S. HRG. 99-1062, PT. 2

OVERSIGHT OF IRS AND JUSTICE DEPARTMENT PROSECUTION OF SEVERAL TAX CASES

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT OF THE INTERNAL REVENUE SERVICE

OF THE

COMMITTEE ON FINANCE UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

JUNE 19, 20, AND 23, 1986

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MONDAY, JUNE 23, 1986

U.S. SENATE,
SUBCOMMITTEE ON OVERSIGHT OF THE
INTERNAL REVENUE SERVICE
OF THE COMMITTEE ON FINANCE,
Washington, DC.

The committee met, pursuant to recess, at 10:05 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Charles E. Grassley presiding.

Present: Senators Grassley and Armstrong.

[The press release announcing the hearing follows:]

[Press Release No. 86-048, June 5, 1986]

FINANCE SUBCOMMITTEE SETS HEARING ON OVERSIGHT OF INTERNAL REVENUE AND DEPARTMENT OF JUSTICE ACTIVITIES IN THE CRIMINAL PROSECUTION OF SEVERAL TAX CASES

Senator Packwood (R.-Ore.) Chairman of the Senate Committee on Finance announced today that the Subcommittee on Oversight of the Internal Revenue Service will hold hearings the mornings of June 19, 20, and 23, on possible improper activities by the Internal Revenue Service and the Justice Department in the prosecution of several tax cases. The hearings will be chaired by Senator Charles E. Grassley (R.-Iowa) and Senator William L. Armstrong (R.-Colorado).

Of particular interest to the Subcommittee will be testimony relating to two recent Federal District Court decisions, *United States* v. *Kilpatrick* (D. Colo. 1984), and *United States* v. *Omni International Corporation* (D. Md. 1986), where the courts dismissed the indictments because of IRS and/or Justice Department abuses committed either before the grand jury or the District Court in opposition to motions to dismiss the indictments.

The Subcommittee will also review the activities of the IRS and the Justice Department in the investigation and prosecution of cases involving abusive tax shelters and/or foreign investments.

Finally, the Subcommittee will review the Justice Department's attempt to keep a Federal District Court opinion, which was critical of the Department's handling of the *Kilpatrick* case, from being published in the Federal Court reports.

Senator GRASSLEY. Good morning, everybody. I am Senator Chuck Grassley from Iowa. Senator Armstrong, from Colorado, is the other member of the committee here so far.

This is a hearing of the Subcommittee on Oversight of the Internal Revenue Service. And I would like to welcome all of our distinguished witnesses to this third day of hearings on the subject of prosecutorial abuse in criminal taxpayer cases.

In the last two hearings, we received some very excellent testimony from Judge Fred Winner, and he gave us an objective overview of this subject matter. In addition, we heard testimony from the defendant's perspective. This testimony has done much to

inform us of what Judge Kane described in the *Kilpatrick* case as an "IRS investigation out of control and a grand jury which was converted into little more than a rubber stamp."

Today, we are going to receive testimony from the Government's representatives on prosecutorial abuse in taxpayers' cases. And I look forward to answers in response to some of the very serious problems that seem to exist in our tax enforcement system.

The most important function of these hearings will be to determine how the Internal Revenue Service can best collect taxes without violating the rights of taxpaying citizens. I would request that each witness before us give a brief oral summary of his written testimony, and then, of course, as is our practice, unless people ask to the contrary, any written testimony will be included in the record as if read in its entirety.

Before I call the first witness, do you have an opening statement, Senator Armstrong?

Senator ARMSTRONG. No, Mr. Chairman, I do not. I agree with what you have said. And I am grateful to our friends in the Justice Department and the IRS for coming. I would be hopeful that we could proceed in a very informal manner because I think what we really need to do here is reason together about the extent of which, if any, legislation is needed, and the extent to which, if any, management practices need to be reviewed by Justice or IRS.

And my feeling is that that will be enhanced actually by more or less of a give and take. So I would be hopeful that the witnesses will be disposed to let us read their statement and summarize it for us as you suggested, and then have a good dialog with them.

Senator GRASSLEY. Do you suggest differently than we have done on the other witnesses of receiving their testimony initially and then asking questions at the end?

Senator ARMSTRONG. No, Mr. Chairman. That is fine.

Senator GRASSLEY. All right. Then with that in mind, I would like to call our one and only panel but call all three panelists at the same time: Roger M. Olsen, and he is the Assistant Attorney General for the Tax Division, Department of Justice here in Washington; and then we have Anthony V. Langone—and I hope I pronounced that right——

Mr. LANGONE. That is correct, sir.

Senator GRASSLEY [continuing]. Acting Assistant Commissioner for Criminal Investigations with the Internal Revenue Service; and John M. Rankin, and he is the Assistant Commissioner for Inspection of the Internal Revenue Service.

So I guess we would go in the order of my introduction. That would be Mr. Olsen first, Mr. Langone, and then Mr. Rankin.

Welcome to all of you, and thank you very much for coming today.

STATEMENT OF ROGER M. OLSEN, ASSISTANT ATTORNEY GENERAL, TAX DIVISION, DEPARTMENT OF JUSTICE, WASHINGTON, DC

Mr. OLSEN. Good morning, Senators. It is a pleasure to appear here this morning and to testify on a subject that the Tax Division of the Justice Department views as one that is of critical impor-

tance. And that is the administration and the enforcement of the tax laws and in particular as they relate to abusive tax shelters.

I would like to briefly summarize my written statement. But in doing so, what I am primarily attempting to do is to provide an overview and a brief background for those things that I think are germane to this subcommittee's hearings.

While the Tax Division has a unique responsibility in the administration and the enforcement of the tax laws, it is perhaps ironic that we rarely come before this particular committee. Rather, it seems that our involvement is with another committee of this Senate, and that is the Judiciary Committee.

The Tax Division has a unique role. As my statement indicates, the Tax Division represents the United States Government in all Federal tax litigation with the exception of litigation in the United States Tax Court.

We also handle all of the appellate work that generates from the United States Tax Court so that the Internal Revenue Service, while it is that agency that handles the litigation at the trial court, the Tax Court, does not handle the appellate litigation.

The Tax Division also has another responsibility, which is on the enforcement side. And that side, I think, is closer to what it is that has been the subject of these hearings. Although the invitation from Senator Packwood refers to abusive tax shelters, it seems clear that from most of the testimony that has been generated in the last 2 days that your primary interest and focus is on the criminal tax shelter side, not the abusive shelter side; the distinction being this: That when Congress enacted in TEFRA the abusive tax shelter rules the definition of "abusive" referred to fraudulent and false statements or an overvaluation of assets of 200 percent or more. Clearly, those are areas that are civil in nature and not just criminal. A false or fraudulent statement would, of course, also be a predicate for a criminal prosecution as opposed solely to a civil tax shelter matter.

On the criminal side, the Tax Division's responsibilities are numerous. We have the authority to authorize the institution of all grand jury investigations. Before any component of the Department of Justice may begin, initiate or expand a grand jury investigation on title 26 offenses, prior written approval must be secured from the Tax Division. For any criminal case that has been completed in terms of an investigation, whether the Internal Revenue Service has conducted the investigation administratively or has conducted the investigation with a grand jury that has been authorized by the Department of Justice, by the Tax Division, previously, the Tax Division must, nevertheless, authorize the prosecution of each and every one of those title 26 or tax-related prosecutions. So that the Tax Division gets into these cases from a unique perspective, I think.

Whether that is a tax shelter case, whether that is an organized crime case, whether that is a procurement fraud case, whether that is an insider trading case, if there are title 26 or criminal tax overtures to that case, the Tax Division is involved and has to review the initiation of the grand jury investigation. In some cases, a U.S. attorney may have a title 18 investigation or title 21 drug investigation and may wish to now focus on the criminal tax aspects. And

to do that, they must come back to the Tax Division for approval. The point I am making is that even after the initiation of the grand jury investigation, the U.S. attorneys offices and the strike forces and the Presidential Drug Task Forces must submit their recommendations for prosecution on the title 26 charges to the Tax Division.

In all of those cases where there is a request for prosecution, or there is a request for a grand jury investigation, the matter is reviewed by the Tax Division, by trial attorneys in the criminal section, by a line attorney; then it is then submitted to a person that we call a "reviewer," that is, a job classification in the criminal section. That person is a criminal prosecutor who then reviews not merely the file that has been submitted to the Tax Division by either the IRS or the grand jury investigation component but also reviews the work product of the line attorney. Then depending on whether or not that case is agreed upon by those attorneys, it is then reviewed at a third line by an Assistant Chief and goes to the Chief.

In some cases, it will come up to the level beyond the criminal section. Within the criminal section, all of those attorneys are career prosecutors. The case may also be reviewed further up the line by a Deputy Assistant Attorney General. That has, historically speaking, been a career position. It is currently a noncareer position. Then as well as by the Assistant Attorney General position that I now hold.

The reason I bring that up is because the administration of the tax laws is within the Department of Justice handled from a very unique perspective. I think if we look at the administration of criminal justice—that you see that it is the U.S. attorneys that have full and complete responsibility and authority to institute grand jury investigations as well as to institute prosecution of cases.

Once we authorize prosecution of a case and when we do, we advise the U.S. attorneys office or the strike force or whoever it is that is actually handling the case, has responsibility for it, that if there is going to be a disposition of the case on anything short of a trial, that is to say there is going to be a plea, that there are certain requirements that have to be followed. The requirement flows from what we call, the practitioners call, the "major count policy." The major count policy is this: We identify what is the most significant count or offense in the indictment that is going to be charged or the information. And the U.S. attorneys office is not permitted, not authorized, to take a plea to the charges unless they include at least that major count. They can go above it, but they cannot go below it.

It is a means by which we maintain some standards of uniformity and prevent the inappropriate disposition of a criminal tax case which some people view as something less than a true criminal offense; that a tax crime is somehow something less than a crime that other people may have committed, whether it is procurement fraud or narcotics or espionage or whatever.

If the case is disposed of on a major count basis, requirements of the Department of Justice include—and it is reflected in the U.S. Attorneys Manual, a written document made a part of public

record in numerous cases litigated across the country, freely available. It provides that pleas on the basis of anything other than a plea of guilty, plea of nolo contendere, for example, or what is called an *Alford* plea, referring to a United States Supreme Court case—that those pleas are not to be accepted by the Department attorney.

Now an Alford plea is a plea that the U.S. Supreme Court has said is a permissible plea constitutionally, legally, and ethically. The defendant comes into court and his approach to the charges is this: I cannot defend myself against those charges. I appreciate what the Government can prove. I do not admit my guilt. Nevertheless, I admit that if the case went to trial that I would be convicted on the state of the evidence. But I do not admit the guilt.

The Department of Justice's standard is perhaps a unique one. Notwithstanding what the U.S. Supreme Court has said, our position is that we will not accept Alford plea. We do not condone what may be perceived by others as over-reaching in the apprehension and bringing to justice of those people who are charged with crimes. If they want to dispose of it short of a trial, they are going to have to plead guilty.

Nolo contendere, that is to say—and this is more frequently seen in cases where you have auto accidents at the state court level where an individual will come into court from an auto accident—perhaps drunk driving—and will not want to admit guilt in a criminal forum because that could be used against them in a civil forum, so the individual will come into court and say, well, I will plead nolo contendere; that will take care of the criminal case, and I will not be establishing liability in a civil case.

It might even be used in the Federal system potentially by white collar crime defendants such as procurement fraud defendants.

Senator GRASSLEY. Mr. Olsen.

Mr. OLSEN. Yes, Senator.

Senator GRASSLEY. I don't want to shut you off, but we have gone 10 minutes now. How much more time do you need for your summary? And then I will remind you when that is up.

Mr. OLSEN. Just a few more minutes, Senator.

Senator GRASSLEY. All right. Go ahead.

Mr. OLSEN. Beginning at page 7 of my written statement, there is a discussion about immunity practices and procedures which although not a specific subject of the invitation to testify has clearly become a subject of some interest by this subcommittee. And I would like to address that in a summary fashion and invite questions from the subcommittee.

The Department of Justice has some fairly well and clearly defined standards with respect to immunity that are both reflected in the U.S. Attorneys Manual as well as in the Tax Division publications. Those standards, I think, provide what has been more recently reflected in a case decided by the U.S. Court of Appeals for the 10th Circuit, and are, I submit, illustrative of those matters that are of interest to this subcommittee.

The *Lowell Anderson* case is the case specifically of which I speak and it addresses questions in reversing the decision of U.S. District Court Judge Kane in a case separate from the *Kilpatrick* or the *OMNI* decisions.

Finally, I think that I should address this because it is, in my view, perhaps the one area in which the Department of Justice and the Tax Division, if it is subject to criticism, and one that warrants inquiry. It is the position that we took on what we call the "publication issue." That is one where the Department of Justice has stated publicly what our position was and what it is. That it was a mistake. That the Department should not have permitted going forward with any attempt to prevent the publication of the decision of Judge Winner.

I say that because while the statements that have been made are clear in terms of what our position was and what it was based on, greater detail of those historical events was provided to the Senate Judiciary Committee by a letter dated March 29, 1984 signed by Robert McConnell, the Assistant Attorney General for the Office of Legislative Affairs.

I understand that a copy of that letter has been made available to the staff of this subcommittee. If it isn't then simply out of an abundance of care and caution, I would ask that a copy of the letter, which I have here, also be incorporated into the record.

[The information from Mr. Olsen follows:]

U.S. Department of Justice
Office of Legislative Affairs

Office of the Assistant Attorney General
Washington, D.C. 20530

GLA:MLP:AHechtkopf:clb
5-13-2879

29 MAR 1984

Honorable Patrick Leahy
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Senator Leahy:

This is in response to your letter of February 27, 1984, regarding the Tenth Circuit's order of January 3, 1984, directing West Publishing Company to postpone the inclusion of an opinion of Judge Fred M. Winner, of the United States District Court for the District of Colorado, in the permanent volumes of that company's Federal Supplement case reporter.

Before turning to the specific questions you have posed, some background may help to place the matter in context. Following a trial on one count of obstruction of justice, a jury returned a verdict of guilty against defendant William A. Kilpatrick in United States v. Kilpatrick, District of Colorado case No. 82-Cr-222. The charge was based on alleged acts by Kilpatrick during the grand jury investigation of a tax shelter that he and others had promoted. During the investigation, a grand jury subpoena was issued directing Kilpatrick to produce certain records, and the District Court ordered him to produce those documents. But, after the District Court had issued its order, Kilpatrick, among other things, allegedly travelled to the Cayman Islands, where the documents were located, removed various of the records from their ordinary location to prevent their production, and even destroyed some records which he himself characterized as highly incriminating.

After the jury returned its verdict, defendant Kilpatrick filed a motion for a new trial and a motion to dismiss the indictment on grounds of prosecutorial misconduct in connection with the grand jury investigation. The District Court commenced hearing these motions on July 12 through July 15, 1983. Because they were to be called as witnesses at the hearing, two of the prosecutors withdrew from representing the Government. The third prosecutor present was similarly prevented from representing the Government when Judge Winner ruled that he was barred from doing so because

he also might be a potential witness. Judge Winner denied a Government request that the defense not be permitted to call that prosecutor as a witness. The Government's request was based on the facts that that prosecutor had not participated in the grand jury investigation, that the subject on which he might be called to testify was not relevant to the motion to dismiss, and that there were other witnesses who could testify as to that matter.

Since all the prosecutors had thus been barred from representing the Government at the scheduled hearings, the Government requested a continuance to give substitute counsel from Washington, D.C. a chance to travel to Denver and to prepare for the hearing. This request was denied, and the hearing proceeded with the Government essentially unrepresented for two half days. An Assistant United States Attorney was present as an observer, but her office stated that it did not wish to participate in the hearing, and she stated that she was not prepared to represent the Government. Thus, defense evidence was taken with the Government unable to cross-examine and otherwise fully protect its interests. Six witnesses called by the defense testified while the Government was forced to sit passively on the sidelines.

Although new Government counsel arrived from Washington on the second day of the hearing, he was not yet fully prepared to represent the Government. And the ability of the prosecutors to assist him was severely restricted. Even though the court viewed the prosecutors as analogous to defendants for purposes of the hearing on alleged prosecutorial misconduct, the court applied the witness sequestration rule to them. Thus, the prosecutors were excluded from the courtroom during the hearing. Judge Winner also ordered that they not read any transcripts of the hearing. Despite these impediments, the substitute counsel represented the Government as best he could for two and a half days of the hearing. But cross-examination of several defense witnesses and testimony of most of the Government's witnesses had not been presented at the time the hearing was continued to August 16, 1983.

When the hearing reconvened in August, Judge Winner announced that because of his impending retirement, he would only rule on the motion for a new trial and the motion to dismiss would be transferred to another judge for resolution. Accordingly, the Government did not present all of its evidence or cross-examine all of the defense witnesses on the question of misconduct. Thereafter, on August 25, 1983, Judge Winner issued a memorandum opinion in which he granted the defendant's motion for a new trial primarily because of what he perceived to be his erroneous exclusion of certain evidence at trial. Most of the opinion, however, was devoted to a discussion of the defense allegations of misconduct. Judge Winner acknowledged, however, that these allegations were

irrelevant to the only matter he was resolving--the motion for a new trial--and that he was making no findings that there had been misconduct. But he nevertheless recited in great detail the specific alleged conduct about which the defense complained and the names of the Government attorneys allegedly involved. In so doing, he left the clear impression, either expressly or impliedly, that the conduct had indeed occurred as alleged by the defense and was improper. The submission for publication of an opinion which for the most part resolved no issue in the case and was little more than a one-sided recitation of the incomplete record in the case was extremely unusual.

When the opinion was issued, a detailed review of the grand jury and court record was made by the Tax Division. Based upon that review, the filing of a motion with Judge Winner was authorized requesting him to withdraw the portions of the opinion containing unproved and, therefore, unfair charges of attorney misconduct and to leave the record free of potentially harmful material until the evidence was fully presented in the hearings to be held by the new judge. Judge Winner denied this motion.

The Solicitor General, thereafter, authorized the Tax Division to file an appeal to the Tenth Circuit seeking reversal of Judge Winner's order refusing to withdraw the offending portions of his opinion and, in the alternative, to seek issuance of a writ of mandamus directing Judge Winner to withdraw parts of that opinion. The brief and alternative petition for a writ of mandamus was filed on November 29, 1983 and this proceeding is still pending. As noted in that filing, the Government believes that Judge Winner violated his judicial duty to keep court records free from scandalous matter. See, e.g., Green v. Elbert, 137 U.S. 615, 624 (1891).

Turning now to your specific questions:

1. Your first question pertains to the initiation of the process of seeking the order in question. As Mr. Schmults' statement of January 27, 1984, indicates, no senior officials of the Department of Justice were involved in that process. This course was, instead, proposed by the attorneys in the Tax Division's Appellate Section who were responsible for handling the Government's appeal and mandamus petition regarding Judge Winner's opinion and authorized by the Acting Chief of the Appellate Section.

At some time after the opinion here was issued, Judge Winner submitted it to West Publishing for publication, and that company thereupon published the opinion in its "advance sheets" for Volume 570 of its Federal Supplement. West Publishing, as you know, serves as an official or quasi-official reporter (a role West has characterized as analogous to that of the Government Printing Office (Lowenschuss v. West Pub. Co., 542 F. 2d 180, 184 (3d Cir. 1976)).

Inquiries were made by an Assistant Chief of the Tax Division's Criminal Section as to whether West would be willing to withhold publication of the opinion from its permanent volumes pending resolution of the appeal and mandamus proceeding in the Tenth Circuit. West Publishing Co. advised the Department of Justice that it exercised no discretion in publishing opinions submitted to it by courts. Therefore, West would postpone its scheduled December 30, 1983, printing of the permanent volume only if it were ordered to do so by the District Court or the Court of Appeals. After the Appellate Section attorneys were advised of West's position, they thereupon began drafting a motion seeking such an order so that the status quo (or what was left of it) could be maintained until the Tenth Circuit had an opportunity to rule on the merits of the pending appeal and mandamus request. That work was begun on the morning of December 28, 1983, two days before West's scheduled publication date.

2. Your second question concerns the approval of the motion. On completing a draft of the proposed motion late in the afternoon of December 28, the matter was presented to the Acting Chief of the Appellate Section, who was authorized to sign outgoing correspondence and court filings in all pending appellate cases. The Acting Chief believed that the request to maintain the status quo by postponing publication of Judge Winner's opinion in the permanent volumes of the Federal Supplement was ancillary to and an interim step necessary to secure the relief sought in the pending appeal and mandamus proceeding, and therefore did not advise the Assistant Attorney General or Deputy Assistant Attorney General of the Tax Division of the motion. Nor, having been advised that West would not oppose the motion, did the Acting Chief seek further approval from the Solicitor General before signing the motion and sending it to the Court. The Tenth Circuit issued an order on January 3, 1984, temporarily granting the requested relief.

Although West itself did not, in fact, oppose the motion or the order on First Amendment or any other grounds, certain news media not affected by the order raised questions about the First Amendment implications of the order in late January 1984. After considering this matter, the Department concluded that, notwithstanding West's role as an official or quasi-official court reporter for the Federal courts, the motion requesting this relief was contrary to the Department's policy against seeking the imposition of prior restraints on the press. At about the same time, however, the Tenth Circuit on January 24, 1984, issued an order vacating its order of January 3, 1984.

3. Your third question pertains to the role played in seeking the order in question by the three attorneys of the Tax Division's Criminal Section. Two of them played no role in seeking that order. Although Appellate Section attorneys were responsible

for drafting the motion, one of the trial attorneys was called on to provide them with some information concerning the trial proceedings before Judge Winner. He was also involved in the contact with West as to its intentions with regard to the publication of the opinion in question and assisted in the transmittal of the motion to the court. None of the trial attorneys had any discussions with the Acting Chief of the Appellate Section regarding the filing of this motion.

