prosecution is warranted, they forward the case to the Assistant Regional Commissioner, Intelligence. If the Assistant Regional Commissioner, Intelligence, is satisfied that the case has merit for criminal prosecution, it is transferred to the Regional Counsel, who causes it to be processed in the Enforcement function of the Regional Counsel's office. Upon Regional Counsel's decision to prosecute, the case is transferred to the Department of Justice, which handles the trial of the case if it goes to court. Of all the cases which originally enter the IRS tax fraud investigation, only about one half of one percent actually go to trial. In 1967, a typical

[8] To avoid the creation of "stale law' 'and the feeling of criminal immunity in a particular area of tax fraud, the IRS tries to prosecute approximately the same number of cases in each tax fraud area.

year, approximately 123,000 cases were submitted to the Intelligence Division for investigation. Ten-thousand five hundred reached the preliminary investigation stage. A full-scale investigation was conducted on only 3,188 cases. Of these, only six hundred actually culminated in criminal prosecutions.

III. HISTORY OF THE CONSTITUTIONAL RIGHTS OF TAXPAYERS

A brief history will indicate how the courts applied the fourth, fifth, and sixth amendments prior to *Miranda* and the effect *Miranda* has had on tax fraud cases. The history begins with the nontax case of *Gouled v. United States*.[9] In this case the Supreme Court held that a government agent violated the fourth[10] and fifth[11] amendments when he obtained entrance to a person's office under the guise of friendship and there obtained incriminating evidence for use against the person. The court reasoned that search and seizure obtained by stealth could not be distinguished from search and seizure obtained by force which had already been ruled in violation of the fourth amendment in *Boyd v. United States*.[12] The court interrelated the fifth amendment through the comparison of stealth to force, which obligated the accused to supply incriminating evidence against himself.

Turner v. United States[13] was one of the first applications of *Gouled* in a tax case. In this case the taxpayers tried to apply the stealth-force analogy to a case where a special agent allegedly informed the taxpayers that he was conducting a routine civil investigation. The taxpayers permitted the special agent to examine their records from which the special agent extracted evidence used to convict the taxpayers of fraudulent understatement of income. The court recognized the constructive notice effect of an IRS investigation and therefore held that this case did not exhibit deceit. *Gouled*, therefore, was found not to be controlling. The court reasoned that the taxpayers knew the special agent was conducting an examination of their books for IRS purposes. Therefore, even if the examination was routine, they must have known that the agent would not close his eyes to evidence of fraud in the records.

About the time of the *Turner* decision, however, the federal district courts in Pennsylvania and New York were developing another interpretation of *Gouled*. These courts held that deceit was practiced when IRS agents led taxpayers to believe that they were investigating civil liability

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[9] 255 U.S. 298 (1921).

[10] *Supra* note 2.

[11] *Supra* note 3.

[12] 116 U.S. 616 (1886).

[13] 222 F.2d 936 (4th Cir.), *cert. denied*, 350 U.S. 831 (1955).

when in actuality they were investigating criminal liability. In 1953 in *United States v. Guerrina*[14] a district court in Pennsylvania held that the fourth and fifth amendments were violated when a revenue agent, with the apparent purpose of ascertaining civil liability, searched the taxpayer's records to procure evidence of fraud for a contemplated criminal proceeding without informing the taxpayer of the criminal nature of his investigation before obtaining permission to review the records. A New York district court held in *United States v. Lipshitz*[15] that evidence should be suppressed when a special agent investigating criminal liability had an agent, already on the case investigating civil liability, obtain evidence for criminal prosecution without informing the taxpayer of the existence of the criminal investigation. *United States v. Wheeler*[16] involved a case where special agents obtained permission to examine the taxpayer's records to investigate possible civil liability. However, they were also interested in the taxpayer's possible connections with wrongdoing involving an IRS agent. While examining the books, the special agents found evidence of fraud which was used to convict the taxpayer. The Pennsylvania district court suppressed the evidence, holding that when the IRS investigates civil and criminal liability and only tells the taxpayer of the civil investigation, deceit is practiced on the taxpayer and the fourth and fifth amendments are violated.

The deceit test of these district courts was not well accepted, however. In fact, the second circuit disapproved the above district court decisions and specifically followed *Turner* in *United States v. Sclafani*.[17] In this case an agent gained permission to examine the taxpayer's records to investigate civil liability. When the agent saw signs of possible fraud, the Intelligence Division was called in without informing the taxpayer of the beginning of the criminal investigation. Evidence was procured with which the taxpayer was convicted of tax evasion. On motion to suppress the evidence, the second circuit held that the fourth amendment requires only that when consent is sought, the taxpayer be appraised of the government's concern with the accuracy of his reports. The court reasoned that such a warning put the taxpayer on notice of such hazards as may be incident to voluntary disclosure. These hazards include the possibility of criminal prosecution. Several cases follow *Sclafani* and hold that where agents practice no deception and do not mislead taxpayers into believing that investigations would be limited to civil penalties, there is no violation of the fourth and fifth amendments.[18] In effect, then, prior to *Miranda*

[14] 112 F. Supp. 126 (E.D. Pa. 1953).