4. Your fourth question pertains to the Department's guidelines for instituting appellate proceedings. Generally, authorization for the prosecution of an appeal or a request for relief in the nature of mandamus from any of the Courts of Appeals must be obtained from the Solicitor General. Once such an authorization has been received, however, all matters that are ancillary to such a proceeding (briefs and motions, etc.) are within the authority of the litigation divisions. Viewed, as it was, as an interim action to effectuate the previously authorized appeal/mandamus action, the motion here would not have required separate authorization from the Solicitor General. On the other hand, the motion could also be viewed as a broadening of the action previously authorized and therefore properly the subject of a new authorization by the Solicitor General. On balance, the latter view is probably the more appropriate one, but the question was close enough that this action should not be considered as more than an inadvertent failure to follow the Department's appeal procedures.

5. Your final question pertains to whether the Department has initiated any internal investigations into this matter. While the Department's Office of Professional Responsibility is now looking into the allegations of attorney misconduct before the grand jury, the initiation of the West motion has already been investigated quite thoroughly, and no further inquiries into that matter are contemplated. As Mr. Schmults indicated in his statement of January 27, the actions taken by all of those involved in filing the motion were well-intentioned and based on their belief that the relief requested was appropriate under the circumstances. As noted above, no First Amendment considerations had been raised by West or were focused on by the Appellate Section attorneys, who were essentially seeking to preserve the status quo pending appeal. Indeed, although the Tenth Circuit ultimately determined that the Government had not made a sufficient showing to warrant the postponement of publication of Judge Winner's opinion, it noted that West's status as an official or quasi-official reporter for the Federal courts may serve to distinguish that company from other publishers and may provide a basis for the courts' exercise of authority over the publication of official case reports in the Federal Supplement and Federal Reporter volumes. In these circumstances, the Department does

not believe that the matters surrounding the filing of the motion warrant further investigation or the imposition of sanctions against any of those who were involved in seeking the order in question, notwithstanding the ultimate determination that the motion was contrary to the Department's policy against seeking prior restraints of the press.

I trust that this answers all of the questions you have regarding this matter.

Sincerely yours,

/s/

ROBERT A. McCONNELL
Assistant Attorney General
Office of Legislative Affairs

Mr. OLSEN. And, finally, in addition I have an appendix to my statement that is a list of tax shelter cases brought by the Tax Division.

Senator GRASSLEY. My staff informed me that we don't have a copy of it. But that doesn't mean that you maybe don't have one along today or something.

Mr. OLSEN. I have one today, Senator.

Senator GRASSLEY. All right. Thank you.

Mr. OLSEN. This is to Senator Leahy specifically addressing the questions that he raised in a letter of February 1984 on this matter.

Thank you, Senator.

[The prepared written statement of Mr. Olsen follows:]

Department of Justice

STATEMENT

OF

ROGER M. OLSEN
ASSISTANT ATTORNEY GENERAL
TAX DIVISION

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT OF THE
COMMITTEE ON FINANCE
UNITED STATES SENATE

CONCERNING

ACTIVITIES OF THE IRS AND THE JUSTICE DEPARTMENT IN
CRIMINAL CASES INVOLVING
ABUSIVE TAX SHELTERS AND FOREIGN INVESTMENTS

June 23, 1986

Thank you for inviting me to participate in this oversight hearing on criminal tax cases involving abusive tax shelters and foreign investments. I would like to proceed by: (1) describing for you the role of the Justice Department in the investigation and prosecution of criminal tax cases; (2) providing details on immunity practices and procedures in criminal tax cases; (3) outlining our experiences with abusive tax shelters and foreign investments; and (4) discussing the attempt to temporarily delay publication of an opinion critical of Tax Division prosecutors.

We recognize that the Subcommittee is particularly interested in the Kilpatrick and Omni cases. In view of their pendency before the Courts of Appeals, however, we are constrained in what we can say about these proceedings.

ROLE OF THE JUSTICE DEPARTMENT

The IRS is primarily responsible for the detection of criminal tax offenses and for the development of cases for prosecution. When the IRS determines a case warrants criminal prosecution, the case is referred to the Justice Department. The conduct and control of all Federal tax litigation, except that in the United States Tax Court, were vested in the Department of Justice by Executive Order No. 6166, issued by the President on June 10, 1933. The Tax Division of the Justice Department is charged with administering the nationwide Federal Tax Enforcement

Program. The paramount objective of the Federal Tax Enforcement Program is the preservation of the tax system by ensuring that the tax laws are fairly and uniformly enforced. All criminal tax prosecutions and all tax grand jury investigations must, therefore, be approved by the Tax Division. This allows the Tax Division to apply national standards of prosecution, and ensures that all taxpayers are treated equally, regardless of their place of residence.

Requests for grand jury and prosecution authorizations undergo careful and thorough review by attorneys in the Criminal Section of the Tax Division. With the exception of cases which are deemed noncomplex and forwarded directly to the United States Attorneys' offices, each case is reviewed by a line attorney, who writes a memorandum recommending for or against prosecution or grand jury authorization. Each case is then reviewed by one or more supervisory attorneys.

In determining whether prosecution is warranted, Tax Division attorneys must be satisfied that there is (1) a prima facie case, and (2) a reasonable probability of conviction. As stated in The Principles of Federal Prosecution (reproduced in the United States Attorneys' Manual) "as a matter of fundamental fairness and in the interest of the efficient administration of justice, no prosecution should be initiated against any person

unless the Government believes that the person probably will be found guilty by an unbiased trier of fact." USAM 9-27.210.

If the Tax Division concurs in the recommendation of the IRS, the case is forwarded to the local United States Attorney's office for prosecution. Although primary responsibility for prosecuting tax offenses rests with the United States Attorney, United States Attorneys often request the assistance of Tax Division attorneys. Since the beginning of fiscal year 1984, United States Attorneys' offices have requested Tax Division assistance in more than 300 cases and 40 grand jury investigations. Of the 300 trial requests, more than 280 involved cases in which the requesting United States Attorney stated that the local office lacked either the personnel or the requisite expertise to handle the prosecution. During fiscal year 1985, Criminal Section attorneys conducted 65 criminal tax trials, 14 grand jury investigations, and 61 grand jury presentments. This represents about 15% of the criminal tax trials during that time period.

Traditionally, the IRS has fully investigated a case administratively and referred it to the Tax Division with a recommendation for prosecution. A second approach to the development of criminal tax cases involves a recommendation by the IRS or the appropriate United States Attorney's office that a grand jury investigation of a particular tax offense be initiated. In

recent years, the number of cases investigated through grand juries has increased. This is due, in part, to a commitment on the part of the IRS to more extensive involvement in cases involving narcotics trafficking, abusive tax shelters, and foreign transactions. Requests for initiation of grand jury investigations by the IRS are usually based upon a determination that the case cannot be fully developed administratively. The great majority of the requests are made when the United States Attorney or Strike Force Attorney conducting a grand jury investigation of violations of Titles 18, 21, 31, or other nontax criminal statutes uncovers potential tax crimes. In 1985, only 10 of the 487 requests for a grand jury authorization were submitted by the IRS.

The use of the grand jury to investigate criminal tax violations must first be approved and authorized by the Tax Division. Decisions are made on a case-by-case basis. As stated, each grand jury authorization request is carefully reviewed by a line attorney and one or more supervisory attorneys in the Criminal Section. When a tax grand jury investigation is authorized, the United States Attorney or Strike Force Attorney will be notified of the authorization by a letter from the Tax Division. Once a request for grand jury investigation is approved, the primary responsibility for development of the case shifts from the IRS to the Justice Department. Most grand jury investigations are conducted by Assistant United States Attorneys.

However, a number of the investigations are conducted by the Tax Division's Criminal Section prosecutors. The prosecutors and the grand jury are assisted in the further development by the case by Special Agents of the IRS, usually the Agents who were responsible for the case during its administrative stages.

When an IRS agent is assigned to assist the prosecutor in conducting a tax grand jury investigation, the prosecutor is required to notify the IRS agents working on the case that grand jury materials are made available to them under the following conditions: (1) grand jury material remains under the custody and control of the United States Attorney, the Strike Force Attorney, or Tax Division Attorney; (2) no disclosure is to be made except for criminal purposes, and only to IRS personnel assisting in the criminal investigation; (3) the IRS agents will furnish the Tax Division with their views and recommendations, whether favorable or unfavorable; and (4) all grand jury materials, including copies, must be returned to the United States Attorney, Strike Force Attorney, or the Tax Division Attorney once the case is concluded. Tax Division guidelines provide that "persons to whom grand jury material is to be disclosed should be advised in writing that such material is secret and that it may be used only for the purpose of assisting the Government attorney in the performance of the attorney's duties in enforcing federal criminal law." Tax Division Institute of Criminal Tax Trials,

1983, p. 164, No. 4. A form letter is provided to Tax Division attorneys for this purpose.

Once a grand jury investigation is authorized by the Tax Division, no indictments or informations charging tax offenses are to be returned without prior authorization of the Tax Division. When the grand jury investigation has produced sufficient evidence to seek indictments, the United States Attorney or the Strike Force Attorney must have one of the case agents prepare a report, which is forwarded to the Tax Division for review. These reports are reviewed fully by Criminal Section attorneys in the same manner that requests for prosecution in IRS administrative investigations are reviewed.

New attorneys in the Criminal Section of the Tax Division undergo extensive training before they receive litigation assignments. All Tax Division attorneys are required to attend the two-week Attorney General's Advocacy Institute. In addition, new attorneys attend an one-week course, sponsored by the Advocacy Institute, on grand jury practice and procedure.

New attorneys are also required to read several training manuals which contained guidelines for litigation procedures. These include the Tax Division's 1983 Institute on Criminal Tax Trials; the two-volume Criminal Tax Manual; and the United States Attorneys' Manual, particularly Title 6--Tax Division. Other

Department publications include the Criminal Division's Manual for Federal Grand Jury Practice, Volumes I and II, and the Office of Legal Policy's Guide on Rule 6(e) after Sells and Baggot.

IMMUNITY PRACTICES AND PROCEDURES

Department of Justice Manuals contain guidelines for two types of immunity: formal, or statutory immunity, and informal, nonstatutory immunity. The latter is commonly referred to as "pocket immunity," and may be granted by a Letter of Assurance or an Agreement Not to Prosecute. Letters of Assurance are used with individuals who are viewed solely as witnesses, whereas Agreements Not to Prosecute are used with individuals who are viewed as potential targets of an investigation.

Requests for statutory immunity must meet the requirements set forth in Title 1 of the United States Attorneys' Manual. Before requesting immunity for a witness, prosecutors must consider: the public interest; the seriousness of the offense and importance of the case; the value of the testimony or information; the likelihood of prompt and complete compliance; the relative culpability and criminal history of the witness; whether there has been a conviction prior to compulsion; possible adverse consequences to the witness who testifies; and the availability

of the Fifth Amendment privilege to the witness. USAM 1-11.210 - 220. Requests for statutory immunity must be approved by the appropriate Assistant Attorney General.

Guidelines governing requests for informal immunity are contained in Title 9 of the United States Attorneys' Manual. This section provides that "the attorney for the government may, with supervisory approval, enter into a non-prosecution agreement in exchange for a person's cooperation when, in his/her judgment, the person's timely cooperation appears to be necessary to the public interest and other means of obtaining the desired cooperation are unavailable or would not be effective." USAM 9-27.610.

This section further provides that supervisory approval is required. "Prosecutors working under the direction of a U. S. Attorney must seek the approval of the U. S. Attorney or a supervisory Assistant U. S. Attorney. Departmental attorneys not supervised by a U. S. Attorney should obtain the approval of the appropriate Assistant Attorney General and his/her designee, and should notify the U. S. Attorney or Attorneys concerned." USAM 9-27.610, par. 4. In certain sensitive cases, approval of the appropriate Assistant Attorney General or his/her designee is required. USAM 9-27.640.

Informal immunity is a necessary component of the concept of prosecutorial discretion. It is widely used by prosecutors, and

has been accepted by the courts. United States v. Winter, 663 F. 2d 1120, 1133 (1st Cir. 1981), cert. denied, 460 U.S. 1011 (1983); United States v. Librach, 536 F. 2d 1228, 1230 (8th Cir. 1976), cert. denied, 429 U.S. 939 (1976); see also, United States v. Quatermain, 613 F. 2d 38 (3d Cir. 1980), cert. denied, 446 U.S. 954 (1980); United States v. Weiss, 599 F. 2d 730, 735 n. 9 (5th Cir. 1979); Galanis v. Pallanck, 568 F. 2d 234, 235-236 (2d Cir. 1977). Indeed, in United States v. Peister, 631 F. 2d 658, 662-663 (10th Cir. 1980), cert. denied, 449 U.S. 1126 (1981), the prosecutor stated that informal immunity was commonly used by prosecutors from the United States Attorney's office in Colorado.

TAX SHELTERS

The use of abusive and illegal tax shelters has created a severe burden on the administration of the federal tax system and resulted in significant revenue losses. In 1980, the Commissioner for the Internal Revenue Service and the Assistant Attorney General for the Tax Division issued a memorandum to all IRS District Directors and United States Attorneys, informing them that "A necessary complement to our civil compliance effort is concerted criminal investigation and prosecution of those who counsel, promote or profit from tax shelter schemes which violate the law." Crackdowns on abusive and illegal tax shelters continue to be a priority concern of this Administration.

A tax shelter has been defined as an investment which allows a taxpayer to offset certain losses not only against the income from the investment, but also against the taxpayer's other income, usually from his regular business or professional activity. Tax shelters derive their name from the fact that the investments shelter from taxation other taxable income earned by the investor.

Most tax shelters are legitimate and are created to take advantage of preferences in the tax code designed to promote desired social and economic goals. Unfortunately, the intended goal of certain tax preferences, i.e. legitimate investment in targeted areas, has been overshadowed by massive abuses of the tax system. Disreputable promoters distort transactions to provide investors with tax benefits which they are not legally entitled to receive. For example, tax shelter benefits are frequently claimed on assets that do not exist or were never placed in service. Documents evidencing investments in assets that do exist are often backdated to the most recently concluded tax year--an illegal form of after-the-fact tax planning. Another common abuse involves the gross overvaluation of assets for the purpose of increasing the investment tax credit, energy tax credit, and depreciable basis of the asset.

Beginning in the late 1970's and continuing into the 1980's, tax shelters have been extensively and aggressively marketed. It has become socially acceptable to own tax shelter investments and

the latest tax shelters are a primary subject of cocktail party conversation. This mindset created a ready opportunity for a variety of con artists and swindlers to promote fraudulent schemes in the guise of tax shelters. These modern-day snake oil salesmen sell the alleged availability of tax benefits to a gullible public, but their ultimate victims are the United States taxpayers.

The present tax code, and its myriad of deductions and credits, provides ample opportunity for devious and unscrupulous promoters. Virtually every type of legitimate tax shelter has an illegitimate twin and investors often have little means of determining whether the transactions underlying the investment have or will occur. The only simple test for separating the legitimate from the abusive is to apply the maxim: "If it appears to be too good to be true, it probably is." Unfortunately, many investors do not care whether the transaction has any substance because they receive, or at least claim, tax benefits far in excess of their investment.

The growth of the abusive tax shelter industry inexorably led to increased investigative emphasis on the part of the IRS and to criminal tax investigations of the promoters. Thus, in fiscal year 1985, the Internal Revenue Service initiated 326 investigations of fraudulent tax shelters, and referred 213 cases involving fraudulent tax shelters to the Justice Department.

During fiscal year 1985, 92 new tax shelter cases were indicted, and the Government obtained 55 convictions and guilty pleas. Forty-six defendants were sentenced; 65 percent of those sentenced received prison terms, and the average term of imprisonment was 30 months.

In most instances, criminal investigations focus on the organizers, promoters and salesmen of tax shelter schemes. Investors are usually subject only to civil assessments and penalties because of the difficulty of proving their criminal intent. Investors will usually claim reliance on representations of the promoters or upon the advice of attorneys. And in many instances, the investors have themselves been defrauded because the tax shelter is nothing but a Ponzi scheme or because the assets underlying the scheme do not exist or their value has been grossly inflated. We are currently looking at some cases involving investors, and expect that in due course we will find a case with adequate evidence to support a criminal prosecution.

The illegal tax shelter schemes which the Justice Department has investigated or for which prosecutions have been brought have involved a broad array of investment and financial arrangements. Our cases have involved, for example, real estate transactions; solar energy panels; coal mining; oil and gas ventures; cattle investments; investments in art work; vitamins; horses; research and development; commodities straddles; and gold and silver

transactions. Some examples of criminal tax prosecutions involving tax shelters are set out in an Appendix to this statement, which we have submitted for the record.

With the enactment of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Public Law 97-248, the Congress provided the IRS and the Justice Department with new weapons for use in the war against promoters of abusive tax shelters. Prior to the enactment of TEFRA, no civil sanctions applied to promoters of abusive tax shelters and, aside from criminal prosecutions, the Government's primary recourse was to audit all of the investors, requiring an enormous outlay of resources. Additionally, some promoters continued to market interests in abusive tax shelters even though criminal investigations had been opened and were in process.

Statutes enacted by TEFRA now allow the Government to attack abusive tax shelters directly at their source by the use of injunctive relief (Code Section 7408) and civil penalties against promoters (Code Section 6700). The injunction provision is a particularly important addition to the Code. Under this provision, the IRS may now request the Department of Justice to institute proceedings directly against tax shelter promoters in much the same manner as the Securities and Exchange Commission acts to halt violations of the securities laws. The related

penalty statute also permits the IRS to assess substantial monetary penalties against abusive tax shelter promoters.

On November 1, 1983, the Tax Division established the Office of Special Litigation for the purpose of conducting all of the tax shelter and related litigation under these provisions. That office now has 21 attorneys to handle its expanding case load of injunction and penalty actions. As of April 30, 1986, 167 cases involving more than 82,000 investors and $9 billion in potential revenue losses had been referred by the IRS to the Tax Division for injunctive relief. Thirty-seven cases have been returned to the IRS by the Tax Division and closed. One hundred and three suits have been filed, and 78 injunctions obtained, 60 by consent and 18 by trial. To date, the Department of Justice has not lost any Section 7408 cases. Thirty-nine cases are awaiting trial, and others are being further developed before suit is initiated. Attached as an Appendix is a list of injunctions granted (categorized by trial and by consent). In addition, the Office of Special Litigation is currently defending 40 actions involving Internal Revenue Code Section 6700 promoter penalties totalling approximately $60 million.

Although many of the injunction cases require a full trial on the merits, the Office of Special Litigation has drawn on the experience of the SEC and has successfully concluded many of its

cases through the use of negotiated consent decrees. In fact, over 78 percent of the cases have been successfully concluded by consent decree. Each of these decrees resulted in the Government's obtaining remedies comparable to those that would have been obtained after a successful trial, including in excess of $5,000,000 in civil tax penalties paid pursuant to the consents and court orders prohibiting the defendants from engaging in future abusive tax shelter conduct. Violations of the injunction orders or consent decrees obtained in two of these cases have resulted in criminal contempt convictions. In three instances, promoters were jailed for up to two years for violating the injunctions.

Neither a decision to seek an injunction nor the entry of an injunction will affect a decision to prosecute a promoter criminally. In a number of cases, we have sought injunctions even though criminal investigations against the promoters were also pending.

The importance of the Government's efforts to shut down abusive tax shelter promotions cannot be exaggerated. The amounts involved in some of these cases is staggering. The massive Sentinel Financial Instruments and Sentinel Government Securities tax shelter case, for example, involved more than $130,000,000 in fraudulent deductions. In short, it is clear that abusive tax shelters are a multi-billion dollar problem.

The Subcommittee's press release also mentioned cases involving foreign investments. Our experience has been that a large percentage of the tax shelter cases under criminal investigation have a foreign connection. Promoters, seeking to obscure the true nature of the scheme, route (or purport to route) all or a part of the transaction through foreign corporations, tax haven bank accounts, or other offshore entities, which are completely under the control of the promoters. Often the transactions are papered, but never take place. Frequently, no money changes hands or the consideration consists essentially of check swaps. These transactions are designed to have the superficial appearance of being at arms-length. Thus, it is commonplace in tax shelter cases for the transaction to involve a series of convoluted dealings with Panamanian, Bahamian or Cayman Islands corporations, banks or trusts, with none of these transactions having any substance. The Senate Permanent Subcommittee on Investigations has conducted extensive investigations over the last several years concerning the use of offshore entities for tax evasion. A catalogue of some reported cases in which offshore entities were used to facilitate tax evasion or avoidance can be found in the report of Senate Permanent Subcommittee on Investigations entitled Crime and Secrecy: The Use of Offshore Banks and Companies, S. Rep. No. 99-130, 99th Cong., 1st Sess. at 158-164 (1985).

We have made great strides in recent years in securing foreign evidence through greater attention to negotiating information exchange provisions in tax treaties, the negotiation of mutual assistance treaties in criminal cases, and implementation of the Caribbean Basin Initiative through the execution of exchange of information agreements. The Tax Division has worked closely with the Treasury Department in these efforts. The investigation of cases having a foreign connection remains a painstaking effort because of the difficulty of stripping away the web of convoluted transactions whose only purpose is to create the aura of legitimacy and to prevent investigators from readily securing necessary evidence.

PUBLICATION ISSUE

On December 28, 1983, the Tax Division sought an order from the Court of Appeals for the Tenth Circuit temporarily delaying publication by West Publishing Company in its permanent volume of Federal Supplement of a decision by Judge Winner in the Kilpatrick case, which criticized Justice Department prosecutors. The Justice Department had previously taken an appeal from that decision. On January 3, 1984, the Tenth Circuit entered an order temporarily prohibiting publication of the opinion in the permanent volume of Federal Supplement. On January 24, 1984, the Tenth Circuit vacated the January 3, 1984, order.

Shortly thereafter, the Deputy Attorney General publicly acknowledged that it had been a mistake to seek the order. The order was requested without the knowledge of senior officials and the episode did not represent any change of the Department's policy in favor of open proceedings. The Deputy Attorney General said that the request resulted from a well-motivated effort on the part of Tax Division attorneys to protect the reputations of three of their colleagues, who they thought were unfairly criticized in the opinion. In making the request, the Tax Division attorneys did not fully appreciate its First Amendment implications.

CONCLUSION

I will be pleased to respond to any questions that you may have. Thank you.

APPENDIX

SUITS TO ENJOIN PROMOTERS OF
ABUSIVE TAX SHELTERS
AS OF MARCH 31, 1986

INJUNCTIONS GRANTED

Trial:

United States v. Buttorff, 563 F. Supp. 450 (N.D. Tex. April 13, 1983). AFF'D ..... F.2d .. (5th Cir. June 3, 1985) (Family Trusts) [Buttorff I]

Your Heritage Protection Association et.al., C.D. Cal. April 16, 1984 (Inj. granted on motion). (Protester org.) (Appeal to 9th Cir. pending)

David White, Minnesota Society for Educated Citizens, Civ. 6-84-405, 84-1 USTC par. 9441, 53 AFTR 2d 1348 (D. Minn. May 1, 1984), aff'd ... f.2d ... (8th Cir. Aug. 8. 1985) (Patriots Protest org.)

Eric L. Clayden (Filed Jan. 5. 1984. D. Ariz.) (default judgment granted 9/13/84) (Equipment Leasing, master videotapes). (Appeal to 9th Cir. Voluntarily dismissed Jan. 8, 1985)

Gerald Savoie, 594 F. Supp. 678 (W.D. La. Sept. 20, 1984). (Protest - Organization)

Charles Shuttleton 596 F. Supp. 186 (ED Va. October 5, 1984) (Patriots protest organization) aff'd ... F.2d ... (4th Cir. August 8, 1985)

Gordon Buttorff (ND Tex. October 5, 1984) (Conviction on contempt, 5 counts, Jury trial. Sentenced November 7, 1984 to 90 days, 5 yrs. probation)

Walter M. Hoarhouse (D Minn. October 9, 1984) (Preliminary Inj - business trusts) (Aff'd per curiam 8th Cir. July 20, 1985)

Harold Turner, 601 F. Supp. 757 (ED Wis. Jan. 24, 1985) Granting permanent inj. vs. one defendant, denying one. Two other defendants enjoined by consent. (Appeal to 7th Cir. pending)

Willis D. Brown (W.D. Okla., default judgment Jan. 10, 1985) (Backdating, horse breeding)

Philatelic Leasing (S.D. N.Y., Feb. 13, 1985) (Stamp Masters) (On appeal to 2nd Cir.)

United States v. Dynes Corp. (N.D. Ga. March 25, 1985) (Default Judgment entered for failure to comply with discovery orders -- equip. leasing, energy system)

Ward Trupp Jones, (Tried 4/15/85) (Convicted 4/23/85, sentenced 25 years)

Consent:

United States v. Hutchinson, 51 AFTR 2d 1141 (S.D. Cal. April 6, 1983). (Family Trusts)

Packaging Industries Group, Inc., et al. (D. Mass. Aug. 8, 1983). (Equipment Leasing)

Gibraltar Properties, Inc., et al. (N.D. Tex. Aug. 15, 1983). (Accrued 'add-on' interest, real estate)

Mid-American Consultants, Inc., et al. (E.D.Mo. Nov. 23, 1983). (Accrued 'add-on' interest, real estate)

Ward Irvegn Jones, et al. (N.D. Tex. Dec. 5, 1983). (Family trusts)

Soundwave International Inc., et al., (C.D. Cal. Mar 1, 1984). (Master Recording Leasing).

Computer Alternatives, et al., (N.D. Cal Mar 6, 1984). (Equipment leasing)

Waterview Inc., et al., (N.D. Tex. March 20, 1984). (Accrued add on interest, real estate)

Gerald Day, et al., (N.D. GA. March 20, 1984) (Energy Equipment Leasing)

Robert Bruce, et al. (C.D. Cal., May 24, 1984) (Master Recording, video, audio tape leasing)

Century Concerts, et al. (C.D. Cal. June 28, 1984) (Master Recording, video games, computer software leasing)

Vision III et al., (W.D. Mo. July 10, 1984) (Master Recording)

North American Investment Group Ltd., et al., (W.D. Ill. July 20, 1984) (Real Estate).

County Accounting & Tax Services, Inc., (E.D. Mo., July 22, 1984) (Rule of 78's)

Southwest Solar Products, Inc. (C.D. Cal. September 17, 1984) (Equipment Leasing)

Shelter Leasing Corp., (N.D. Tex., August 30, 1984) (Master Recording)

Triple Educational Publications (ND Tex 9/4/84) (Master Recording)

John Oaks (WD Mo., October 29, 1984) (Protester)

Arthur B. Pulitzer (ND NY, October 31, 1984) (Cattle)

Southern Music Corp. (MD Tenn November 6, 1984). (Master Recording)

Bradbury Independent Mining Co. (D. Colo. August 27, 1985) (Goldmine)

First Energy Leasing Corp (E.D. N.Y., Aug. 30, 1985) (Energy management systems)

Col-Columbian Mines, Ltd., (C.D. Cal., Sept. 4, 1985) (Gold mines)

Sagittarius Recording Inc. (S.D. Ohio, Sept. 9, 1985) (Master Recording)

Bernard Van Zyl, et al. (M.D. Fla., Sept. 9, 1985) (Mining)

Craig R. Forney, et al. (D. Neb., Sept. 16, 1985) (Mining)

Robert G. Palagyia, (D. Mass., Sept 23, 1985) (Master Recording)

Mary M. Hernandez, (S.D. Tex., Sept. 27, 1985) (Return preparer)

Balanced Financial Management Inc., et al., (D. Utah, September 30, 1985) (Partial)

Walter Moorhouse, et al. (D. Minn.), (Business trusts)
Walter Moorhouse - July 25, 1985
Cheri Moorhouse - April 15, 1985
Cheryl Foshaug - March 25, 1985
Armageddon, Inc. - March 25, 1985
Marti Inman - March 25, 1985
Darnell, Inc. - March 25, 1985

Advanced Design West, Inc., et al. (WD Wash) (Master Videotapes)
Jack Brown - December 26, 1985
Frank H. Dollar - December 26, 1985

Gary Babler & Financial Strategies, Inc. (E.D. Wis) (Complete, December 30, 1985) (Wind-powered turbine equipment)

International Recovery Inc., and David C. Cook, (C.D. Cal. Jan. 9, 1986) (Gold Mine)

Multi-Equipment Leasing Corp., et al. (ND In) (Ethanol producing equipment) (Partial) Gary R. VanWaevenberghe - Feb. 3, 1986

Integrated Control Systems, et al (MD Al) (Energy management systems) (Partial) Integrated Control Systems, Inc. - Feb. 12, 1986, Robert Norwood - February 12, 1986.

Samuel L. Winer, et al (MD Fl) (Feb. 18, 1986) (Equipment Leasing) (Complete) Samuel L. Winer - Feb. 18, 1986
Winer Development Corp - Feb. 18, 1986.

APPENDIX

CRIMINAL TAX PROSECUTIONS

INVOLVING

TAX SHELTERS

REAL ESTATE

United States v. F. Thomas Little, et al., 753 F. 2d 1420 (9th Cir. 1985).

In a real estate tax shelter conspiracy prosecution to defraud the United States (Klein-conspiracy), in violation of 18 U.S.C. 371, the Ninth Circuit confirmed the convictions of F. Thomas Little and Harold Crutchfield, officer and director of a real estate development company, and Peter Chernik, its legal counsel. The prosecution involved, inter alia, the backdated sale and financing of fraudulent real estate investments to an undercover I.R.S. agent, posing as a representative of interested tax shelter investors.

In affirming the convictions, the Ninth Circuit factually distinguished its earlier decision in United States v. Dahlstrom, 713 F. 2d 1423 (9th Cir. 1983), as the defendants in Little had, in concert, promoted, encouraged, and assisted others to evade the payment of taxes by means of a fraudulent retroactive allocation of partnership losses, notwithstanding an expressly contrary statutory provision. The defendants in Little also prepared fraudulent partnership records and backdated a promissory note.

In Little, the Ninth Circuit also found that I.R.S. undercover operations fall within the broad authority which Congress delegated to the agency. See also, United States v. Everett, 692 F.2d 596 (9th Cir. 1982); Jones v. Berry, 722 F. 2d 443 (9th Cir. 1983), cert. denied, 104 S. Ct. 2343 (1984). The I.R.S. has broad Congressional authority to collect taxes (26 U.S.C. 6301); a broad Congressional mandate to investigate all persons who may be liable for any internal revenue tax (26 U.S.C. 7601); and broad discretion in determining what "reasonable devices or methods" may be "necessary or helpful in collecting revenue tax. (26 U.S.C. 6302(b)). The Court also rejected defense contentions of alleged misconduct by I.R.S. agents in the case which required reversals of the convictions pursuant to either the due process clause of the Fifth Amendment or the Court's inherent supervisory powers.

United States v. Kenneth E. Allen, et al. (M.D. Fla.)

Kenneth Allen, general partner of a real estate limited partnership, and Richard D. Smith, a tax attorney, were convicted in June 1983, in Orlando, Florida, of conspiracy to defraud the United States (18 U.S.C. 371) and multiple counts of aiding and assisting in the preparation and presentation of false partnership and individual investor income tax returns (26 U.S.C. 7206(2)). This shelter involved fraudulent losses and deductions resulting from fictitious real estate assignments and illusory partnership property and stock transactions. The partnership merely contracted to purchase properties and never closed on any of the transactions. Moreover, there was no actual intent to respect the financing arrangements purportedly underlying the transactions. Allen and Smith marketed their scheme to investors by offering 7-to-1 writeoffs. In November 1984, the Eleventh Circuit summarily affirmed the convictions obtained against the two defendants. Smith received a three-year sentence, and Allen, a former mayor of Melbourne, Florida, received a one-year sentence. Each was sentenced to five-years' probation.

United States v. Peter Bonastia, et al (D. N.J.)

In September and October 1981, Peter Bonastia, Thomas Gaffney, and Robert Petrallia pleaded guilty to mail fraud, conspiracy, and tax offenses in the District of New Jersey. The defendants were engaged in the syndication of limited partnership tax shelters to purchase and operate various types of improved real properties. However, all funds received from investors in approximately 130 partnerships were not used to acquire the properties, and all of the partnerships did not own the parcels of real estate. The defendants were sentenced to incarceration, probation, and fines.

United States v. John D. Clardy, 612 F. 2d 1139 (9th Cir. 1980)

The Ninth Circuit affirmed convictions of John D. Clardy, a real estate tax shelter promoter, for aiding in the filing of false income tax returns, in violation of 26 U.S.C. 7206(2). Clardy utilized a circular financing scheme which resulted in fraudulent prepaid interest deductions. In the Clardy scheme, three different taxpayers purchased properties from Clardy or controlled entities for an inflated purchase price. The property was paid for by nonrecourse financing and alleged prepayments of interest occurred. In fact, with the "cooperation of a friendly bank," there was a mere pretended payment of interest through the use of offsetting check swaps. In affirming the conviction, the Ninth Circuit held that the kiting or swapping of worthless checks was simply a sham.

CURRENCY/COMMODITY TRADING

United States v. Edward A. Markowitz (S.D. N.Y.)

On April 25, 1985, Edward A. Markowitz, a District of Columbia tax shelter promoter, pleaded guilty in the Southern District of New York to conspiring to defraud the United States (Klein conspiracy); assisting in the filing of false income tax returns for two of his companies; and evading more than $1,000,000 in personal income taxes. The prosecution originated with an investigation of Markowitz's tax shelters which generated more than $445,000,000 in false and fraudulent tax deductions. Markowitz established fraudulent partnerships to create fictitious tax deductions involving paper losses in the trading of Government securities and precious metal forward contracts. He rigged security trades; created false documentation; conducted "sham" trades in Government security repurchase (REPO) agreements; and paid fees to Cayman Island and Netherlands Antilles' firms to provide documentation for his fraudulent transactions.

United States v. William and Gail Dunn (D. Ore.)

In August, 1985, in Portland, Oregon, William and Gail Dunn pleaded guilty to substantive income tax violations with respect to the years 1978 and 1979 in connection with a fraudulent Treasury bill tax shelter straddle scheme which they operated in those years. The scheme involved fictitious Treasury bill future straddle trades conducted through purported Cayman Island corporations and resulted in at least $1,725,000 in falsely claimed investor deductions. During the two years involved, the Dunns received $500,000 in income from their tax shelter scheme. In October 1985, William Dunn, the mastermind of the scheme, received a two-year prison term. In November 1985, Gail Dunn was sentenced to six months in prison.

United States v. Michael Senft, et al. (S.D. New York)

In this case, the government was successful in a major tax shelter prosecution in Manhattan involving the creation of fraudulent tax deductions for investors in two tax shelters, Sentinel Financial Instruments and Sentinel Government Securities. On June 8, 1984, four of the five defendants were convicted of conspiracy to defraud the United States (18 U.S.C. 371), and numerous counts of aiding and assisting in the preparation of false tax returns (26 U.S.C. 7206(2)). Michael Senft, Sentinel's founder and general partner, was sentenced to 15 years in prison and an $80,000 fine. Co-defendant Walter Orchard, Sentinel's former head tax trader, was sentenced to four years in prison and a $15,000 fine. Co-defendant David Senft, a securities trader, was sentenced to two years in prison and a $70,000 fine. Joseph Antonucci, another securities trader, received a six month sentence and a $10,000 fine. The Second Circuit affirmed the convictions and the Supreme Court has recently denied certiorari in this case.

United States v. Roger S. Baskes, 687 F.2d 165 (7th Cir. 1981)

In November 1981, the Seventh Circuit affirmed the convictions of Roger S. Baskes, a tax attorney, for conspiring to defraud the United States (Klein conspiracy), in violation of 18 U.S.C. 371, and aiding and assisting in the filing of false income tax returns, in violation of 26 U.S.C. 7206(2). Baskes prearranged a series of fraudulent currency futures straddle transactions through foreign trusts established by a Japanese businessman to defer tax liability on $7,000,000 in capital gains income for his clients.

United States v. Alvin Winograd, et al., 656 F.2d 279 (7th Cir. 1981)

In August 1981, the Seventh Circuit affirmed convictions of Alvin Winograd and Joseph Siegel, for conspiring to defraud the United States (Klein conspiracy), in violation of 18 U.S.C. 371, and aiding in the preparation of false tax returns, in violation of 26 U.S.C. 7206(2), in connection with "rigged" commodity tax straddles. The defendants utilized their positions as "brokers" to create fictitious short-term losses through sham commodity trades. The defendants were fined in excess of $500,000. Over $1,000,000 in losses were generated through the defendant's "rigged" commodity futures trades.

EQUIPMENT LEASING

United States v. John W. Duffell, III (C.D. Ca.)

In August 1982, in Los Angeles, California, Judge Cynthia Hall sentenced tax shelter promoter John W. Duffell, III, to six years' imprisonment for Title 18 and Title 26 U.S.C. offenses arising out of an illegal truck tax shelter scheme involving approximately 160 limited partnerships and more than 1,200 investors. The defendant caused losses estimated at $11,000,000 to the U.S. Treasury through his actions in falsely claiming to have used investor funds for the purchase of tractor trailers and related expenses. The Ninth Circuit affirmed his convictions in August 1983.

United States v. Charles J. Walsh (D. D.C.)

In March 1985, following a three-year grand jury investigation, Charles J. Walsh, an accountant, pleaded guilty to mail fraud and false pretense charges in connection with two fraudulent tax shelter schemes involving equipment container leases and Government securites. The Government was defrauded of $6,800,000 in tax revenues by the equipment leasing program, and false investor deductions totalling $10,600,000 were generated by Walsh's schemes. Walsh, who was extradited to the United States from Ireland through the new United States-Ireland Extradition Treaty in December 1984, received a seven-year prison sentence for his offenses in April 1985.

COAL MINING

United States v. W. Garland Nealy, 729 F. 2d 961 (4th Cir. 1984)

The Fourth Circuit affirmed the conviction of W. Garland Nealy, a tax shelter promoter, for conspiring to aid in the preparation of false income tax returns, in violation of 18 U.S.C. 371 and for aiding and assisting in the preparation of false income tax returns, in violation of 26 U.S.C. 7206(2). Nealy obtained the production of a fraudulent coal mining engineering report, in connection with a tax shelter investment offering of William Nardone. Nealy knew that the fraudulent engineering report would be used to entice people to invest in the coal tax shelters. In affirming Nealy's conviction, the Fourth Circuit stated that, "[a]ll that is required is that he 'knowingly participated in providing information that results in a materially fraudulent tax return, whether or not the taxpayer is aware of the false statements.'" See, United States v. Siegel, 472 F. Supp. 440, 444 (N.D. Ill. 1979).

United States v. William Nardone (S.D. W.Va.)

In July, 1984, William Nardone, a tax shelter promoter in West Virginia, was sentenced by Chief Judge Charles Hayden to serve 15 years in prison and was fined $60,000 following his May 1984 convictions on conspiracy to defraud the United States (Klein-conspiracy) and aiding in the filing of false income tax return charges. Nardone promoted a fraudulent coal tax shelter scheme to more than 350 investors predicated upon vastly overestimated coal reserves which defrauded the Government of at least $7,000,000 in income tax revenues. At sentencing, Chief Judge Hayden termed Nardone's scheme, "a monstrous fraud perpetrated on the People and the Government of the United States."

United States v. Howard C. Flomenhoft, 714 F.2d 708 (7th Cir. 1983)

The Seventh Circuit affirmed mail fraud (18 U.S.C. 1341) and aiding in the filing of false partnership return (26 U.S.C. 7206(2)) convictions against Howard C. Flomenhoft a tax attorney, formerly employed by the Internal Revenue Service, involving a coal tax shelter scheme. Flomenhoft backdated certain documents provided to investors and made false statements on partnership tax returns to make it appear as if the coal shelter partnership was entitled to claim, and pass through to investors, certain advance royalty deductions under Treasury regulations. Flomenhoft's scheme generated fraudulent deductions in excess of $12,000,000. In affirming the convictions, the Seventh Circuit debunked the defense contention that the case involved a mere violation of a proposed Treasury regulation, asserting that Flomenhoft was charged with both mail fraud and filing false statements on tax returns. Flomenhoft received an eight-year sentence.

United States v. Lyle Neal, et al. (S.D. W.Va.)

In December 1980, in the Southern District of West Virginia, Lyle Neal, Kenneth Winters, and Harold Jeffers, promoters of a fraudulent coal tax shelter scheme, were convicted of conspiring to defraud the United States (Klein conspiracy), in violation of 18 U.S.C. 371, and aiding in the preparation of false income tax returns, in violation of 26 U.S.C. 7206(2). The three defendants falsified the evaluation of available coal reserves. Winters received an 18-month prison term and a fine of $53,000, and Jeffers was fined $10,000 following their trial convictions. Neal was sentenced to 14 months in prison and was fined $5,000 following his guilty plea.

GOLD MINING

United States v. Trenton H. Parker (D. Co.)

In February 1982, in Denver, Colorado, Trenton H. Parker pleaded guilty to one count of mail fraud (18 U.S.C. 1341); one count of wire fraud (18 U.S.C. 1343); one count of assisting in the preparation of false tax returns (26 U.S.C. 7206(2)); one count of failing to file an individual tax return (26 U.S.C. 7203); and one count of perjury (18 U.S.C. 1621). Parker promoted tax shelters which allegedly involved gold mines in two foreign countries. He was sentenced to five years in prison and was fined $10,000. Parker agreed to make restitution in the amount of $8,000,000 to investors.

OIL & GAS

United States v. George H. Badger, et al. (D. Ut.)

In September 1981, in Salt Lake City, Utah, George H. Badger, the promoter of a fraudulent oil and gas tax shelter, which utilized fictitious loans among sham corporations to create over $4,000,000 of fraudulent partnership deductions in the form of interest and intangible drilling expenses, was convicted of conspiring to defraud the United States by impeding and impairing the lawful function of the Internal Revenue Service (18 U.S.C. 371). He was sentenced to five years' imprisonment and was fined $10,000. Assen Ivanoff, a co-defendant, is a fugitive.

SOLAR ENERGY

United States v. Ronald Farnsworth, et al. (S.D. Calif.)

During April and May 1983, Ronald Farnsworth and five other defendants involved in Major Dynamics, a fraudulent solar panel tax shelter, were convicted in San Diego, California. The shelter was marketed to over 1200 taxpayers, collected $8,300,000 in cash, and distributed an estimated $27,000,000 in false tax deductions and credits. The prosecution involved nonexistent solar panels; substantial inflation of purported tax losses; extensive backdating; and the concealment of money in offshore Cayman Island bank accounts. Periods of incarceration were imposed upon each defendant with a five-year sentence being imposed upon Farnsworth, the President-Director of the concern. In addition, the court ordered Roland Colton, the tax attorney who prepared the "tax opinion letter" for the tax shelter to make restitution in excess of $153,500.

ANIMAL BREEDING

United States v. Thomas A. Carruth, et al., 699 F. 2d 1017 (9th Cir. 1983)

The Ninth Circuit in February 1983, affirmed conspiracy convictions against Thomas A. Carruth and Jackson L. Reed, promoters of an illegal cattle and feed tax shelter. The defendants fraudulently overstated the extent of the cattle herds involved and used illusory financing and cattle feed expenses created by passing worthless checks among controlled entities in the United States and Canada to fraudulently inflate investors' deductions. Carruth and Reed marketed their scheme to investors on the basis of 3-to-1 tax writeoffs. Each defendant was sentenced to three-years imprisonment.

United States v. Dennis G. Crum, 529 F. 2d 1380 (9th Cir. 1976)

Dennis G. Crum a beaver breeder, was convicted of aiding the filing of false investor income tax returns, in violation of 26 U.S.C. 7206(2), in a tax shelter scheme predicated upon the backdating of beaver purchase contracts. An attorney who devised the program sold the scheme to doctors at tax return filing time, and the doctors and Crum, who was solicited for the program by the attorney, signed backdated contracts.

MOVIE

United States v. Emanuel Barshov, et al. (S.D. Fla.), 733 F.2d 842 (11th Cir. 1984)

Emanuel Barshov and James E. Ross, two promoters of an illegal movie tax shelter, were convicted in Miami, Florida, during October 1982, of filing false partnership returns (26 U.S.C. 7206(1)), aiding and assisting in the preparation of false individual investor income tax returns (26 U.S.C. 7206(2)), and conspiring to defraud the Internal Revenue Service (18 U.S.C. 371). The Barshov defendants illegally inflated the cost of movies under the income forecasting method in order to provide investors with improper deductions totaling $5,000,000. The defendants' sentences included fines ranging from $2,500 to $10,000.