[15] 132 F. Supp. 519 (E.D.N.Y. 1955).

[16] 149 F. Supp. 445 (W.D. Pa. 1957).

[17] 265 F.2d 408 (2d Cir.), *cert. denied*, 360 U.S. 918 (1959).

[18] Greene v. United States, 296 F.2d 841 (2d Cir. 1961), *appeal dismissed*, 369 U.S. 403 (1962); United States v. Spomar, 339 F.2d 941 (7th Cir. 1964).

it was generally held that deceit was practiced by the IRS only when an agent made an affirmative misrepresentation that the taxpayer would be subject to civil penalties only. There was no deceit practiced when the IRS obtained information from a taxpayer without informing him that a criminal investigation was being conducted because an IRS investigation in itself was deemed to be constructive notice of the possibility of criminal penalties.

On June 22, 1964, the Supreme Court handed down its opinion in *Escobedo v. Illinois*,[19] holding that when the investigation is no longer a general inquiry into an unsolved crime but begins to focus on a particular suspect in police custody, the police interrogation lends itself to eliciting incriminating statements so that if the accused is denied opportunity to consult a lawyer and is not effectively warned of his right to remain silent, he is denied assistance of counsel in violation of the sixth amendment.[20] Though this decision is a landmark decision with reference to the sixth amendment, it is more important with reference to *Miranda* in that it establishes the point at which the accusatory stage of a criminal investigation begins, *i.e.*, when the inquiry begins to focus on a particular suspect.

Miranda, decided in 1966, prohibited the prosecution from using statements stemming from custodial interrogation unless it demonstrates the effective use of custodial safeguards of the accused's privilege against self-incrimination. Custodial interrogation is described as questioning after the accused has been taken into custody or otherwise deprived of his freedom of action in any significant way.[21] In *Miranda* the Supreme Court set up a standard to guarantee that the defendant knowingly and intelligently waived his privilege against self-incrimination and right to counsel if he spoke when interrogated after the accusatory stage of an investigation began.

The *Miranda* decision had little immediate effect on the constructive notice theory of tax fraud cases developed prior to *Miranda*. The federal appellate courts in every circuit hearing cases on the issue before 1969[22] have held that pre-arrest interviews held in the taxpayer's home or office remain unimpaired by the *Miranda* decision because the taxpayer is not in custody or otherwise deprived of his freedom of action in any significant way or because the accusatory stage of the investigation has not yet

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[19] 378 U.S. 478 (1964).

[20] *Supra* note 4.

[21] 384 U.S. 436, 444 (1966).

[22] Morgan v. United States, 377 F.2d 507 (1st Cir. 1967); Spinney v. United States, 385 F.2d 908 (1st Cir. 1967), *cert. denied*, 390 U.S. 921 (1968); United States v. Squeri, 398 F.2d 785 (2d Cir. 1968); United States v. Mancuso, 378 F.2d 612 (4th Cir. 1967); United States v. Maius, 378 F.2d 716 (6th Cir.), *cert. denied*, 389 U.S. 905 (1967); United States v. Mansfield, 381 F.2d 961 (7th Cir.), *cert. denied*, 389 U.S. 1015 (1967); Frohmann v. United States, 380 F.2d 832 (8th Cir.), *cert. denied*, 389 U.S. 976 (1967); Feichtmeir v. United States, 389 F.2d 498 (9th Cir. 1968); Hensley v. United States, 406 F.2d 481 (10th Cir. 1968).

begun. The Federal District Court in the Northern District of Illinois, however, took a different view in *United States v. Turzynski*.[23] The court held that when an IRS investigation shifts from civil to criminal without the taxpayer's knowledge, agents must warn the taxpayer of his constitutional rights or have the evidence thus obtained suppressed. The court felt that there was no difference between the situation where a person incriminated himself because of ignorance of his rights and a coercive custodial atmosphere or the situation where a person incriminates himself because of ignorance of rights combined with an inference that the purpose of interrogation is civil in nature. It felt custody was only relevant in *Miranda* to announce the inception of the adversary process. *Turzynski* thus became the leading case in support of the application of *Miranda* to tax fraud cases and the reasoning was followed by other federal district courts in *Goodman v. United States*[24] and *United States v. Wainwright*.[25]