United States v. Verland T. Whipple, et al (D. Ut.)

In November 1981, in Salt Lake City, Utah, Verland T. Whipple, Jack L. Hadley, and Charles DeZonia, who promoted and sold fraudulent movie tax shelters to more than 200 limited partners, were convicted on charges of aiding and assisting in the preparation of false partnership and investor returns, in violation of 26 U.S.C. 7206(2). In December 1981, Whipple, the main promoter, was sentenced to prison for three years, and the others were sentenced to fines and/or probation. The motion picture tax shelters, operated and sold as limited partnerships, were marketed in California and Utah from 1974 through 1980. A number of schemes were employed, including the fraudulent valuation of the motion pictures and the use of illusory transactions between sham entities in Andorra and the Cayman Islands, to create millions of dollars of fraudulent partnership expenditures and resultant fraudulent deductions for U.S. taxpayers. The scheme resulted in a $950,000 tax loss to the Government.

BOOK

United States v. Robert L. Moore, Jr. (D. Ct.)

On April 7, 1986, in New Haven, Connecticut, Robert L. Moore, Jr., entered a plea of guilty to a charge of conspiring to defraud the United States (Klein conspiracy) through the sale of literary tax shelters. The fraud involved approximately $37,000,000 in false deductions claimed on more than 1,000 individual income tax returns filed throughout the country.

Moore, the author under the pen name of "Robin Moore" of such best-selling books as The Green Berets, The French Connection, and The Happy Hooker, willfully conspired between 1976 and 1982 to defraud the United States through the marketing and selling of tax shelters involving paperback books whose values had been artificially inflated. Moore aided and assisted taxpayers who invested in these tax shelters to file false income tax returns, which claimed false depreciation deductions and tax credits. As a result of audits and court proceedings, approximately $37,000,000 in deductions based on Moore's literary tax shelters have been disallowed to date.

Moore had been responsible for obtaining and publishing a series of paperback books, which were then used as tax shelters for wealthy investors who sought to reduce their tax liabilities. Appraisals which grossly overvalued the royalty rights to each book were furnished to promoters and investors in the scheme. The author's royalty rights were then sold to taxpayer/investors for unrealistically inflated prices. The invester would then make a small downpayment by cash or check and sign a large promissory note with the understanding that the note would never be paid off or collected upon. The purchase price to the investors was based upon the fraudulently overvalued appraisals. The investors were thus able to claim false depreciation deductions and investment tax credits on their income tax returns, using as the basis for their deductions and credits the inflated purchase price, including the worthless notes.

Moore has not yet been sentenced.

U.S.T.P.S.

United States v. Robert Schwind and David Hill (N.D. Ga.)

In May of 1985, defendants Robert Schwind, former Chief Counsel, Comptroller of the Currency, Southeast Region, and David Hill, a tax attorney, agreed to plead guilty to charges of conspiracy to defraud the United States (18 U.S.C. 371) for their role in promoting tax shelter packages offered by the United States Tax Planning Service, Ltd. (USTPS). Defendant Schwind also pled guilty to aiding and assisting in the preparation of false tax returns (26 U.S.C. 7206(2)). The tax shelter packages involved the use of client-controlled foreign corporations and offshore bank accounts. The scheme also involved the establishment of client-controlled offshore trusts; the creation of commodity straddles with offshore foreign involvement; the creation of transactions appearing to be loans and/or other non-taxable sources of income from the Cayman Islands; the use of so-called churches for phony charitable contribution tax deductions; and the creation of fictitious liability insurance, particularly medical malpractice insurance, to permit tax deductions for apparently legitimate insurance premiums. Central to all of these schemes was a return to the investor of approximately 92 percent of the alleged deduction. The promoters retained an 8 percent fee for their services.

STATEMENT OF ANTHONY V. LANGONE, ACTING ASSISTANT COMMISSIONER (CRIMINAL INVESTIGATION), INTERNAL REVENUE SERVICE, WASHINGTON, DC

Senator GRASSLEY. Now Mr. Langone.

Mr. LANGONE. Thank you, Senator.

I appreciate the opportunity to appear before this subcommittee. I have submitted my statement for the record, and I will briefly summarize for you the key points contained therein.

The subcommittee has indicated an interest in IRS procedures for providing assistance to government attorneys in grand jury investigations, so I have attached a copy of those procedures to my statement.

I have also provided you with an overview of our investigative programs, with particular emphasis on investigations involving offshore banks and tax havens, which are utilized by many abusive tax shelter promoters to evade taxes.

Our completed investigations have indicated potentially billions of dollars in lost revenue.

Senator ARMSTRONG. Mr. Chairman, I don't want to interrupt Mr. Langone, but I wonder if we have these witnesses here under false pretenses. Basically, the statement which Mr. Olsen made was not in any sense responsive to the purpose of this series of hearings nor of the testimony presented Thursday and Friday. Mr. Langone is about to raise a number of policy issues, which though not unworthy, are basically unrelated to the matters before the committee at the present time.

I don't mind taking the time to hear this, but if we have failed to communicate what our interest is, I think we owe these witnesses an apology. My staff advises me that in arranging for the appearance of the Justice Department that she did make it clear the focus of our inquiry was not on, as Mr. Olsen characterized it, illegal and abusive tax shelters, but, in fact, illegal and abusive activities by Government employees, including lawyers, unethical conduct, improper motivation.

Senator GRASSLEY. It would probably be appropriate at this time then if you would ask them their understanding of the purpose of this. Because if that has been miscommunicated before this hearing, then, we can't pursue those points, and perhaps we ought to call the hearing at another time.

Senator ARMSTRONG. Well, I would be happy to proceed in any way you think appropriate.

Senator GRASSLEY. I think with the points that you just made here——

Senator ARMSTRONG. I have briefly reviewed the written testimony of Mr. Langone, and it appears to me while it is not a matter without interest to the Senate Finance Committee, it does not address itself to the particular concerns that motivated this hearing. And I would be glad to have them come back another time when they are prepared or I would be glad to ask some questions arising out of the testimony on Thursday or Friday or I would be glad to do whatever you say. But it is very clear that at least the first two witnesses are not, in their prepared remarks at least, really focusing on the issues that are before this committee. Nothing wrong

with it. If they want to go ahead, and then come back to the issues that are before the subcommittee, or if they feel there is a relevance here that isn't immediately apparent to me, I have no objection. But I just want to make the point.

Senator GRASSLEY. Well, regardless of your testimony, are you prepared to respond to the previous 2 days of hearings, the points that were brought up at those hearings? Are you prepared to respond to those?

Mr. OLSEN. I can answer that with respect to the Department of Justice. Because of the fact that both the *Kilpatrick* and the *OMNI* cases are still pending in court, the Department of Justice, as the staff of this subcommittee has been advised, that the Department of Justice is in a position where we are extremely constrained in terms of what, if anything, we can say about the facts relating to those cases. It is a longstanding Department of Justice policy. It is not one that is focused on the Tax Division. And the policy is that we don't comment on pending cases.

Senator ARMSTRONG. The straightforward way to proceed, it seems to me—I am not surprised by what Mr. Olsen has said. I am not sure, I think, however that is a great impediment to the purpose of this hearing. The facts of the *Kilpatrick* case with respect to anything that may be on appeal or so on are not the focus of this hearing; the focus is the conduct of Government prosecutors and IRS agents and the internal management and what legislation, if any, is needed to safeguard the rights of persons who have business, taxpayers and other citizens who have business before the Government. So it seems to me that that isn't a big problem, although I have got a fair list of questions and more occurring to me more or less moment by moment. And if Mr. Olsen can't answer me, he can't, and we will just have to go from there.

In any case, it wasn't my purpose to interrupt the testimony, but I am ready to go forward and either have Mr. Langone continue and then Mr. Rankin or to go to questions or whatever is your pleasure.

Senator GRASSLEY. All right. Proceed as you were then.

Mr. LANGONE. Just a few more moments, Senator. I will be happy to respond to any questions relating to IRS policy or procedure or investigative actions. However, as Mr. Olsen has said, we would be very limited with regard to any information specifically on either the *Kilpatrick* or the *OMNI* case.

Senator GRASSLEY. Well, let me clarify, too, that we are aware of that policy, and we do not intend to do anything at this hearing that would upset or impinge upon negatively any of those cases.

Senator ARMSTRONG. Nor, Mr. Chairman, if I may elaborate—nor do we intend that that policy on the part of IRS or Justice would prevent us from finding out what we need to know to make a reasonable evaluation of the performance of IRS and Justice, and to determine what legislation, if any, may be necessary to protect the rights of citizens.

I don't know whether or not any of you were present or had aides present on Thursday and Friday, but I made the point that I come to this hearing this morning with the assumption that Justice Department and the IRS is at least as willing, at least as eager, as the Senators are to protect the rights of citizens. Now a

lot of people have whispered, no, they are going to circle the wagons, and they are going to close ranks, and they are going to give a typical bureaucratic response, and I am going to assume until the facts show otherwise that that is not the case. That you see your duty the same as we see ours which is not only to enforce the law, but it is to protect the rights of citizens. And if you stonewall us, we are going to react accordingly. If you help us, we are going to react accordingly.

Is that a fair summation of where we are, Mr. Chairman?

Senator GRASSLEY. Very definitely.

Go ahead, Mr. Langone.

Mr. LANGONE. I am finished, Senator. I will be happy to answer any questions.

[The prepared written statement of Mr. Langone follows:]

Statement Of

Anthony V. Langone

Acting Assistant Commissioner (Criminal Investigation)

Internal Revenue Service

Before The

Subcommittee On Oversight Of The IRS

Senate Finance Committee

June 23, 1986

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to testify before your Subcommittee. Assistant Commissioner (Criminal Investigation) Wassenaar, as you may know, is still recovering from surgery, and has not yet returned to his duties. I am now the Acting Assistant Commissioner, but normally serve as the Deputy Assistant Commissioner (Criminal Investigation). Prior to this, I served as the Assistant District Director in the Jacksonville District and as the Assistant Regional Commissioner (Criminal Investigation) Southeast Region.

Although the Subcommittee has specifically expressed interest in two recent Federal District Court decisions, United States v. Kilpatrick (D. Colorado 1984), and United States v. Omni International Corporation (D. Md. 1986), I am limited on what I may discuss since these cases are either on appeal or pending appeal. I can, however, address the issue of IRS Criminal Investigation grand jury procedures, as well as other procedures of concern to the Subcommittee. IRS procedures are set forth in

detail in the Internal Revenue Manual (IRM), and I would be pleased to provide for the record the IRM provisions relating to any procedure(s) the Subcommittee requests. I have attached the IRM provisions describing our grand jury procedures.

In order to provide you with an overview, and to put our procedures in perspective, I will first discuss IRS Criminal Investigation programs. Second, the tax haven problem is discussed followed by a review of Criminal Investigation's efforts against abusive tax shelters. Finally, taking into consideration the foregoing, I focus upon IRS grand jury participation in relation to tax shelter investigations.

OVERVIEW

Criminal Investigation enforcement programs are directed toward achieving the highest possible degree of voluntary compliance with the Internal Revenue Code by enforcing the criminal statutes within our jurisdiction. Included in this responsibility is the investigation and prosecution of abusive tax shelter schemes. This is of particular importance because it assures the honest taxpaying citizens that we can combat the phony schemes promoted by those who want to take advantage of the public and the Government. Criminal Investigation work has been divided into two program areas, the General Enforcement Program (GEP) and the Special Enforcement Program (SEP). Enforcement of the Bank Secrecy Act can involve both GEP and SEP, depending on the nature of the subject.

General Enforcement Program (GEP). This program encompasses all criminal enforcement activities except for those cases in which the taxpayer derives substantial income from illegal sources. The identification and investigation of tax evasion cases with prosecution potential is a primary objective. The program also provides for balanced coverage as to types of violations, as well as geographic locations and economic and vocational status of violators as considered necessary to enhance voluntary compliance. Sixty percent of all criminal investigations initiated in the fiscal year ending September 30, 1985 were GEP.

During FY-85 there were 3607 cases initiated in GEP. These cases covered abusive tax shelters -- 326 (9%); illegal tax protesters -- 447 (12%); and the Questionable Refund Program -- 209 (6%). The balance of the cases -- 2625 (73%) -- was the result of referrals from the IRS Examination and Collection Divisions, other Government agencies, the public, and efforts of Criminal Investigation to identify flagrant areas of non-compliance.

Special Enforcement Program (SEP). This program encompasses the identification and investigation of that segment of the public who derive substantial income from illegal activities and violate the tax laws or other related statutes in contravention of the Internal Revenue laws. Of all criminal investigations initiated in fiscal year ending September 30, 1985, approximately 40% were SEP - (the other 60% GEP).

Comparison of activity within SEP based upon cases initiated in FY 85 (2458), is as follows: Narcotics - 1188 (50%); Strike Force - 308 (13%); Wagering - 73 (3%); all Others - 889 (34%). The "Other" category includes such cases as corruption in Government, commercial bribery and Bank Secrecy Act violations.

OFFSHORE BANKS AND TAX HAVENS

The offshore tax haven problem spans all of our criminal investigation programs. In both GEP and SEP, we are emphasizing investigations in which offshore banks, tax havens, and money laundering are part of the evasion scheme. Technological developments in the financial community have created a worldwide-instant access - financial network. This network offers the efficiency, security, and most of all privacy, cherished by individuals who engage in money laundering, tax evasion, and other financial crimes.

Criminals have learned how to make the maximum use of international banking services. Although the particular schemes are as varied and complex as human imagination, a common scheme involves a wire transfer of funds out of the United States followed by a Caribbean Island hopping tour from one haven bank to another in order to cover the trail leading back to the source. The final foreign destination is often a traditional European financial center from which the funds can be repatriated with an added appearance of legitimacy.

The enormous difficulty of unraveling the facts in these foreign transactions is complicated by legal issues of extraterritoriality and sovereign rights. Absent treaties, or other bilateral agreements, it is extremely difficult for the IRS to obtain the production of records from banks or other businesses located in financial secrecy jurisdictions. Conventional investigative tools, such as the summons or subpoena, are useless unless a U.S. Court can acquire personal jurisdiction over the foreign entity and enforce compliance. We have achieved success in those cases where the foreign company has a branch office in the United States, or where a United States entity's foreign branch is involved.

Congressional concern about the foreign tax haven problem was voiced by the Senate Subcommittee on Investigations, which, after a three year investigation, has called for sanctions against foreign tax havens who express no interest in treaty negotiations. See Hearing Before the Permanent Subcommittee on Investigations of the Senate Committee on Government Affairs, 98th Congress, 1st Session (1983). The subcommittees review culminated in a 180 page report entitled "Crime and Secrecy: The Use of Offshore Banks and Companies" and encompassed the full range of criminal activities from those commonly associated with drug trafficking and commodities fraud, to "the more unexpected use of offshore facilities by American tax protesters."

Sanctions recommended by the subcommittee were as follows: "a) The requirement that loans from the havens be reportable as income for Federal income tax purposes; b) the denial of any deduction for Federal income tax purposes for any expense or loss arising out of a transaction entered into, with, or by an entity located in the havens; c) the requirement that U.S. Corporations report income earned through the havens as U.S. source income; d) the requirement that U.S. domiciled banks report all transactions between the havens and the banks; and, e) the consideration of limitations on direct airline flights to and from the havens."

Congressional concern about international money laundering is also embodied in the recent money laundering legislation aimed at bolstering the Bank Secrecy Act. Bills have been introduced by Representatives Pickle and Schulze (H.R. 4573 on April 15, 1986), in the House, and Senator D'Amato in the Senate (S.2306 also on April 5 1986). Internal Revenue Service, Criminal Investigation, has testified at hearings in support of both of these bills.

ABUSIVE TAX SHELTERS

Almost 3 years ago to the day, (June 24, 1983), Acting Commissioner Philip E. Coates testified before this Committee on the subject of abusive tax shelters. I will not repeat the extensive historical overview of the tax shelter problem contained in Mr. Coates' testimony; however, his discussion of the definition of "Abusive Tax Shelter" bears repeating:

"It is difficult to define in a precise, academic manner an abusive tax shelter. Any definition would be unlikely to cover all of the possible structural alternatives which could be created by promoters of such shelters.

The Internal Revenue Code itself does not define an abusive tax shelter, although it should be noted that any tax shelter contemplated by the Code is by definition non-abusive, whatever its form or substance.***

The Internal Revenue Manual contains what we have found to be useful working definitions of abusive and non-abusive tax shelters. Those definitions make the following distinctions:

- Non-Abusive Tax Shelters - Involve transactions with legitimate economic reality, where the economic benefits outweigh the tax benefits. Such shelters seek to defer or minimize taxes.

- Abusive Tax Shelters - Involve transactions with little or no economic reality, inflated appraisals, unrealistic allocations, etc., where the claimed tax benefits are disproportionate to the economic benefits. Such shelters typically seek to evade taxes.

Our Manual's definition implies -- correctly, I believe that there is a broad spectrum of tax shelters. At the obvious extremes, there are the clearly abusive and clearly non-abusive shelters. Between these extremes, there is a gray area, where the basic nature of a tax shelter can only be determined by a factual analysis of its components. However, once all the facts are known, the determination of abusive vs. non-abusive is relatively easy to make. But getting those facts is often the most complicated part of the process; this is particularly troublesome in the case of certain of these schemes which invclve foreign jurisdictions."

Moving from Mr. Coates' past testimony, the Internal Revenue Service believes a large number of the abusive tax shelters being sold today are not really tax shelters in any traditional sense, but are frauds euphemistically referred to as tax shelters. Such

frauds are characterized by fictitious notes, false affidavits, inflated appraisals, rigged transactions, forged trading records and distorted accounting methods, as well as a number of other clearly illegal mechanisms. These are the types of schemes that IRS Criminal Investigation investigates and ultimately may recommend to the Department of Justice for prosecution.

Statistics available from 1980 forward reflect increasing progress by Criminal Investigation in the prosecution of individuals or other entities in promoting and facilitating abusive tax shelters. These statistics are summarized below:

	FY80*	FY81	FY82	FY83	FY84	FY85	FY86**	Total
Inv. Initiated	92	103	178	152	224	326	194	1269
Pros. Rec.	31	66	102	108	105	213	88	713
Indict./Inf.	7	39	40	44	49	92	71	342
Total Conv.	3	13	33	34	31	55	51	220

*Ending September 1980
**As of April 30, 1986

Prosecutions against the creators and facilitators of abusive tax shelters have involved many different occupational groups. However, in the fiscal year ending September 1985, more than 60% of our prosecution recommendations involved individuals in managerial occupations, or the legal and accounting professions.

The judiciary, recognizing the seriousness of abusive tax shelters, handed out prison sentences in 65% of the cases sentenced in FY 85 and 70% of the cases so far this fiscal year. Moreover, the average prison sentence in tax shelter cases has increased from 30 months in FY 85 to 45 months thus far in FY 86.

Four recent significant tax shelter schemes, on which the legal aspects have been completed are discussed below. (These cases are not on appeal or pending appeal):

(1) **Government Securities Fraud**

a. Scheme: sale of non-existent (fictitious) Treasury Bills and Notes. Ostensibly involved "hedged" or "straddled" trading to create losses. Customers provided the principals with a figure for the losses needed to offset legitimate gains. Leverage was 4 to 1 and there was an informal minimum buy-in policy of $100,000. (Leverage is the ratio of tax benefits to actual investment).

b. Scope: $190 million in false deductions.

c. Results (or status): all defendants were convicted at a six-week jury trial of conspiracy and aiding and assisting in the preparation of false returns. One principal was sentenced to 15 years in prison and another was sentenced to 2 years. Fines totaled $175,000. Others received prison sentences ranging from 4 years to 6 months.

(2) **Gold and Silver Trading Fraud**

a. Scheme: sham investments in non-existent partnerships alleged to have been engaged in gold and silver trading. Investor funds were routed through Liechtenstein, Cayman Islands and the Bahamas. Leverage was approximately 6 to 1.

b. Scope: $50 million in false deductions.

c. Results (or status): convicted at a jury trial of conspiracy and aiding and assisting in the preparation of false tax returns and sentenced to 62 years in prison, fined $67,000 and ordered to pay $30,000 in court costs. The Judge ordered the defendant not be considered for parole before he has served at least 20 years. Ten others had previously plead guilty and received various sentences.

(3) **Book Fraud**

a. Scheme: sale of overvalued book publishing rights. Leverage of 4 to 1.

b. Scope: $37 million in false deductions.

c. Results (or status): the principal plead guilty to conspiracy charges and sentencing has been set for July 1, 1986.

(4) **Art Fraud**

a. Scheme: sale of overvalued art lithographs. Bogus recourse notes, fabricated appraisals and backdated purchase contracts were used. Leverage 5 to 1. Secret letters were furnished to the investors stating that the recourse notes would not be enforced.

b. Scope: $20 million in false deductions.

c. Results (or status): the principal and four associates plead guilty to conspiracy and aiding and assisting in the preparation of false income tax returns. The principal received 18 months in prison and his associates received sentences ranging from 36 months in prison to probation. A number of related investigations are continuing.

Assisting Grand Juries in Tax Shelter Cases

Due to the increasing complexity and the unique considerations involved in investigating tax shelter operations, many of which include multi-regional conspiracies and millions of dollars in evaded taxes, Criminal Investigation has had to adopt more sophisticated methods of combating them, such as participating in grand jury investigations. It should be noted, however, that participation in grand juries in these cases is not routine and that the administrative process is the preferred alternative. Only 24% of Criminal Investigation's Tax Shelter cases are currently being investigated through means of the grand jury process. This percentage has been consistent for approximately the past 3 years.

The IRS guidelines for assisting grand juries are specific and require substantial involvement by high ranking Service officials as well as IRS and Department of Justice attorneys. Grand jury requests involving tax shelters require approval of the IRS District Director, the Regional Commissioner, IRS Regional Counsel, and the Director of the IRS Criminal Tax Division before the requests can be forwarded to the Department of Justice Tax Division.

For example: in significant cases, a grand jury investigation is considered to be necessary and appropriate if:

(1) the administrative process has been exhausted but it appears that the grand jury can develop the additional evidence needed to support prosecution;

(2) it is apparent that the administrative process cannot develop the relevant facts within a reasonable period of time; or

(3) coordination of the investigation with an ongoing grand jury investigation would be more efficient.

In the latter situation, the Service is usually requested by a United States Attorney to provide resources and assistance. Regardless of whether it is a Service generated proposal or a United States Attorney request, Service procedure provides for segregating all information obtained during the administrative process for subsequent civil use.

In summary, we have explained our enforcement programs relating to abusive tax shelters and related off-shore investigations, as well as grand jury procedures. It is hoped that this has assisted your understanding of the process.

That concludes my statement. I will be pleased to respond to your questions at this time.

ATTACHMENT

9266 *(9-17-80)*
Assisting United States Attorneys

(1) Special agents are authorized to assist the United States Attorney in preparing for indictment and/or trial and in conducting additional investigation of Title 26, U.S.C. and Title 18 U.S.C. (those committed in contravention of the internal revenue laws, see IRM 9213) cases which have originated in the Criminal Investigation Division and have been processed by Regional Counsel and the Tax Division of the Department of Justice, or which have been authorized for direct referral by the Chief to the United States Attorney. For the above Title 26 and Title 18 cases, a United States Attorney or Strike Force Attorney may request special agents to assist in an investigation by, or a presentation to, a Federal grand jury (see policy statement P-9-16).

(2) Request for information and assistance by a United States Attorney, except as provided for above, shall be handled in accordance with IRM 9267.1 and 9267.2.

(3) The duties, responsibilities and deportment of special agents when making appearances in court are set forth in 737.72 of IRM 9781, Handbook for Special Agents.

9267 *(11-16-78)*
Assisting Grand Juries

9267.1 *(12-10-84)*
General

(1) Federal Rule of Criminal Procedure 6(e), (hereafter cited as Rule 6(e)) governs the secrecy and disclosure of grand jury information. The Rule was amended by Congress (Public Law 95-78) with an effective date of October 1, 1977.

(2) Rule 6(e) as amended states in pertinent part:

"(e) Secrecy of Proceedings and Disclosure—

"(1) General Rule.—A grand juror, an interpreter, a stenographer, an operator of a recording device, a typist who transcribes recorded testimony, an attorney for the Government, or any person to whom disclosure is made under paragraph (2)(A)(ii) of this subdivision shall not disclose matters occurring before the grand jury, except as otherwise provided for in these rules. No obligation of secrecy may be imposed on any person except in accordance with this rule. A knowing violation of rule 6 may be punished as a contempt of court.

"(2) Exceptions.—

"(A) Disclosure otherwise prohibited by this rule of matters occurring before the grand jury, other than its deliberations and the vote of any grand juror, may be made to—

"(i) an attorney for the government for use in the performance of such attorney's duty; and

"(ii) such government personnel as are deemed necessary by an attorney for the government to assist an attorney for the government in the performance of such attorney's duty to enforce Federal criminal law.

"(B) Any person to whom matters are disclosed under subparagraph (A)(ii) of this paragraph shall not utilize that grand jury material for any purpose other than assisting the attorney for the government in the performance of such attorney's duty to enforce Federal criminal law. An attorney for the government shall promptly provide the district court, before which was impaneled the grand jury whose material has been so disclosed, with the names of the persons to whom such disclosure has been made.

"(C) Disclosure otherwise prohibited by this rule of matters occurring before the grand jury may also be made—

"(i) when so directed by a court preliminarily to or in connection with a judicial proceeding; or

"(ii) when permitted by a court at the request of the defendant, upon a showing that grounds may exist for a motion to dismiss the indictment because of matters occurring before the grand jury."

(3) Pursuant to Rule 6(e) as amended, disclosure of matters occurring before the grand jury may clearly be made to such Service personnel as are deemed necessary by an attorney for the Government to assist in the performance of such attorney's duty to enforce Federal criminal law. Service personnel to whom disclosure is made under this authority shall not disclose matters occurring before the grand jury to any and all others (including other Service personnel) except as deemed necessary by the attorney for the Government including attorneys in the Tax Division who have responsibility for the matters under investigation. Under the provisions of Rule 6(e), a knowing violation may be punished as a contempt of court.

(4) As under prior law, disclosure of matters occurring before the grand jury may also be made when so directed by a court preliminarily to or in connection with a judicial proceeding. Two Supreme Court decisions have severely restricted the obtaining of Rule 6(e) orders. In *United States v. Baggot*, 103 S.Ct. 3164 (1983) the Court held that IRS civil examinations are not preliminary to judicial proceedings within the meaning of Rule 6(e). In *United States v. Sells Engineering Co., Inc.*, 103 S.Ct. 3133 (1983), the Court held that the Government must establish "particularized need" to obtain an order even if the *Baggot* test is satisfied.

(5) A court order under Rule 6(e) is applied for by an "attorney for the Government." "Attorney for the Government" is defined by Rule 54(c) to include only "the Attorney General, an authorized assistant of the Attorney General, a United States Attorney, (and) an authorized assistant to a United States Attorney." When the terms "attorney for the Government" or "Government attorney" are used herein without further explanation, they refer to the attorney directly involved in the conduct of the Grand Jury proceeding. This does not include District or Regional Counsel and Chief Counsel Attorneys, but may include Strike Force Attorneys and Criminal and Tax Division Attorneys of the Department of Justice.

(6) Because of various problems associated with information developed by state grand juries, access to and use of information developed by a state grand jury depends upon the law of the particular state involved. Therefore, District Counsel should be consulted for legal advice prior to Service acceptance of such information.

(7) In general, for purposes of tax administration, the Service may disclose returns and return information to the Department of Justice on its own motion, if the case to which the information relates has been referred to the Department of Justice. If the case has not been referred by the Service, disclosure for tax administration purposes may be made only upon the proper written request of the Attorney General, the Deputy Attorney General, or an Assistant Attorney General. See 26 U.S.C. 6103(h)(3). In a Federal grand jury proceeding involving a matter of tax administration, if either of the above procedures were followed, the Service may disclose returns and return information to Department of Justice attorneys (including U.S. Attorneys) who are personally and directly engaged in, and solely for their use in, preparation for any such proceeding (or investigation which may result in such a proceeding), if one or more of the following conditions are satisfied: the taxpayer whose returns and return information are to be disclosed is or may be a party to the proceeding; the treatment of an item on the return is or may be related to the resolution of an issue in the proceeding or investigation; or the return or return information relates or may relate to a transactional relationship between a person who is or may be a party to the proceeding and the taxpayer which affects, or may affect, the resolution of an issue in the proceeding or investigation. See 26 U.S.C. 6103(h)(2). In this regard, any taxpayer under investigation by the grand jury is considered to be an individual who is or may be a party to the proceeding.

(8) Service personnel who assist an attorney for the Government do so as assistants to an attorney for the Government rather than as employees of the Service. (See IRM 9267.3 for detailed explanation.)

9267.2 (5-16-80)
Requests for Grand Jury Investigations

9267.21 (9-4-80)
General

(1) Investigations of particular cases or projects may be conducted by means of the administrative process, or by seeking a grand jury investigation. The administrative process is the preferred alternative and all investigations shall be by means of the administrative process unless, in the opinion of the approving officials, seeking a grand jury investigation is necessary and appropriate in the circumstances. A grand jury investigation is considered to be necessary and appropriate in the circumstances where:

(a) It is apparent that the administrative process cannot develop the relevant facts within a reasonable period of time, or

(b) Coordination of the tax investigation with an on-going grand jury investigation would be more efficient; *and*

(c) The case has significant deterrent potential.

(2) The Department of Justice's present position is that a referral of a person or entity for grand jury investigation should normally include the referral of all years subsequent to the particular years involved. When this is done, no action will be taken with respect to any subsequent years without prior approval of the Department of Justice. When under the particular facts and circumstances of a given case, it is deemed advisable to withhold referral of subsequent years, this should be specifically set forth in the referral. Such action may occur in cases involving large corporations and tax shelters with substantial civil tax considerations.

9267.22 (10-16-84)
Service Initiated Requests

(1) In those instances where the administrative process has been exhausted and prosecution cannot be recommended and it appears that a grand jury investigation may properly be utilized to develop information of violation within the investigative jurisdiction of the Service, the special agent must submit a documented report (including exhibits) to the Chief, Criminal Investigation Division. In situations where the investigation has been completed to the extent where prosecution will be recommended, but it is felt that a grand jury investigation would strengthen the case, the prosecution report will accompany the documented report, but in these situations the documented report should be limited to that information that is not contained in the prosecution report. The document report should contain the following information to the extent possible and appropriate.

(a) Identification of the criminal case or cases which is/are considered probable, inclusive of all tax returns at issue, identification of all specific taxpayers involved, identification of the contemplated offenses within the investigative jurisdiction of the Service, and all indications of wrongdoing which reflect such contemplated offenses.

(b) The progress of the investigation to date, inclusive of all investigative steps already taken, all evidence already developed, identification of all witnesses interviewed and the testimony of such witnesses, and the status of any administrative summonses issued but not complied with including any summons enforcement proceedings involving the taxpayer as well as a statement showing any civil action that is underway or contemplated on the subject, including years under examination and years before the Tax Court.

(c) The reason or reasons why seeking a grand jury investigation is believed to be necessary and appropriate in the circumstances. By way of illustration, and not by way of limitation, facts such as the following may indicate that the administrative process cannot develop the relevant facts within a reasonable time: lack of cooperation by important witnesses; efforts by the taxpayer to impede orderly investigation by intimidation of witnesses; destruction or threat of destruction of records or evidence; the secreting of evidence; and severe time limitations imposed by the statute of limitations.

(d) The potential deterrent effect of the anticipated case or cases on an area or areas of noncompliance, together with the reason or reasons for concluding the anticipated case or cases is/are sufficiently significant to tax administration to warrant transferring further investigative responsibility to a grand jury.

(e) Recommendations as to testimony and documentary evidence to be sought before the grand jury together with identification of the possible witness or witnesses from whom such testimonial and documentary evidence may be obtainable.

(f) Any other factor which in the judgment of the special agent bears upon the recommendation for grand jury investigation.

(2) The Special Agent's Report will be prepared for the concurrence of the Chief, Criminal Investigation Division, and the District Director. Prereferral advice should be sought from Regional Counsel prior to starting the report. If approved by the Chief, Criminal Investigation Division, and the District Director, the report will be referred to the Regional Commissioner for concurrence. If approved, this report will be forwarded to Regional Counsel. If approved, the report will be forwarded to the Tax Division, Department of Justice, for appropriate action. If Counsel does not agree with the Service recommendation for grand jury investigation, the matter may be referred by the Regional Commissioner to the Assistant Commissioner (Criminal Investigation), for further consideration and possible referral to the Director, Criminal Tax Division. If the matter is referred to the Director, Criminal Tax Division, and he/she agrees with the Regional Commissioner, then the Director, Criminal Tax Division, will forward the report to the Tax Division, Department of Justice, for appropriate action. If the Director, Criminal Tax Division, does not agree with the recommendation, his/her decision will be final.

(3) The request for grand jury investigation will be reviewed upon receipt within the following time frames:

(a) District Director 10 workdays
(b) Regional Commissioner 5 workdays
(c) Regional Counsel 20 workdays

(4) All efforts should be made to take action on these grand jury requests as early as possible to meet the time frames indicated. The Regional Commissioner may authorize the Assistant Regional Commissioner (Criminal Investigation) to take action on his/her behalf.

(5) In instances where the requested grand jury investigation is likely to result in an investigation of taxpayers in more than one region, or where the grand jury investigation is of alleged violations committed in a single region but one or more of the taxpayers resides in another region which will be responsible for the Taxpayer's civil liabilities, the Regional Commissioner of the key Region where the proposed investigation is to be conducted (if in concurrence) will forward the report directly to the other Regional Commissioner(s) affected. The latter Regional Commissioner will return the report with his/her concurrence or non-concurrence to the Regional Commissioner of the key region. If all Regional Commissioners concur, the report will be forwarded to Regional Counsel of the key region who (if in concurrence) will forward the report to the Tax Division, Department of Justice, for appropriate action. Should Regional Counsel not concur, the Regional Commissioner of the key region may refer the matter to the Assistant Commissioner (Compliance) who, if in agreement with the Regional Commissioner, will forward the report to the Director, Criminal

Tax Division. If the Director, Criminal Tax Division concurs, he/she will forward the report to the Tax Division, Department of Justice. In the event the Director, Criminal Tax Division does not agree with the recommendation, his/her decision will be final. If the Regional Commissioners do not agree on the merits of a grand jury investigation, the Regional Commissioner of the key region may refer the matter to the Assistant Commissioner (Criminal Investigation) who will make the decision. If approved by the Assistant Commissioner (Criminal Investigation), the report will be forwarded to the Director, Criminal Tax Division, for concurrence. If the Director, Criminal Tax Division, concurs, he/she will forward the report to the Tax Division, Department of Justice. In the event the Director, Criminal Tax Division, does not concur, the Assistant Commissioner (Criminal Investigation) may request further consideration by the Deputy Chief Counsel (General). If the matter is referred to the Deputy Chief Counsel (General) and he/she agrees with the Assistant Commissioner (Criminal Investigation), then the Deputy Chief Counsel (General) will forward the report to the Tax Division, Department of Justice, for appropriate action. If the Deputy Chief Counsel (General) does not agree with the recommendation, his/her decision will be final. Requests involving Tax Shelters, Limited Partnerships with out-of-region partners and Church/Mail Order Ministry/Vow of Poverty taxpayers are subject to procedures contained in IRM 9267.24.

(6) A request for a grand jury investigation which contains a prosecution report and which is not approved will be a declination by the office declining the case. In instances where a request for a grand jury investigation is not approved and does not contain a prosecution report, the case will be returned through channels and completed through Service processes. See A(1)(b) of Exhibit 400-1 of IRM 9570, Case Management and Time Reporting System Handbook, for the proper handling of Form 4930, Criminal Investigation Case/Project Report, in the above situations.

9267.23 (5-16-80)
Government Attorney Requests

The Government Attorney's request for assistance may involve information resulting from an ongoing grand jury investigating non-tax criminal matters or he/she may request that the Service participate in a proposed grand jury investigation of possible tax violations by a subject of a non-tax criminal investigation. If the Government Attorney alleges that the subject(s) of this non-tax investigation is an important figure in organized crime and/or narcotics trafficking and as such is believed to be earning substantial income from the illegal activities, this will be sufficient basis to authorize Service participation in the investigation, provided that the Government Attorney provides sufficient information indicating that the proposed subject is in fact an important figure in these activities; that the Service has reviewed the subjects' tax return and concluded that reported income is not commensurate with the allegation; and that the Service has concluded that resources are available within the allocation of SEP.

9267.231 (12-11-81)
Information Resulting from the Grand Jury Process

(1) Government attorneys may wish to disclose directly to Service personnel information from a grand jury investigating nontax criminal matters. Service personnel are authorized to review such information only with prior approval of the Chief, Criminal Investigation Division. In this instance the following procedures will be observed:

(a) The Chief, Criminal Investigation Division, or his/her delegate will first determine whether it is the Government attorney's desire to investigate by grand jury the possible commission of crimes within the investigative jurisdiction of the Service if the information so warrants. If not, Service employees may review the proffered information *only* if the Government attorney obtains a Rule 6(e) order releasing the information from the grand jury secrecy provisions and permitting its use for the tax administration purposes of the Service, both criminal and civil. Information governed by IRC 6103 will *not* be disclosed to the Government attorney.

(b) If the Government attorney desires to investigate by grand jury possible commission of crimes within Service jurisdiction, the Chief, Criminal Investigation Division, or his/her delegate may review and analyze the grand jury information as to its criminal tax potential. Any such review will take place in the Government attorney's office. The person(s) who reviews the grand jury information shall not disclose it to any person not authorized by the Government

attorney. Under no circumstances will documents, reports or other grand jury information, or copies thereof, be removed from the office of the Government attorney.

(c) Upon completion of such a review, the Chief, Criminal Investigation Division, will advise the Government attorney whether or not he/she believes that Service assistance to a grand jury is warranted in accordance with the standards set forth in IRM 9267.21:(1) or 9267.23. He/she will also advise the Government attorney that requests for Service participation in a grand jury investigation must be approved by the District Director, Regional Commissioner and Regional Counsel. The Chief, Criminal Investigation Division will advise the Government attorney that the request for Service assistance should be specific with regard to taxpayers, tax periods and type of tax. However, the Chief, Criminal Investigation Division, may not disclose any 6103 material.

(d) In the event the Chief, Criminal Investigation Division, believes that the grand jury information indicates a potential criminal tax offense(s) meritorious of investigation, the Chief will explain to the Government attorney that approval to commit Service resources may be sought by making a written request to the Chief, Criminal Investigation Division, which will be processed through service channels pursuant to IRM 9267.

(e) The Chief, Criminal Investigation Division, will secure in writing the Government attorney's authorization in accordance with Rule 6(e) to disclose the grand jury information to Service employees as described in IRM 9267, for the purpose of further evaluation and possible commitment of Service resources to a recommended grand jury investigation. The Government Attorney's written approval should specifically authorize disclosure to persons in accordance with IRM 9267 and should authorize such persons to make any additional disclosure he/she deems necessary to assist in the evaluation of the Request. Disclosure of grand jury information to members of such persons' staff should be made only when necessary to carry out the procedures in IRM 9267. Generally, disclosure of grand jury material outside of the district Criminal Investigation Division should be limited to the District Director, Regional Commissioner, Assistant Regional Commissioner (Criminal Investigation), Secretary for the Assistant Regional Commissioner (Criminal Investigation), Regional Counsel, Deputy Regional Counsel (Criminal Tax) and the Secretary for the Deputy Regional Counsel (Criminal Tax), and necessary clerical personnel. Once a grand jury request has been approved or disapproved by an appropriate Service or Counsel official, the names of all personnel to whom grand jury material was disclosed should be immediately supplied in writing to the Chief, Criminal Investigation Division, for transmittal to the Government attorney. These requirements apply to names of managerial, technical and secretarial personnel. Anyone to whom such disclosure is made shall be informed of the strict secrecy provisions of Rule 6(e).

(f) In the event the Chief, Criminal Investigation Division, or his/her delegate believes a grand jury investigation is warranted and the attorney for the Government requests that the Service initiate consideration of a recommendation for grand jury investigation, a summary of the grand jury facts will be prepared. This fact sheet should list each fact in numerical order to facilitate subsequent comparisons with returns and return information filed with or independently developed by the Service. No reference to any material derived from return and return information filed with or independently developed by the Service should be included in the summary. This summary of grand jury facts will be prepared in an original and three copies. Service employees will not make any other copies of the summary. Any page of a report or other documentation which contains informa-

tion governed by the grand jury secrecy provisions should indicate by rubber stamp in the top right corner the following: "CAUTION: THIS PAGE CONTAINS SECRET GRAND JURY INFORMATION."

(g) The Chief, Criminal Investigation Division, or his/her delegate will also prepare in numerical order a separate summary of pertinent returns and return information filed with or independently developed by the Service including copies of tax returns for all proposed years for all proposed subjects whose tax liabilities are at issue. This summary will be prepared in an original and three copies. This fact sheet, when compared to the grand jury fact sheet, will disclose the potential criminal tax violations within the investigative jurisdiction of the Service. These two summaries (fact sheets), numbered numerically by paragraph, will facilitate cross-referencing in the Chief's transmittal memorandum.

(h) The Chief, Criminal Investigation Division, will transmit to the District Director the original and two copies of the grand jury summary, the summary of return information and the letter from the Government attorney authorizing disclosure. The Chief should keep one copy of all the materials forwarded. If the District Director concurs, he/she will forward the completed package to the Regional Commissioner. If the Regional Commissioner concurs, the completed package will be forwarded to Regional Counsel. If in concurrence, Regional Counsel will keep one copy of the package and refer the original and one copy to the Tax Division of the Department of Justice. If the Regional Commissioner concurs with the request but Regional Counsel does not, the Regional Commissioner may follow the referral procedures in IRM 9267.22:(2) if he/she desires further consideration of the matter. Neither the District Director nor the Regional Commissioner will keep copies of the grand jury summary. If the request affects more than one region, see IRM 9267.22:(6) for instructions regarding the routing of the request. If the procedures in IRM 9267.22:(2) (relating to the Regional Commissioner forwarding the request to the National Office), IRM 9267.22:(5) or (6) are followed, the grand jury summary will be retained only by the Chief Counsel official referring the matter to the Tax Division of the Department of Justice.

(i) The transmittal from the Chief, Criminal Investigation Division, transmitting the material and all subsequent transmittals will include the names of all Service employees to whom any grand jury information has been disclosed. These names should coincide with the names of Service employees included in the Government attorney's written approval as well as those supplied to the Government attorney pursuant to IRM 9267.223:(1)(a).

(j) In the event the request for grand jury assistance is declined by any approving official, the original and *all* copies of the grand jury fact sheets will be returned to the Chief, Criminal Investigation Division, who *must* return the original and all copies to the Government attorney. If declined by the Department of Justice, the two copies in possession of the Service must be returned to the Government attorney. Absent authorization under IRC 6103, no information available to the Service from sources independent of the grand jury which constitutes return or return information may be disclosed to the Government attorney. Therefore, it is imperative that grand jury information be strictly segregated, including all discussions which would reveal grand jury information particulars, from all non-grand jury information to facilitate the return of the grand jury information without disclosing material derived from tax returns and tax return information filed with or independently developed by the Service. During discussions with the Government attorney regarding the Service's determination to decline to render grand jury assistance, care should be taken to avoid any reference to information acquired solely as a result of access to returns and return information in the possession of the Service.