The Seventh Circuit Court of Appeals in *United States v. Dickerson*[26] also followed the district court's reasoning in *Turzynski*. *Dickerson* involves criminal investigation stemming from a civil audit. When the special agent interviewed Dickerson he identified himself as a special agent but did not advise the taxpayer that the investigation had become criminal. Dickerson was convicted based on information derived from subsequent interviews all conducted at his place of business. The court felt that questioning the taxpayer in his own place of business did not remove an interrogation from the realm of custodial investigation in view of the Supreme Court's holding in *Orozco v. Texas*[27] that a warning was required prior to interrogating a suspect in his own bedroom if it appears that he is not free to go. The court determined that the defendant was deprived of his freedom of action in a significant way because the average citizen, when questioned by government agents, would not feel free to go. It was also held that the taxpayer need not be under arrest in view of *Mathis v. United States*[28] where the Supreme Court suppressed evidence in a tax fraud case in which the taxpayer was questioned without warning of his rights while in jail serving the sentence for another crime. In view of these cases, the seventh circuit held that *Miranda* warnings must be given to a taxpayer under criminal investigation at the inception of the first contact with the taxpayer after the case has been transferred to the Intelligence Division or the evidence thus obtained would be suppressed. The

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[23] 268 F. Supp 847 (N.D. Ill. 1967).
[24] 285 F. Supp. 245 (C.D. Cal. 1968).
[25] 284 F. Supp. 129 (D. Colo. 1968).
[26] 413 F.2d 1111 (7th Cir. 1969).
[27] 394 U.S. 324 (1969).
[28] 391 U.S. 1 (1968).

court thus held that the accusatory process begins when the Intelligence Division enters the case.

Both *Turzynski* and *Dickerson* stand as a minority view in taking a broad interpretation of *Miranda*. Both cases deny that the *Miranda* warning need only be given in accusatory, custodial interrogations. In so doing, the courts who decided these two cases go beyond the strict holding of *Miranda* and follow the majority of courts which deal with nontax criminal cases in expanding the *Miranda* doctrine. The majority of courts hearing tax fraud cases, however, still interpret *Miranda* strictly when applying it to tax fraud investigations by the IRS.[29] The majority thus holds that *Miranda* does not apply to tax fraud investigations which are noncustodial and nonaccusatory and therefore following the pre-*Miranda* holding of *Turner*[30] and *Sclafani*.[31]

IV. ANALYSIS OF THE APPLICATION OF MIRANDA TO TAX FRAUD INVESTIGATIONS

The majority rule of non-application of *Miranda* to pre-arrest tax fraud investigations is a more sound rule than the minority rule of *Dickerson*. The fifth amendment prohibits compelling a person to be a witness against himself in a criminal case.[32] Prior to *Miranda* the fifth amendment test was whether or not the self-incriminating statement was voluntarily given. The Supreme Court realized that this test was inadequate when a suspect was questioned while in custody and in foreign surroundings because psychological pressures could be exerted upon him in such a way that it was impossible to determine whether or not his statements were voluntarily given. To prevent abuse in these situations the Supreme Court created the *Miranda* doctrine as an umbrella for protection of fourth, fifth, and sixth amendment rights.

The questioning of a taxpayer in the second and third stages of the IRS tax fraud investigation occurs, however, in the taxpayer's home or office. The taxpayer is not under arrest or restricted in his movement to any greater extent than he would be when visited by a business associate. Since the elements of custody and foreign surroundings are not present, the umbrella of *Miranda* is unnecessary to protect his constitutional rights.

Secondly, *Miranda* and the cases which follow it are only applied when the questioning is accusatory, *i.e.*, when the inquiry begins to focus on a particular suspect. In the nontax cases to which *Miranda* has been applied, the accusatory stage of the investigation only begins once a crime

[29] Among the post-*Miranda* cases strictly interpreting *Miranda* in tax fraud cases are: United States v. White, 417 F.2d 89 (2d Cir. 1969); United States v. Browney, 25 AFTR2d 70-387 (4th Cir. 1970); United States v. Caiello, 25 AFTR2d 70-402 (2d Cir. 1969).

[30] *Supra* note 13.

[31] *Supra* note 17.

[32] *Supra* note 3.

has been discovered. Prior to the discovery of the crime and prior to focusing upon a particular suspect, the questioning is considered investigative and *Miranda* does not apply. The tax fraud interrogation is necessarily directed at a single person, since that person is known before the crime is discovered. The purpose of the questioning, however, is to ascertain whether, in fact, a crime has been committed, not to discover the perpetrator of a known crime. This is demonstrated by the fact that prosecution occurs in only about twenty percent of the cases where there is pre-arrest interrogation. The questioning in a tax fraud interrogation is therefore investigative rather than accusatory and *Miranda* should not be applied.