(k) If the Government attorney is not satisfied with the Service's decision in IRM 9267.223 that the grand jury information, when compared to information contained in the Service's files, does not warrant the Service's assistance, he/she should be informed that such information governed by IRC 6103 may be disclosed only in accordance with a lawful request by the Assistant Attorney General, Tax Division, under the provision of IRC 6103(h)(3)(B) when made for tax administration purposes.

9267.232 *(5-16-80)*
Information Received From a Government Attorney Prior to a Grand Jury Investigation

(1) This section provides procedures to process grand jury requests from a Government Attorney that do not contain any grand jury information. In the event the request does contain grand jury information from another grand jury, procedures in IRM 9267.231 apply.

(2) The Government Attorney should be asked to submit a written request to the Chief, Criminal Investigation Division, including a statement that the information was not obtained by the grand jury process, the identity of the subject of the investigation, the identity of the law enforcement agency who will be (or is) investigating these offenses, the type(s) of non-tax charges involved, the years involved, the probable tax violations and the type of evidence available. The Government Attorney should be requested to furnish financial information and other information that may be relevant to the tax investigation, to the extent that this information has been developed during the non-tax criminal investigation.

(3) Upon completion of review, the Chief, Criminal Investigation Division will advise the Government Attorney whether or not he/she believes that there is a potential tax case involved.

(4) If the Chief, Criminal Investigation Division, believes that there is a potential tax case involved and the Government Attorney wishes to proceed by the grand jury process, he/she must obtain a Title 26 Grand Jury authorization. In these cases the Special Agent will submit a report to the Chief, Criminal Investigation Division, containing the following information to the extent possible and appropriate:

(a) Identification of all specific taxpayers involved.

(b) Identity of the law enforcement agency who is (or will be) investigating the non-tax criminal offenses.

(c) Identification of the non-tax criminal case or cases which is/are considered probable and the type of evidence available.

(d) Identification of the contemplated offenses within the investigative jurisdiction of the Service.

(e) All tax returns at issue.

(f) Financial information and other information that may be relevant to the tax investigation, to the extent that this information has been developed during the non-tax criminal investigation.

(g) The potential deterrent effect of the anticipated case.

(h) Any other factor which in the judgment of the Special Agent bears upon the recommendation for grand jury investigation.

(5) If the Government Attorney ultimately decide that he/she does not wish to investigate the potential tax case by the grand jury process, the Service may work the case by the administrative process. If during the administrative process, the Service determines that a Grand Jury should be recommended, the procedures in IRM 9267.22 should be followed.

(6) In those cases where an investigation is worked administratively in coordination with another agency, all disclosure provisions will remain in effect.

(7) The approving officials in this type of grand jury request will be the same as in IRM 9267.231.

9267.233 *(5-16-80)*
Processing Time for Government Attorney Requests

(1) The request for grand jury investigation will be reviewed upon receipt within the following time frames:

(a) Chief, CID 10 Workdays
(b) District Director 5 Workdays
(c) Regional Commissioner 5 Workdays
(d) Regional Counsel 10 Workdays

(2) All efforts should be made to take action on these requests as early as possible to meet the time frames indicated. The Regional Commissioner may authorize the Assistant Regional Commissioner (Criminal Investigation) to take action on his/her behalf. If for some reason the time frames cannot be met, the responsible reviewing official will promptly submit a status report direct to the Chief, CID (copies to previous approving officials) so that he/she can keep the Government Attorney apprised of why the request is being delayed. The Assistant Regional Commissioner (Criminal Investigation) will maintain a log of these grand jury requests so that the time frames can be monitored.

9267.24 *(12-10-84)*
Requests Involving Tax Shelters, Limited Partnerships with Out-of-Region Partners and Church/Mail Order Ministry/Vow of Poverty Taxpayers

(1) Grand jury requests involving taxpayers or promoters of tax shelters in the Tax Shelter Program; requests involving any limited partnership with out-of-region partners and requests involving church/mail order ministry/vow of poverty taxpayers, except for expansion requests, will be referred as follows: Chief, Criminal Investigation Division, District Director, Regional Commissioner(s), Director, Criminal Tax Division, and Tax Division, Department of Justice. For the above, if more than one region is involved and if the Regional Commissioners do not agree on the merits of the grand jury investigation, the matter will be referred to the Assistant Commissioner (Criminal Investigation) who, if in agreement, will forward the report to the Director, Criminal Tax Division, for his/her concurrence. In the event the Director, Criminal Tax Division declines the request, he/she will notify the Assistant Commissioner (Criminal Investigation) who may request further consideration by the Associate Chief Counsel (Litigation). If the matter is referred to the Associate Chief Counsel (Litigation) and he/she agrees with the Assistant Commissioner (Criminal Investigation), then the report will be forwarded to the Tax Division, Department of Justice, for appropriate action. If the Associate Chief Counsel (Litigation) does not agree with the recommendation, his/her decision is final. For these requests, the Chief, Criminal Investigation Division will prepare summaries as required in IRM 9267.

(2) Original referral and expansion requests concerning Tax Shelter Program cases should make note of any pending civil litigation involving the shelters known to be promoted by the referred individuals. Any pending referral for injunctive relief under I.R.C. 7408 or action for I.R.C. 6700 penalties should be discussed.

9267.25 *(12-10-84)*
Expansion Requests

(1) Once a grand jury request has been approved by Service and Justice officials, Service resources will only be utilized for the purpose described in the request.

(2) Grand jury expansion requests will be initiated only by the government attorney conducting the grand jury and are appropriate only for adding an additional subject(s), taxable period(s), or type(s) of tax to an ongoing grand jury authorized to investigate Title 26 matters. Where a request is received to expand an authorized existing grand jury investigation, the Chief, Criminal Investigation Division, will prepare a short report recommending that the additional subject(s) be included, together with information justifying the inclusion of the additional subject(s) along with copies of the tax returns involved. The Chief, Criminal Investigation Division should include in the request a statement that the government attorney has requested the expansion, and should specify the relationship to the initial approved grand jury target(s). It is not necessary to repeat background information that has been included in the onginal grand jury request. To expedite review, a copy of the original request and subsequent approval memorandums should be included as exhibits to the expansion request. The Chief, Criminal Investigation Division, will prepare a transmittal memorandum for the approval of the District Director. Upon approval, the District Director will forward the expansion request direct to the Deputy Regional Counsel (Criminal Tax). The District Director will advise the Regional Commissioner of the pending expansion request. Upon approval, the Deputy Regional Counsel (Criminal Tax) will forward the expansion request to Tax Division, Department of Justice, for approval. If an expansion request for a related taxpayer is necessary at the time evaluation assistance from District Counsel is requested because prosecution of that taxpayer has been recommended in the Special Agent's Report which recommends prosecutive action against referred subjects, the expansion request may be referred to District Counsel as a part of the evaluation assistance package. Upon approval, District Counsel will forward the expansion request as a part of the grand jury evaluation letter. See IRM 9267.25:(3) and (4) for expansion request procedures involving out-of-district and out-of-region taxpayers.

(3) When the expansion request involves a taxpayer(s) residing in another district within the region, the District Director in the (key) district where the investigation is to be conducted will (if in concurrence) request written authorization from the Government attorney for the affected District Director to assist in the evaluation of the request. Upon receipt of the authorization, the District Director will seek written concurrence on the expansion request from the affected District Director. The request for concurrence

will include a statement that the information provided is governed by the secrecy provisions of Rule 6(e). Upon receipt of the affected district's concurrence, the District Director of the key district will refer the expansion request direct to the Deputy Regional Counsel (Criminal Tax) who, if in agreement, will refer the matter to the Tax Division, Department of Justice, for approval. Should the affected District Director not agree, the matter will be referred to the Regional Commissioner who will make the decision.

(4) When the expansion request involves a taxpayer(s) residing in another region, the District Director in the (key) region where the investigation is to be conducted will (if in concurrence) request written authorization from the Government attorney for the District Director and Regional Commissioner in the affected region and the Assistant Commissioner (Criminal Investigation) to assist in the evaluation of the request. Upon receipt of the authorization, the District Director will seek written concurrence on the expansion request from the District Director in the affected region. The request for concurrence will include the statement that the information provided is governed by the secrecy provisions of Rule 6(e). Upon receipt of the affected district's concurrence, the District Director in the key region will forward the expansion request for subsequent approval in accordance with procedures in IRM 9267.25:(2) or (3). Should the affected District Director not agree with the expansion request, he/she will refer the matter to the Regional Commissioner. If the Regional Commissioner concurs in the expansion request, he/she will indicate concurrence and return the expansion request to the District Director in the key region for processing in accordance with the procedures in IRM 9267.25:(2) or (3). If the Regional Commissioner does not concur in the expansion request, he/she will notify the Regional Commissioner in the key region. If the Regional Commissioner in the key region agrees with the expansion request, he/she will forward the request with all concurrences and nonconcurrences to the Assistant Commissioner (Criminal Investigation) who will process the request in accordance with the procedures in IRM 9267.22:(6).

(5) In emergency situations, where immediate approval of an expansion request is necessary, Deputy Regional Counsel (Criminal Tax) may be asked to telephonically refer the request to the Department of Justice and the Department of Justice may be requested to telephone approval to the United States Attorney. The Deputy Regional Counsel (Criminal Tax) must have the written expansion request before this procedure is utilized.

9267.3 (12-10-84)
IRS Responsibilities and Procedures in Grand Jury Investigations

(1) After the Service has referred a case or cases for grand jury investigation in accordance with any of the procedures in IRM 9267.2, and upon the request by the attorney for the Government for assistance, the District Director and Chief, Criminal Investigation Division, will determine the Service personnel who will be assigned to assist the attorney for the Government. Prior to the time that any such personnel receive any grand jury information, there should be a written request made by the attorney for the Government specifically listing the names of each Service employee whose assistance is being requested. This list will include names of all managerial, investigative, and secretarial personnel who will necessarily have access to grand jury information. The list will include a Criminal Investigation group manager and the Chief, Criminal Investigation Division. The District Director will not be included on this list unless he/she and the attorney for the Government determine that it is essential for him/her to carry out his/her responsibilities regarding personnel who are assisting the attorney for the Government. If, during the course of a grand jury investigation, the attorney for the Government requests the assistance of additional Service employees or the assistance of Regional Counsel, and the Service and/or Regional Counsel agree to provide such assistance, the attorney for the Government should make a written request listing the names of such employees. No Service employees who are not specifically listed in the written requests of the attorney for the Government pursuant to this paragraph will have access to grand jury information. This means that those Service officials authorized disclosure in IRM 9267.2 are not authorized to have additional grand jury information once Service personnel start providing assistance, unless their names are listed in a written request of the attorney for the Government pursuant to this paragraph. In addition, see IRM 9267.5 with regard to those individuals who may review the report prepared at the conclusion of the grand jury investigation.

(2) For those grand jury requests as described in IRM 9267.231, 9267.232, and 9267.25, which are approved by Service and Justice officials, the Chief, Criminal Investigation Division, will forward to Regional Counsel each approved taxpayer's name and case number. The Chief, Criminal Investigation Division, will also advise Regional Counsel when the investigation of an approved grand jury case has been discontinued. This will permit Counsel to control these cases by using Criminal Investigation's case number.

(3) To prevent doubt about the ongins of information available for civil use, information in the possession of the Service prior to the receipt by Service personnel of any grand jury information must be identified by preparing a comprehensive record, with appropriate indexes and descriptions prior to the receipt of grand jury information. Thereafter, any related information obtained by the Service apart from grand jury information should similarly be recorded and its independent source specified. Should it become necessary to make a civil assessment or to solicit consents after the initiation of the grand jury investigation, only non grand jury information may be used.

(4) Service personnel who have received grand jury information that is subject to the secrecy provisions of Rule 6(e) shall, exclude themselves from involvement in non grand jury matters concerning the individuals, entities, and subject matter of the grand jury information. This provision applies to employees of the Service, including those at the highest management levels. The exclusion from any involvement applies to all activities including investigative and management functions. Service officials having primary responsibility for both civil and criminal tax matters such as District Directors and Regional Commissioners should maintain a confidential list of matters wherein they have had access to grand jury information and should exclude themselves from personal involvement concerning such matters in non grand jury civil and criminal cases. Responsibility for such non grand jury cases should be designated to subordinates. It s understood thut Chief Counsel's office will be issuing similar instructions. The Chief, Criminal Investigation Division, and Criminal Investigation Division group managers may not use secret grand jury information in directing a non grand jury investigation.

(5) Information disclosed to or developed by IRS personnel while assisting an attorney for the Government in connection with a grand jury will generally be considered to be grand jury information governed by the secrecy provisions of Rule 6(e). All grand jury information (including any copies, summaries, workpapers, etc.) is to be returned to the attorney for the Government when it is no longer needed for use in assisting the Government attorney in the investigation of the matter under consideration. If such information has become available to the Service independent of the grand jury by virtue of a public trial or other judicial proceedings or an order under Rule 6(e), the Service should then obtain the information from the public record or pursuant to a Rule 6(e) order.

(6) A Criminal Investigation group manager will be assigned to all grand jury approved investigations. See also IRM 9267.3:(1).

(7) Service employees assisting the attorney for the Government may not use the Summons (Form 2039) under any circumstances. In addition, Document Receipt (Form 2725) will not be used when securing documents pursuant to a grand jury subpoena.

(8) Service procedures relative to district conferences in IRM 9356 do not apply.

(9) Service procedures relative to giving subjects Miranda-type warnings in IRM 9384 do not apply. The attorney for the Government will provide necessary instructions concerning any required warnings.

(10) While acting as assistants to the attorney for the Government, Service personnel may use their official Service credentials for identification purposes only. When exhibiting their credentials, they must advise that they are acting as assistants to the attorney for the Government in conjunction with the grand jury.

(11) While acting as assistants to the attorney for the Government, neither special agents nor revenue agents may solicit or seek information for other than criminal purposes.

(12) Information to assist the attorney for the Government will usually be obtained by the agents assigned to the grand jury. However, if any information is to be obtained by a collateral request, the Criminal Investigation group manager assigned to assist the grand jury should first obtain a written approval of the Government attorney. The collateral request should clearly state that it is part of a grand jury investigation governed by the secrecy provisions of Rule 6(e). Any information supplied by the replying district which is governed by IRC 6103 may be disclosed only in accordance with IRM 9267.1:(7). Transmittal memorandums should be used in responding to a request and should include the names and titles of Service person-

nel who assisted in the reply and to whom grand jury information was disclosed. Upon receipt of the reply, a written list of such Service personnel will be given to the attorney for the Government. The attachments to the transmittal should include all copies of the requested information and the collateral request itself. No copies of the transmittal or attachments should be retained by the replying district.

(13) At the time the Criminal Investigation group manager learns that the grand jury has initiated a tax case on a person residing in another IRS district, the group manager should request written approval from the Government attorney to notify the Chief, Criminal Investigation Division in the district where the taxpayer resides. If information is also going to be requested on the taxpayer, then the request and notification of the grand jury investigation should be in the form of a collateral request and the procedures in IRM 9267.3:(12) should be followed. If information on the taxpayer is not needed, then the notifying Chief, Criminal Investigation Division should include in the memorandum that the information concerning the taxpayer is governed by the secrecy provisions of Rule 6(e). In either situation above, the notifying Chief, Criminal Investigation Division should indicate whether a TC 914 or TC 916 control has or will be initiated.

(14) Physical facilities should be utilized which provide adequate security for grand jury information. Materials should be kept in a separate work area inaccessible to other Service personnel not assisting the grand jury.

(15) No information documents, e.g., Form 3949 (Criminal Investigation Information Item), may be prepared which contain grand jury information, absent a Rule 6(e) order.

(16) Service personnel are directed to continue to observe Service guidelines regarding crimes that may be investigated by IRS agents, notwithstanding any greater authority of the grand jury. For example, Service personnel are authorized to investigate only violations of Title 26, Title 18 (in contravention of the Internal Revenue Code) and properly authorized Title 31 investigations.

(17) The Criminal Investigation Division may utilize TC 914 or TC 916 (IRM 9326) to establish control of the tax periods under investigation by the grand jury. However, this should be done only with the approval of the Government attorney.

(18) With regard to the use of monitoring and other investigative devices, the general instructions in IRM 9389.1 should be followed. With respect to IRM 9389.2, Consensual Monitoring of Telephone Conversations, if the Government attorney requests the monitoring of telephone conversations with the consent of one or all parties, Form 8041, Request for Authorization to Use Electronic Equipment and Consensual Monitoring, should be prepared in accordance with IRM 9389.2:(2) and should be approved by the Chief, Criminal Investigation Division. If he/she is not available, the Acting Chief or the District Director may approve the request provided he/she has been authorized to have grand jury material disclosed to him/her by the Government attorney. With regard to IRM 9389.2:(4), Form 6795, Consensual Monitoring Report, should be prepared for the Government attorney. In order that the Service may properly respond to any request from the Department of Justice relating to electronic surveillance, and to furnish required Department of Justice reports, the Chief, Criminal Investigation Division, should request a written disclosure authorization from the Government attorney for the Assistant Commissioner (CI), and his/her staff so that the Assistant Commissioner (CI) may be provided the information contained in Exhibit 9380-3 as it pertains to Grand Jury procedures. The Assistant Commissioner (CI), will notify the Chief, Criminal Investigation Division, of the names of staff members who will have access to the grand jury information for notification to the Government attorney. With respect to the procedures in IRM 9389.3, Consensual Monitoring of Non-Telephone Conversations, the Chief, Criminal Investigation Division, will forward the request directly to the Assistant Commissioner (CI), for his/her approval, with written authorization for disclosure to the Assistant Commissioner (CI) by the Government attorney. The Chief, Criminal Investigation Division, will advise the District Director and the Assistant Regional Commissioner (Criminal Investigation) that the Government attorney has requested approval to conduct consensual monitoring of non-telephone conversations, which he/she concurred with and that the request was forwarded directly to the Assistant Commissioner (CI). The report required by IRM 9389.3:(3) should be processed using the above procedures for consensual monitoring of telephone conversations. See IRM 9389.(10)3 regarding reports to be submitted in those instances where information pertaining to electronic surveillance conducted by another federal agency was received through the grand jury.

(19) Any information provided to the grand jury by an informant is grand jury information and cannot be included in Service files or disclosed to Service personnel not assisting the grand jury, even if the informant is also considered a "controlled informant" for the Service in accordance with IRM 9373. If a special agent, group manager, or Chief, Criminal Investigation Division, is requested by the Government attorney to direct the activities of the informant, that Service employee should follow the procedures in IRM 9373.3:(3) and 9373.3:(4). Any violations of instructions and law by informants should be reported immediately to the Government attorney. If the Government attorney requests that the Service make a payment to or on behalf of an informant, the Chief, Criminal Investigation Division, will request written disclosure authorization from the Government attorney for the Service official responsible for approving the request. See IRM 9372.2. The written request for authority to make confidential expenditures should be in accordance with IRM 9372.2:(8) and should state that the request is based on grand jury information and should not be disclosed to individuals not authorized by the Government attorney.

(20) With regard to the use of search warrants in grand jury cases, the government attorney will be responsible for obtaining approval consistent with Department of Justice policy. District Counsel will review requests for search warrants in grand jury cases when so requested by the government attorney. To the extent allowed by grand jury secrecy provisions, the Chief, CID will advise the District Director and the ARC(CI) that a government attorney has requested a search warrant.

(21) Regional Counsel's office will notify the Chief, Criminal Investigation Division when each grand jury case evaluation report (described in Paragraph 34C of Chief Counsel Order 3060.1A) has been forwarded to the Department of Justice. Such notification will include the grand jury subject(s) name and charges referred. This will permit the Criminal Investigation Division to effectively update case status on the Case Management and Time Reporting System (REPORT SYMBOL NO-9100-46 (formerly NO-CP CI-46))

(22) Requests for Special Agent foreign travel or for information to be requested through channels from a foreign country will be initiated at the written request of the U. S. Attorney, Assistant U. S. Attorney, or the appropriate DOJ Attorney. All requests should be made in accordance with IRM 9265.

9267.4 (12-10-84)
Responsibility for Control of Returns and Solicitation of Civil Consents

(1) Once a grand jury request has been approved by Service and Deparment of Justice officials, the District Director will notify the Chief, Examination Division (in streamlined districts, the Chief, Examination Section, or the group manager) that the taxpayer is under grand jury investigation and that civil action must either be suspended or not initiated on the subject taxpayer for the type of tax involved and all subsequent periods except as otherwise hereinafter provided.

(2) If the Examination function has an examination in process at the time a grand jury investigation starts, either as part of a joint investigation with the Criminal Investigation function or as an independent examination, the Examination function must suspend all examinations of the same taxpayer involving both the same type of tax and periods which the grand jury is investigating. All original tax returns and administrative files for periods under investigation by the grand jury which are in the control of the Examination function must be transferred to the Criminal Investigation function. However, the Examination function will be responsible for the civil statutes relative to the periods under investigation by the grand jury.

(3) In the event the returns for periods under investigation are in the control of Examination functions in more than one region or are in a region other than the one where the grand jury investigation is being conducted, the original returns must be transferred to the Criminal Investigation function of the District where the grand jury is empaneled. However, the Examination function(s) will be responsible for the civil statutes relative to the periods under investigation by the grand jury.

(4) In those cases where there has not been any involvement by Examination prior to the start of the grand jury's investigation and a Rule 6(e) order has not been obtained, the Criminal Investigation function will maintain control of the tax returns. This applies even if a revenue agent is assigned to provide technical assistance. In such cases, neither the Examination

function nor the Criminal Investigation function will be responsible for the civil statutes relative to those periods under investigation by the grand jury. Situations may occur where Examination, after the start of a grand jury investigation, receives information independent of the grand jury on the subject taxpayer. If Examination feels this information will result in a material civil assessment, the Chief, Examination Division (in streamlined districts, the Chief, Examination Section, or the group manager) will notify the Chief, Criminal Investigation Division (in streamlined districts the District Director) and secure a copy of the return from Criminal Investigation. Examination will provide Criminal Investigation with the specific details concerning the reason or dollar amount of the adjustment. The Examination function will then place the copy in suspense and be responsible for the civil statutes.

(5) The Examination function may proceed in examinations of the subject taxpayer of the grand jury only with respect to other types of tax or the same type of tax for other periods than those being investigated by the grand jury. For such examinations, the Examination function will maintain control of the original tax returns as well as having responsibility for the civil statutes. Prior to the initiation of a grand jury investigation, the Criminal Investigation function should inquire whether the Examination function has any civil action planned or pending concerning the particular taxpayer.

(6) In the absence of a Rule 6(e) order which permits civil use of grand jury evidence, the Examination function will not have access to or use grand jury information for civil purposes. Recent Supreme Court decisions have made the obtaining of such orders unlikely in these situations. See 9267.1:(4).

(7) If the Examination function is involved in a civil case that is also the subject of a grand jury investigation and makes a determination to solicit consents, issue a statutory notice, or make an assessment on the basis of non grand jury information, the Chief, Examination Division, (in streamlined districts, the Chief, Examination Section, or group manager) will make his/her recommendation to the District Director or, in the event that the District Director is excluded under IRM 9267.3:(3), to the Assistant District Director. In those instances where there is no Assistant District Director, the ultimate determination will be made by the Assistant Regional Commissioner (Examination) or someone designated by the Regional Commissioner who has had no access to grand jury information relating to the taxpayer. The person making the ultimate decision regarding whether or not to proceed with the civil aspects of a case will also be furnished with the opinion of the Chief, Criminal Investigation Division, (in streamlined districts, the District Director) as to whether to proceed with the civil action. The Chief, Criminal Investigation Division, (in streamlined districts, the District Director) will first discuss the matter with the Government attorney. If the Government attorney gives sufficient written reasons that civil action would jeopardize the criminal case and the Chief, Criminal Investigation Division, (in streamlined districts, the District Director) in accordance with policy statement P-4-84 believes that the criminal actions should take precedence over the civil aspects and that no civil action should be taken, this recommendation will be made. The Chief, Criminal Investigation Division, (in streamlined districts, the District Director) will not disclose any grand jury information which forms the basis for his/her determination. The District Director, Assistant District Director, Assistant Regional Commissioner (Examination), or someone designated by the Regional Commissioner will make the decision regarding the appropriate civil action. The determination of the District Director, Assistant District Director, Assistant Regional Commissioner (Examination) or someone designated by the Regional Commissioner in this instance will be final.

9267.5 (12-10-84)
Reports and Review of Matters Which Include Grand Jury Information

(1) A report, similar in content to a special agent's final report, should be prepared and addressed to the attorney for the Government upon the conclusion of the grand jury investigation is to be transmitted to designated Counsel attorneys; however, if the report does not recommend prosecution against any subject of the grand jury and the attorney for the government concurs in this evaluation, the report and any grand jury material will be transmitted to the United States Attorney or Department of Justice, as appropriate, without Counsel review. The special agent should notify Regional Counsel when a grand jury investigation has terminated without a prosecution recommendation.

STATEMENT OF JOHN M. RANKIN, ASSISTANT COMMISSIONER (INSPECTION), INTERNAL REVENUE SERVICE, WASHINGTON, DC

Senator GRASSLEY. Mr. Rankin.

Mr. RANKIN. Good morning, Mr. Chairman, Senator Armstrong. Just briefly, I will summarize my already brief statement that I submitted for the record. But I think it is important for the subcommittee to understand the function of the Inspection Service and the role that we play within the IRS. As the Assistant Commissioner, I am responsible for the program. And I think it is also important that you understand that we have two divisions within Inspection—the Internal Audit Division that conducts independent reviews and appraisals of IRS management and policy, and the Internal Security Division which conducts investigations affecting the integrity of the Internal Revenue Service.

In order to accomplish this mission and to do it in an independent manner, Inspection was organized within the Service back in the 1950's to provide for autonomous operations. I report directly to the Commissioner and to the Deputy Commissioner. Unlike other IRS Assistant Commissioners, I have direct line authority over the regional inspectors and the regional inspection people. They are not part of the IRS regional commissioner's offices, but instead report directly to me.

In addition, I also report directly to the Treasury inspector general's office, which has the overall integrity oversight responsibility for the Department of the Treasury.

Since the purpose of this hearing involves alleged misconduct, I will focus just for a moment on the types of investigations we conduct, how we evaluate allegations and the results of those investigations.

Internal security investigations include employee misconduct, and the information needed to conduct such investigations originates from many sources. It comes from inside as well as outside the Service and may be received by IRS employees, managers, or directly by internal security. We have specific procedures in the Internal Revenue Manual for handling employee misconduct investigations.

All reports of misconduct must be reported directly to Inspection, unless they are purely administrative in nature. Each complaint is properly and promptly evaluated, and a determination is made if an investigation should ensue. We have the responsibility to report allegations of misconduct by senior officials of IRS to the inspector general in the Department of the Treasury. All of the dispositions are approved by at least two levels of internal security management.

Once an investigation is initiated, then sufficient information is gathered to resolve the issue. If there is no basis for the allegation, the issue is closed. When the investigation reveals serious misconduct or a violation of Federal law, the report will be forwarded to IRS management for adjudication or, if it is warranted, to the U.S. attorney for prosecutive action.

We do refer Inspection internal security matters concerning criminal violations directly to the U.S. attorney's office. And they

then make a determination as to whether the case should be prosecuted or not.

One final note. In the last fiscal year, fiscal year 1985, Inspection conducted 582 investigations of employee misconduct. The administrative dispositions were such that 180 employees were exonerated, while various forms of disciplinary action were taken against 221 employees.

Also, in the last fiscal year, 120 current or former IRS employees were arrested or indicted as a result of Inspection investigations. Criminal dispositions in the last fiscal year resulted in the conviction of 84 employees and the acquittal of nine employees.

That concludes my statement. I will be glad to answer any questions that you may have that relate to Inspection's procedures or responsibilities.

[The prepared written statement of Mr. Rankin follows:]

STATEMENT OF

JOHN M. RANKIN

ASSISTANT COMMISSIONER (INSPECTION)

BEFORE THE

SENATE FINANCE OVERSIGHT SUBCOMMITTEE

JUNE 23, 1986

As the Assistant Commissioner (Inspection), Internal Revenue Service, I am the principal assistant to the Commissioner in planning and carrying out the Service's Inspection program.

To briefly describe my area of responsibility, Inspection consists of two divisions:

Internal Audit which conducts independent reviews and appraisals of all IRS activities; and

Internal Security which conducts investigations affecting the integrity of the Internal Revenue Service.

In order to effectively accomplish this mission, Inspection is organized within the Internal Revenue Service in a manner which provides for the necessary functional independence and autonomous operations.

I report directly to the Commissioner and Deputy Commissioner. Unlike other IRS Assistant Commissioners, I have direct line authority over Regional Inspection officials, who are not part of the IRS Regional Commissioner offices, and who report directly to me.

In addition, I also report directly to the Inspector General, Department of the Treasury, who has overall integrity oversight responsibility for the Department.

Since the purpose of this hearing concerns alleged misconduct, I will focus briefly on the types of investigations we conduct; how we evaluate allegations of employee misconduct; and how the results of these investigations are subsequently referred for criminal or administrative action.

INTERNAL SECURITY INVESTIGATIONS INCLUDE ALLEGATIONS OF IRS EMPLOYEE MISCONDUCT, AS WELL AS ATTEMPTS BY THOSE OUTSIDE THE SERVICE TO CORRUPT OR INTERFERE WITH THE ADMINISTRATION OF THE FEDERAL TAX SYSTEM. ALLEGATIONS CAN ORIGINATE FROM MANY SOURCES INSIDE AS WELL AS OUTSIDE THE SERVICE AND MAY BE RECEIVED BY IRS EMPLOYEES, MANAGERS, OR DIRECTLY BY INTERNAL SECURITY. SPECIFIC PROCEDURES ARE OUTLINED IN THE INTERNAL REVENUE MANUAL FOR HANDLING ALLEGED EMPLOYEE MISCONDUCT. ALL REPORTS OF MISCONDUCT MUST BE MADE PROMPTLY AND DIRECTLY TO INSPECTION, UNLESS THEY ARE PURELY ADMINISTRATIVE IN NATURE, IN WHICH CASE THEY ARE REPORTED TO IRS MANAGEMENT.

EACH COMPLAINT, WHETHER FROM A TAXPAYER OR EMPLOYEE, RECEIVED BY INTERNAL SECURITY IS PROMPTLY EVALUATED TO DETERMINE IF AN INVESTIGATION IS WARRANTED. DECISIONS REGARDING DISPOSITION OF INFORMATION RECEIVED ARE APPROVED BY AT LEAST TWO LEVELS OF INTERNAL SECURITY MANAGEMENT. INTERNAL SECURITY ALSO HAS THE RESPONSIBILITY TO REPORT ALLEGATIONS OF MISCONDUCT BY SENIOR OFFICIALS OF IRS TO THE INSPECTOR GENERAL, DEPARTMENT OF TREASURY.

ONCE AN INVESTIGATION IS INITIATED, SUFFICIENT INVESTIGATION WILL BE CONDUCTED TO RESOLVE THE ISSUES. IF THE INVESTIGATION SHOWS THERE IS NO BAS'S FOR THE ALLEGATION, THE INVESTIGATION WILL BE CLOSED. WHEN THE INVESTIGATION DISCLOSES SPECIFIC MISCONDUCT AND/OR A VIOLATION OF FEDERAL LAW, THE REPORT WILL BE FORWARDED TO IRS MANAGEMENT FOR ADJUDICATION OR IF WARRANTED, TO THE UNITED STATES ATTORNEY FOR PROSECUTIVE ACTION.

IRS Policy Statement (10)-43 provides for Inspection's direct referral of criminal violations to the United States Attorney for prosecution. Generally, all cases in which the investigation has indicated that a Federal law may have been violated are referred to the U.S. Attorney. However, in the interest of eliminating unnecessary referrals involving violations of a type and degree that specific U.S. Attorney's Offices have indicated will not be prosecuted, Regional Inspection Offices and U.S. Attorneys have developed guidelines to deal with these matters. An example of such an offense is a false statement on a Government employement application, which in the absence of any aggravating circumstances, will not be presented for prosecutive action and will be referred for administrative adjudication.

In FY 1985, Inspection conducted 582 investigations of alleged employee misconduct. Administrative dispositions in FY-85 resulted in the exoneration of 108 employees, and various forms of disciplinary action were taken against 221 employees.

Also in FY-85, 120 current or former IRS employees were arrested or indicted as a result of Inspection investigations. Criminal dispositions in FY-85 resulted in the conviction of 34 employees and the acquittal of 9 employees.

Senator GRASSLEY. What is the IRS policy with regard to permitting its agents to serve as grand jury agents investigating tax violations?

Mr. LANGONE. Senator, our policy is to cooperate with the Department of Justice in any inquiry that either may be generated by IRS or in some instances where the Department of Justice or the U.S. attorney's office request our assistance on a grand jury investigation.

In instances where the Internal Revenue Service has investigated a situation and certain criteria are met and after a rather extensive review and approval process, we do make requests that certain cases be investigated via the grand jury process. In those instances, our agents do cooperate with the local U.S. attorney's office. They are completely segregated from the usual administrative process. They participate in the investigation jointly with, generally, the assistant U.S. attorney. All information is segregated and maintained separately. And the information obtained from the grand jury is maintained in that secret atmosphere.

Upon the completion of a joint grand jury investigation, the special agents who participate with the assistant U.S. attorneys write a report and send that to the U.S. attorney involved indicating a view of the information and the evidence obtained and whether or not they feel that criminal prosecution is justified. They then proceed further and participate in any trial that might occur from any indictment that is brought.

Senator GRASSLEY. Are they sworn in as grand jury agents?

Mr. LANGONE. Generally not, Senator. They operate independently. They are managed by IRS managers. And they assist the U.S. attorney, but it is not routine practice or necessary to have them sworn in as grand jury agents.

Senator GRASSLEY. Well, are they sometimes sworn in as grand jury agents?

Mr. LANGONE. There may have been occasions in the past when they were. But I don't know of any recent instances where they were sworn in as grand jury agents.

Senator GRASSLEY. So the policy of the Department is that that would be a determination made at the time as to whether or not they are sworn in as a grand jury agent, right?

Mr. LANGONE. Not as I understand it, Senator. I believe that the law makes it appropriate for the U.S. attorney to disclose certain information to Government officials who can assist them in their inquiry. And, consequently, there is no need to be sworn in as grand jury agents.

Senator GRASSLEY. All right. Is there any recognition of conflict of interest if they are sworn in as grand jury agents?

Mr. LANGONE. Senator, I don't believe there is any conflict of interest because there are no instances that I am aware of recently where they have been sworn in as grand jury agents.

Senator GRASSLEY. All right. Where they have been sworn in as grand jury agents, is there any concern that there is a conflict of interest?

Mr. LANGONE. We are always concerned about maintaining a separateness between the administrative process and the grand jury process. And if there was an instance or if in the past there

was an instance where they were sworn in as grand jury agents, then they would be totally segregated from IRS, and they would be directly reporting to, and in fact, working for, the Department of Justice or the U.S. attorney.

Senator GRASSLEY. We had a judge make a comment that he wasn't aware that this was done anywhere else. And he cited it as an abuse that should not have happened. How do you respond to that harsh criticism?

Mr. LANGONE. I am not aware of the specific instance he is talking about.

Senator GRASSLEY. All right. This is Judge Winner testifying in the *Kilpatrick* case in his testimony before us here on the *Kilpatrick* case.

Mr. LANGONE. Senator, again, I don't think that I should respond or react to any question with regard to the *Kilpatrick* case since it is a pending case on appeal. I don't believe I should make any statements with regard to that particular case.

Senator ARMSTRONG. Mr. Chairman, if you are getting ready to leave at this point, there are a couple of issues we ought to pin down.

Senator GRASSLEY. Yes.

Senator ARMSTRONG. It is not clear to me.

Senator GRASSLEY. And let me also say——

Senator ARMSTRONG. If you are going to continue this line of questioning, please do.

Senator GRASSLEY. I do want to defer to you. The only thing is I did want to make clear that I didn't address it just to Mr. Langone, although he is the one that is most appropriate to respond. But I don't want to preclude anybody else from responding as well. Would you like to respond?

Mr. OLSEN. Senator, I would be happy to. There were three or four questions that came up. One was about the question of the agents of the grand jury; two, the question of swearing in agents to the grand jury; and, three, whether or not we perceive any conflict of interest. I would like to address those.

In the *Lowell Anderson* case decided by the Tenth Circuit, which is the law that applies in the Tenth Circuit, the Tenth Circuit specifically held that it was perfectly appropriate to use agents of the grand jury. That is the law—778 Fed. 2d at 602. The discussion on page 605. And I would be more than happy to have a copy of that opinion made a part of the record.

[Information not available at press time.]

Mr. OLSEN. The Department of Justice utilizes agents of the grand jury in virtually every grand jury investigation. It is not confined to the IRS. We use it with the FBI, with DEA, with Customs, and all the Federal law enforcement agencies. It is done particularly effectively by the President's drug task force, which operates across the country utilizing agencies that cut across all subject matter barriers and to address the unique problems that come up in the drug area.

In my experience when I was a Deputy Assistant Attorney General in the Criminal Division, we used it extensively with the FBI when we were trying to address problems having to do with procurement fraud.

Senator ARMSTRONG. Was that really the question that Judge Winner was addressing, Mr. Olsen? I thought the point that Judge Winner was making was not that it was per se improper to have agents of the grand jury. Clearly not. But that it was improper for somebody who, in effect, was a part of the prosecution team to be an agent of the grand jury.

Mr. OLSEN. Well, the Tenth Circuit addressed that, Senator.

Senator ARMSTRONG. And that's the issue addressed therein?

Mr. OLSEN. Well, I believe it is. I don't know what Judge Winner addressed when he was here, but I was addressing the question that was asked by Senator Grassley.

Senator ARMSTRONG. There is no doubt in my mind that Judge Winner thought it was 100-percent wrong. In fact, I think he characterized it in his opinion as a subversion of the grand jury process, and, in fact, just to put it in perspective, he hit the ceiling over it. That might not make him right. That is just how he felt about it. He made a pretty persuasive case that in any event that it seriously prejudices the grand jury process. And that is not to say it may not be perfectly legal. One of the things we are looking at here is what changes, if any, may be necessary. But it is your position that it is perfectly legal to have an IRS agent or a Justice Department agent sworn in as an agent of the grand jury.

Mr. OLSEN. There are two questions there, Senator, that you raised. The grand jury is an investigative body, and it is conducting an investigation. What better way to make it effective than to use specially trained Federal law enforcement investigative agents to assist the grand jury in a purpose? When we talk about who is conducting an investigation, it is always clear that while the supervision of what happens with the development of the investigation is done on a joint effort, it is the grand jury that is the constitutionally empowered body that makes the decision on who is or will not be prosecuted or indicted rather than prosecuted.

On the question of swearing in, there I think you have to appreciate what it is they are being sworn in to do. As I reflected on the idea of swearing in a witness, an agent to become an agent of the grand jury, my perception was slightly different than perhaps Judge Winner or Judge Kane. My perception was that, if anything, the prosecutor should have been applauded because what he was doing was reinforcing with that agent the fact that when that agent was conducting whatever investigative work he or she had to do, they were doing it on behalf of the grand jury; not on behalf of the IRS. And that whatever was going to be done, was going to be done with that in mind. And that, therefore, with regard to the rules of secrecy, rule 6(e) of the Federal Rules of Criminal Procedure, that would be reinforced. And that the agent could not later say, gee, I didn't know that I had to maintain the secrecy even though it is in the manual, even though it is here and the supervisors tell me.

When you stand up before a grand jury and raise your hand and be sworn in as an agent of the grand jury, while there may be some legitimate criticism as to whether or not that is a necessary practice, if anything, I would think that it would only reinforce the purposes of maintaining secrecy; that the agent would, if anything,

maintain a higher level of confidence in the secrecy of the proceeding of the grand jury.

On the question of whether there is a conflict of interest, I don't perceive any. But quite honestly, I hadn't heard the question raised that way before either. But I can't think of how there would be a conflict of interest.

Senator ARMSTRONG. You ought to go back and read what Judge Winner said Thursday. He has a pretty vivid idea of how that might be a conflict of interest and was very outspoken about it Thursday and also in his opinion in the *Kilpatrick* case.

Mr. OLSEN. But if the objective of any investigator, of any employee in the government in law enforcement, is to see that justice is served and the grand jury's function is to only see that those people who are prosecuted are those for whom they have established sufficient probable cause to believe that a crime has been committed, I don't see how the agents could be put in a position of conflict.

Senator GRASSLEY. Senator Armstrong, do you want to change the line of questioning?

Senator ARMSTRONG. No; we have gotten to it, Mr. Chairman. That was exactly the point. And what I was going to ask Mr. Langone and what we have elicited from him and Mr. Olsen is that it is their opinion that in all or at least some circumstances it is proper for an IRS agent who is working on the case or a Justice Department person who is working on a case to be sworn as an agent of the grand jury. That is one of the activities that is cited as a flagrant abuse by Judge Winner. And so I think we have elicited what we want to know. It is a difference of opinion. And then it is up to us to determine whether or not we want to do anything about it or whether we want to leave it alone.

Mr. OLSEN. By way of clarification, Senator, I don't think that I said or that any of the witnesses said—and I am not sure the issue ever came up—that agents of the grand jury applied to anyone other than investigative agents. It did not include Department of Justice lawyers. Is that not correct?

Senator ARMSTRONG. I think in the *Kilpatrick* case that is correct. Well, no, it really isn't. I believe Judge Winner made two points. That he was concerned—in fact, I think it is fair to say outraged, although that is not his word—by the swearing of the IRS agents because it conveyed an impression to the grand jurors of impartiality, that here is somebody who is here for the purposes of the grand jury to weigh this thing and to determine whether or not there is probable cause, as you put it so well a moment ago, when, in fact, that really isn't their real motive or it may not be in the opinion of Judge Winner.

The second concern he raised is when in some cases people were sworn, not as agents, but simply sworn in their testimony before the grand jury, I guess, who were serving as legal counsel to some defendant, creating a different kind of a problem, but at least on the surface a fairly serious one. If you are sworn to secrecy about such matters, he felt it might compromise your ability to act as legal counsel for somebody. That is a little different issue, but he raised it in the same testimony.

Senator GRASSLEY. I would like to bring up the issue now of pocket immunity. This was also discussed in the 2 days of prior testimony. And from that testimony, I understand there is no statutory basis for it but the courts have upheld its use. It has also been charged that Department prosecutors routinely ignore the Department's procedure for the use of pocket immunity and abuses are widespread.

So what exactly are the required procedures, and are they always followed? Does a grant of pocket immunity amount to a contract not to prosecute? And is the agreement enforceable on both sides?

Mr. OLSEN. Is the question to me, Senator?

Senator GRASSLEY. Yes.

Mr. OLSEN. Let me start by saying that with respect to statutory immunity I think the record is pretty clear in terms of what the procedures are in the Department of Justice, whether it applies to the Tax Division or any other division. Depending on what the subject matter is of the investigation, that will direct the appropriate request for immunity to an Assistant Attorney General of either the Tax Division, Antitrust Division or Criminal Division. So if it is an antitrust investigation, it will come up to the Assistant Attorney General of the Antitrust Division. All title 26 matters will come up to my attention.

And I would simply ask that the Department of Justice manual, U.S. Attorney Manual, provisions be made a part of the record to demonstrate what that process looks like; if that is the model from which we are going to then compare to some other practice that does not conform strictly to that.

Because I think that the criticism that flows from Judge Kane and from Judge Winner is that—is simply stated this way: That the immunity that is provided statutorily by Congress is the exclusive method by which prosecutors are to use immunity for witnesses to testify.

I don't wish to repeat myself, but the same district court decision in Lowell Anderson that was reversed by the tenth circuit also addressed informal immunity. And at page 606 of that opinion, that 778 Federal reporter, page 606, the court states, and I quote: "The fourth, and last, area of prosecutorial misconduct perceived by the district court concern the government's use of 'informal immunity,' " with a footnote. "Apparently government agents would grant a potential witness, either by a letter or verbally, immunity from any prosecution which would be based on his testimony before the grand jury. Such in the eyes of the district court was a 'damnable practice' which tended to breach the integrity of the grand jury system and violated the fifth amendment rights of the witness. "We are unable to agree. The propriety of using informal immunity has been frequently upheld," citing a list of cases that has been of that opinion. "Furthermore, the defendants have not shown how the use of informal immunity in the present context biased the grand jury."