Thirdly, one of the policy bases for the fifth amendment is that a criminal system which relies on incriminating statements from the accused to establish guilt is unreliable because a person threatened with physical or psychological pressure is apt to confess to a crime he did not commit. To protect the reliability of our judicial system's fact-finding process, the incriminating evidence from the accused's own mouth must be suppressed unless its validity can be assured. *Miranda* assures validity to some extent by promoting uncoerced confessions. However, prosecution in tax fraud cases is not based solely on self-incrimination. If incriminating evidence is obtained from a taxpayer, it is verified independently by the IRS before it is used in prosecution.[33] The IRS interrogation, therefore, does not possess the inherent unreliability of unverified confessions. The reliability of our judicial system's fact-finding process is therefore protected in tax fraud investigations without using *Miranda*.

Finally, even if it is assumed, as it was in *Dickerson*, that the IRS questioning of a tax fraud suspect prior to arrest creates a coercive atmosphere similar to that present in the nontax police interrogation, the IRS has, of its own initiative, created procedures to insure that the taxpayer is informed of his constitutional rights. The credentials of the special agent now have a badge attached to them which aids in indicating to the taxpayer that he is being confronted by a criminal law enforcement agent. In addition, IRS News Release Number 897[34] was issued in 1967. The News Release requires that upon first contacting the subject of a criminal investigation, the special agent produce his credentials for examination; state that one of his functions is to investigate the possibility of criminal violations of the Internal Revenue Code, and advise the suspect of his constitutional rights. To insure that the requirements of the News Release are followed and that the taxpayer's constitutional rights are guaranteed, the IRS does not prosecute cases where crucial evidence has been obtained by a special agent who has not informed the taxpayer that the

[33] *Supra* note 5.

[34] 7 CCH 1967 Stand. Fed. Tax Rep. ¶ 6832.

investigation has become criminal in nature, who has made an affirmative misrepresentation or concealment, or who has failed to warn the taxpayer of his constitutional rights prior to questioning him or gaining permission to examine his records.[35] Thus the IRS, without judicial compulsion, has created its own method of safeguarding the taxpayer's constitutional rights.

Rather than to undermine such laudable conduct by a police-type agency as *Dickerson* would, a better approach would be to follow the holding of the fourth circuit in *United States v. Heffner*.[36] There the court held that when a government agency creates a procedure, such as is stated in IRS News Release Number 897, it must follow it scrupulously even if the procedure established is more generous than the Constitution requires. The fourth circuit, then, recognized the factual limitations of *Miranda* and also recognized the self-made restrictions of the IRS, which it properly enforced. Such an approach adequately protects the taxpayer's constitutional rights and avoids the necessity of making tenuous arguments for the application of *Miranda* to cases which do not fall within the factual limitations of the *Miranda* holding.

V. CONCLUSION

The fifth amendment states that "No person . . . shall be compelled in any criminal case to be a witness against himself. . . ."[37] There can be no debate on this point. *Miranda v. Arizona*[38] sets up specific safeguards to protect the accused from denial of his privilege against self-incrimination. Even in this respect the Supreme Court qualified its holding by providing that the prescribed warning be given unless other suitable safeguards were devised to protect the constitutional rights of the accused.[39]

IRS investigations differ somewhat from the "typical" criminal investigation. It is questionable, therefore, whether *Miranda* applies. However, the constitutional rights of a taxpayer are as sacred as those of the accused criminal, so they must also be protected. The IRS, by its own initiative, has promulgated rules for special agents which guarantee the protection of the taxpayer's constitutional rights. These rules are enforced within the IRS by restraint from prosecution in the event of violation of the rules. The IRS is not likely to strictly construe and thus test their own rules because one of the basic purposes of criminal prosecution by the IRS is deterrence.[40] The IRS obtains deterrence by maintaining an almost perfect conviction record. Such a record cannot be

[35] *Supra* note 5.

[36] 25 AFTR2d 70-343 (4th Cir. 1969).

[37] U.S. Const. amend. V.

[38] 384 U.S. 436 (1966).

[39] *Id.* at 444.

[40] *Supra* note 5.

maintained if the IRS attempts to litigate in "gray" areas, especially where collateral issues are involved.

The IRS, therefore, effectively protects the taxpayer's constitutional rights, and a further extension of *Miranda* is unnecessary. This is not to say that there should be no judicial overseeing of the IRS in this area, but rather that there should be restraint until the IRS self-regulation proves inadequate. If inadequacy appears, there is judicial basis in the case of *United States v. Heffner*[41] to hold the Internal Revenue Service to its own internal regulations.

Donald G. Paynter

[41] *Supra* note 36.