I submit that at least in terms of the law we are not talking about an area of abuse; that that is to be distinguished from what may be an area of legislative reform. There may be a distinction there. I submit that there well could be. But where reasonable men

differ, it certainly is not an abuse and certainly not a damnable practice.

In any event, on the question of something short of a decision not to prosecute, I think that the answer is that the——

Senator GRASSLEY. Don't lose your train of thought, but just think in terms of whether or not you are addressing informal immunity as opposed to statutory immunity.

Mr. OLSEN. I am.

Senator GRASSLEY. All right, proceed.

Mr. OLSEN. Prosecutors make a decision every day on who is to be prosecuted. When they make the decision of who is to be prosecuted, they may decline prosecution of some people. Those people may become——

Senator ARMSTRONG. Would you say that again? I didn't quite hear that.

Mr. OLSEN. They may decline to prosecute certain individuals.

Senator ARMSTRONG. Fine.

Mr. OLSEN. The evidence is not there. It is not warranted. That is an area that I submit is probably covered by the separation of powers, which is who is to decide who is to be prosecuted. I doubt that constitutionally, it would be provident to try to include the courts in that process because I think that the old argument you are going to be judge and jury at the same time is one that focuses on that type of a problem.

It is frequently used as a matter of practice where we do not use the statutory immunity provisions. There are a number of reasons for that. One is that the attorney for the witness or the witnesses themselves may say I want to cooperate, but I just want to be sure that what I say can't be used against me. It is just an ounce of common sense.

A sophisticated lawyer will say I don't need to have statutory immunity for my client; you don't have to go all the way back to Washington, DC. Washington, DC does not have the only lawyers in the country with common sense. Some people may think we probably don't have much back here at all. But I dare say that the prosecutors that are in your respective States have the same kind of good judgment about whether or not someone ought to be prosecuted.

Now what frequently happens is that the U.S. attorney or an assistant with the approval of the U.S. attorney or division lawyer will sign a letter. The letter will say: "If you testify, what you say will not be used against you."

If you ask most defense attorneys, I think you will get the answer that if you can't trust the prosecutor by his word then you can't deal with them at all. And the reason I think that there is a practice is because those prosecutors are taken for their word.

Many times in reviewing what happens on cases, I think we do find that it isn't a perfect system. We are dealing with human beings whose judgment we may, with hindsight, reflect on and conclude that that was not a good judgment. Government doesn't renege on the benefit of the bargain. That is not the way the administration and justice in this country can operate. The public and the Government have to lose on those issues. And it has to be that way because the prosecutors in our country have to at all

times maintain the highest standards of propriety and fairness. It is not just whether we are doing it according to the rules, but whether or not when we stand up in open court, public court, whether what we are doing generates the appearance that it is fair.

So it is a practice that is frequently used not just by the Tax Division but be all components of the Department of Justice.

Thank you, Senator.

Senator GRASSLEY. If the Government would renege on a promise in one of these agreements, is there any way that the Government can be held accountable?

Mr. OLSEN. Well, I am not sure I can answer that question. I haven't seen it come up.

Senator GRASSLEY. Isn't the fact that——

Mr. OLSEN. If a witness is immunized, then under the departmental guidelines in order for that witness to be prosecuted, in other words, for us to renege, the Attorney General of the United States has to approve that prosecution.

Senator GRASSLEY. Are the guidelines always followed?

Mr. OLSEN. Well, if they are not, I would think that any judge or that any defense attorney or any defendant would certainly make it known. I can't imagine a situation where it would not come up, Senator, because it would be so unusual that something like this would come up. I have had situations come up where the benefit of the bargain for the Government was certainly not as good as we wanted it to be and that a U.S. attorney mistakenly assumed that they had authority to sign a plea agreement under title 26. It did not meet the standards that we use on a major count, for example.

We have to agree to those because the prosecutor has to be able to go into court and it is his word. That is all we have. That is how the system works.

Senator GRASSLEY. Before I go on to another point, do you have a question, Senator Armstrong?

Senator ARMSTRONG. Well, I have several general questions about pocket immunity. How extensive is this? Is this something that happens all the time? Thousands of times? Hundreds of times? Dozens of times? Once a year? Once a week?

Mr. OLSEN. The answer is that I don't believe the Department maintains statistics on this area. I would have to go back and check. There is a publication put out by the U.S. attorneys—it is U.S. Attorneys Publication that comes out annually that has 100 pages of different statistics that are gathered by the Department. I don't think that that is included in there. I don't think that that is a——

Senator ARMSTRONG. Should it be?

Mr. OLSEN. But the answer, I think, to be directly responsive is that I think it is substantial. To put a numerical count on it, I am not sure because——

Senator ARMSTRONG. For those of us who don't know anything about this—and I am speaking for myself and not Senator Grassley—but when you say it is substantial, does that mean it is used in one case out of ten? If we had 100 prosecutions of cases of this kind, would it be used in 10 percent of the cases or 20 percent or 50 percent?

Mr. OLSEN. Where you have multiple target cases, that is to say a number of people that are under investigation, you are targeting them for prosecution, then you are going to find that is more likely to come up. If it is a drug case, for example, it is rare that you can find someone that can explain why they had any relationship at all with a drug dealer. I mean what was it that they were doing.

When you get into the tax shelter area, the focus either is on the investors that have invested in it, and they may take the fifth and not want to provide any cooperation at all, or they may be lower level individuals in the promotion scheme. That is to say they may be salesmen, they may be the engineers, they may be the attorneys that provided the opinion, they could be the accountants that did the numbers put onto the prospectus. So the answer that you are going to get is that you are going to find that as you get into certain kinds of cases that the likelihood is much greater that you are going to be giving someone immunity. That is how you crack the conspiracy ring. And the object in all those cases is to make sure you immunize the guppie and not the whale.

Senator ARMSTRONG. I believe it was David W. Russell who is the president of the National Association of Criminal Defense Lawyers that suggested that such statistics ought to be compiled. Would you agree with that? I am not certain it was his testimony that suggested that. It was either Mr. Russell or William C. Waller. But in any case, one of the suggestions that we received last week is that this is a widespread practice and that Congress ought to know exactly how widespread it is.

Mr. OLSEN. Well, my boss might not like me recommending that we create another paper obligation.

Senator ARMSTRONG. Do you want to pass on that for now?

Mr. OLSEN. Let me just say as a general rule it seems to me that, if anything it is healthy to the administration of justice to have statistics on what the Government is doing in some substantial area. I mean the case law, I think, defends our activity because it is so widespread. Not because it is a unique matter, but because most of these judges have been either former prosecutors or defense attorneys. They are familiar with it. They are comfortable with it which suggests that it is not something that we are doing on an extremely isolated basis.

Senator ARMSTRONG. Mr. Waller, in his testimony last week, pointed out to the committee that U.S. attorneys "routinely" ignored the Department of Justice manual with respect to pocket immunity. What do you think?

Senator GRASSLEY. That would be similar to the second part of the first question I asked. So I would be interested in that as well.

Mr. OLSEN. I beg to differ with them. If anything, I have found that U.S. attorneys break their backs to comply with all the various requirements in the Department that we have. And that that includes the area of immunity.

But I would also point out that these cases don't remain hidden. I mean if someone is improvidently granted immunity, it is going to come up and bite you in open court. And it is going to be a judge in the trial court that is going to point that out to the prosecution team. If there is a problem, I think the judges would, through one means or another, either advise the U.S. attorney or one of the ap-

propriate more senior administration officials in the Department that there is something wrong.

Senator ARMSTRONG. Let me mention just in passing, Mr. Olsen, that the U.S. attorney for the district of Colorado was specifically mentioned last week by Judge Winner, and it was pointed out that the general criticisms which he noted did not to any extent apply to the U.S. attorney. He is not involved in this particular case.

But the question, I think, is not so much what you have described. The concern that was surfaced last week was more that you get a very determined prosecutor, one of the kinds of prosecutors who was quoted to us as saying he could get a grand jury to indict a ham sandwich, a point of view, by the way, which was shared by all four of the attorneys who testified before us last week, who then——

Mr. OLSEN. Senator, I would like to say that it seems to me when a lawyer makes that kind of a statement that in one sense they are bringing disrespect to the administration of justice.

Senator ARMSTRONG. Well, one may—that was the point the witnesses were making.

Mr. OLSEN. Well, one could have some criticisms to make of any criminal justice system. When you start using that as an example and you are starting to say to people who live in a free democractic society that they ought to be hiding under their beds because the grand juries in this country could and would indict a ham sandwich——

Senator ARMSTRONG. Well, Mr. Olsen, let me just restate that point which was really only in preparation for the point I was really seeking to make, but you have come right to it. That is one of the main concerns here. That the grand jury process may be abused. And, in fact, it is the allegation of some of the witnesses before this committee that it is being systematically and determinedly abused in a way that is really shocking, and depending on how widespread it is, it is frightening.

What you are saying is that if an attorney were to say that he could get a grand jury to indict a ham sandwich that that would be a terrible thing. And that is exactly right.

But what I am telling you is that at least the people who have appeared previously think that attitude, if not that lingo, is a commonly held opinion. In fact, one of the witnesses pointed out that a prosecutor who fails to get an indictment out of a grand jury goes back to the office and is the butt of jokes. You know, it is just understood that any prosecutor worth his salt can get the grand jury to return an indictment, for heaven's sake. I guess that sums it up. I don't know who it was that said they could get the grand jury to indict a ham sandwich, and we never asked for the name of that person, but I did ask the other witnesses, made a point after that came out, I made a point of asking if that attitude was reflected in their experiences as attorneys. And they said it was. And these were not people who were inordinately hostile to the administration of justice. One of them was a former prosecutor for the Department of Justice. Another is chairman of an ABA committee. Another is a chairman of the defense attorneys organization, whatever you call that. And they were not being flippant about it. They

were expressing great concern, the same concern that you have expressed. The question is how widespread it is.

Mr. OLSEN. But I think the flip statement repeated often enough starts to become discussed as if there is some basis for truth in it. And I repectfully dissent from the standpoint of whether or not that is, in fact, a widely held and respected view.

Senator ARMSTRONG. Not respected. Just widely held is the only testimony we have had.

Senator GRASSLEY. I would put it this way: You know, there is a certain amount of cynicism out there about government generally. It hasn't reached the point where people are hiding under their beds, as you indicated. And thank God it isn't because then we would have a different society than what we have.

But it seems to me like whether you are Members of Congress like we are or administrators like you or professional people in the IRS, whatever we can do to overcome that cynicism, I consider that one of my main responsibilities. And I have got to contribute to it as well because the whole congressional process leads to some of that cynicism, because it is the faith that people have in our governmental system, and we want to restore that whenever we can.

Mr. OLSEN. That is why, Senator, I was pointing out some standards on plea agreements. Let me try to put some of that in focus because it is directly applicable to the question of whether or not there is grand jury abuse.

The standard for returning an indictment by a grand jury is probable cause. But the standard for conviction is one of beyond a reasonable doubt. If there is any reasonable doubt, the jury must, as a matter of law, they are instructed—they must acquit the defendant.

Our statistics show that when we indict defendants charged with title 26 offenses, we are successful in approximately 96 percent of all those cases. That is a percentage, a standard that is second to none in the Federal criminal justice system. That is meeting the standards that I outlined earlier, no nolo contendere pleas, no Alford pleas. You plead to the major count or you go to trial, and then we try you and we convict you.

Now if we were indicting all these cases that had no basis for them, then our percentage of success would be much less, wouldn't it? I suggest that those statistics establish that we are successful.

Senator ARMSTRONG. What percentage of those are pleas rather than trials?

Mr. OLSEN. I think that the figures are about 80, 85 percent of all the cases, I think, that we return indictments on. We have statistics on those that I can give to the subcommittee.

[The information from Mr. Olsen follows:]

The conviction rate for all cases is approximately 95 percent. Guilty pleas are entered in about 70 percent of the cases. The conviction rate following trials—which are often long and complex—is approximately 85 percent.

Senator ARMSTRONG. Eighty to 85 percent?

Mr. OLSEN. By plea.

Senator ARMSTRONG. By plea rather than by trial?

Mr. OLSEN. Right.

Senator ARMSTRONG. Well, you see, the contention of Mr. Kilpatrick and others is precisely that. That once you get an indictment, unless you are a person of great means, you are a cooked goose. Mr. Kilpatrick testified it cost him $6 million to defend himself. And he at least thus far has been very successful in doing so. That is exactly the point that he raised the first time he brought this matter to my attention. That the average guy, even a person of considerable means, really doesn't stand a chance once this process starts. Once the indictment is handed down, it is almost automatic. Now I understand that is only one side of it.

Did you want to comment on that? I really was leading in another direction altogether and we just got sidetracked.

Mr. OLSEN. No; I think the view of the defense bar is quite different. It is that because the IRS is so effective in conducting their investigation—because remember, tax cases are different than other cases. They are not eyewitness cases. You are not talking about a teller in a bank saying that is the person I remember in the bank 2 weeks ago. It is a paper trail. And after—and that is why I was going to point as well as Mr. Langone in terms of how we conduct our investigations and what the review procedures are because when we wash out those cases that we do wash out, and we don't prosecute everybody we investigate. Some of the cases are killed by the IRS CID level. Some of them are killed by District Counsel of the IRS. Some of them are killed by the Tax Division; some by the U.S. attorneys' offices.

But the answer is that review process provides us with what is an exemplary standard in terms of whether or not these are good cases. And the bar knows that so that when they get their clients charged, they know we have a complete investigation.

Senator ARMSTRONG. Well, I thank you for that response.

Let me go back to the point we were pursuing which was pocket immunity.

Mr. OLSEN. Yes.

Senator ARMSTRONG. And I was raising the potential, at least, for abuse when you get a very determined, perhaps overly determined prosecutor. And I want to just read you one paragraph from the testimony of Robert D. Grossman. Mr. Grossman, among other things, was a member of the staff of the chief counsel's office of the Internal Revenue Service tax court litigation division, trial branch in Washington, DC for 4 or 5 years and ended up as a senior trial attorney so he is at least in a position to be knowledgeable. It doesn't make what he says right.

Mr. OLSEN. On civil tax cases, nonjury cases, the Tax Court does not have—the attorneys trying cases in the Tax Court do not try criminal cases.

Senator ARMSTRONG. That is not the point I am making.

The point is he is a person who is experienced on both sides of the issue. And here is the observation he made about one of the prosecutors in the *Kilpatrick* case. I am not asking you to comment on it. I am just kind of setting the stage for what my question is.

Mr. OLSEN. He represents one of the defendants in the case?

Senator ARMSTRONG. Yes.

Mr. OLSEN. Thank you.

Senator ARMSTRONG. "I had the impression that Snyder wanted to make this case so badly he would have done anything to win, irrespective of consequence. He viewed the case as a gun fight." And it goes on.

Now if you have a prosecutor like that, the concern that is expressed is that in that kind of circumstance the permissive use of pocket immunity makes it really very easy to get testimony from people who might not otherwise testify. It is a question of fairness. That if you get, as you characterized it, the minnows—and I don't know how you tell who the minnows are. Leaving that aside—you go around, shop around and say, look, if you will testify and help us convict Smith or Jones or Kilpatrick or whoever it is, we will let you off. That is the concern that was rising about the pocket immunity. And I can't evaluate whether that is a legitimate concern or whether it is just farfetched. What do you think?

Mr. OLSEN. Well, I won't comment on his remarks with respect to the *Kilpatrick* case, but I think you would find that the approach by the Government, whether it is by the Department of Justice prosecutors or by the agents that are assisting them in the investigation, whether they are FBI, DEA or IRS, that they are not searching out to find crime because there is a dearth of it in this country. Quite the contrary. And that what we are finding is that with respect to the tax laws you are finding greater organized resistance so that the cases are not just the old mom and pop store cases where they are cheating on their returns and overstating the cost of goods sold or underreporting their gross income. These are cases of a much different and greater magnitude. The use of the offshore entity. I think the Service's figures now show that with respect to the shelters that we have under investigation, something like 40 to 45 percent involve offshore entities. It doesn't take a genius to figure out which ones in the Caribbean we are talking about or elsewhere in the world.

But the approach is that when you are conducting your investigation, you have a certain amount of information you have and now you need to verify it with individuals. You are going to corroborate whatever the documentary evidence is. In the foreign side, you may be actually trying to get that documentary evidence.

And the approach is that you contact that witness, that witness provides immediate cooperation with you, or instead they say, gee, I am not sure I could talk to you. And after give and take, then they may have an attorney represent them or may not. But clearly what follows is that we want to find out what they have to say. They are making some type of fifth amendment claim. They submit to us either orally or in writing a proffer to tell us, yes, the witness has some legitimate information to provide to us but wants the assurance that if they do cooperate, what they say, they are not going to be convicted by the words from their own lips.

And so there is a judgment factor that goes into it. But it is done in every prosecutor's office every day, Federal, State, and local.

Senator ARMSTRONG. I think we understand that. And I believe that you have really told us what we want to know. I wanted you to be sure to understand the concern. And I think what you have said is that it is not a concern that you feel is very pressing, that

you are not aware of widespread abuses. At least you seem to be comfortable with the situation as it now exists.

Mr. OLSEN. Senator, that is correct. The defense bar in this country does have access to the prosecutor's offices every day. And if they have got a problem, they let them know. Because there is a working relationship that is done every day that accomplishes the administration of criminal justice.

Senator ARMSTRONG. Ready to move to a new subject, Mr. Chairman?

Senator GRASSLEY. Yes; if I could, I want to bring up another issue that we were told about in prior testimony. And I refer to it as the "reviewer issue." I don't know whether that is the technical term or not. But anyway, we have been told that a Justice Department reviewer provides a defendant a final opportunity to make his case to an objective party before prosecution is initiated. Mr. Olsen, do you agree with this description? Are there certain guidelines that a reviewer must follow?

Mr. OLSEN. Anyone in the Tax Division that reviews a criminal tax case for prosecution is a prosecutor. They may be functioning as a reviewer or as an assistant chief or chief or a trial attorney, line attorney, but we consider ourselves all prosecutors. I am a prosecutor. When I authorize a grand jury investigation or authorize an indictment to be returned against certain individuals, I am functioning as a prosecutor. The reviewer and the review function of the Tax Division is just that. It is to review someone else's investigation, whether it is an IRS administrative investigation or a grand jury investigation.

But the function of a review is to do that—to provide in Washington, DC, through the Tax Division, a review of that investigative effort to see whether or not it meets our standards.

The reviewer is the second line of review in the Tax Division on a case. Because consider just having one lawyer look at it that didn't investigate it and then authorize it. What we do is force it up through the system so that we haven't made mistakes. And we keep that prosecution conviction rate up to the 95, 96 percent year-by-year.

All of the publications that the Department has, including the Tax Division, clearly, I think, set forth what the conference procedures were in the Tax Division up until I changed them last month. I changed them because the review of cases did not permit plea negotiations with defense counsel. It seemed to me that at every stage of every proceeding with the Government, that whether or not we agree, an individual ought to have the opportunity through his or her attorney to attempt to dispose of the case in some expeditious but fair and effective means.

The system that I saw when I came onboard the Tax Division 2½ years ago did not permit that. We have made some changes permitting pleas at the stages in which an administrative investigation is being conducted 'That is, in some sense, a revolutionary change, but it took into account, I think, the realistic situation that occurs. Where an individual suddenly becomes under criminal investigation, gets a lawyer, a lawyer says to him, well, what about it, and he says, oh, I did it, I am dead, I didn't report my income from interest accounts, whatever it is, and I want to dispose it, the system

did not permit that individual to dispose of it. We went ahead and conducted our investigation.

And the same thing would happen in the Tax Division when we were reviewing a case. A lawyer would come to us and say, well, I finally got through to the IRS administrative investigation, now I want to talk to a Justice lawyer, I want to talk about disposing of the case. And we said no.

But the review function is essentially the same. There has been no change. I am not aware of any situation where a lawyer came in and after the conference claimed he or she was misled by our conference procedures. They were quite rigid, quite to the point and unmistakable in terms of what anyone would have understood them to be. And that includes conducting conferences. I would just ask you to reflect on all the cases involving individuals of public notoriety that have been successfully prosecuted for tax offenses, who might have a gripe—public officials, members of the bench and others, religious leaders. That issue has never come up. Reverend Moon and Judge Harry Claiborne are examples of cases where we had conferences in the Tax Division and other cases, including the *OMNI* case. Those issues have never come up.

Senator ARMSTRONG. The point that was raised last week, Mr. Olsen, was that the defense counsel in one of the cases felt abused because he thought that he was entitled to talk to the reviewer in a very candid and open manner, and that he was sandbagged when that reviewer then showed up as the prosecutor on the case. Do you just reject that notion that he should—should he feel, let me put it that way, should he just feel that anyone he is talking to from the Department of Justice is on the other side and that it is not a review in the sense of being impartial; it is just a review of the facts, situation?

Senator GRASSLEY. Well, I would like to ask that same question but not in the sense of it being anything to do with the *Kilpatrick* case. But just generally, is that standard procedure that a reviewer would later take part as a prosecutor in a case?

Mr. OLSEN. It is not unusual.

Senator GRASSLEY. It is not unusual.

Mr. OLSEN. It happens. The reason it doesn't happen with the frequency on a statistical basis is simply because numerically speaking we don't have that many reviewers.

Senator ARMSTRONG. But nothing wrong with it as far as you are concerned?

Mr. OLSEN. But it is kind of curious to me. What does somebody think they are going to do when they come back to the Justice Department talking about whether their client is going to be charged with a crime? They are going to see an ombudsman, and they are going to come in and then they are going to say this is why my client should not be charged? And then that individual is somehow going to decide yes or no, but the Government can't use it affirmatively; they can only use it in a negative fashion? I am not aware of any procedure in the Department of Justice, Tax Division or otherwise, where that occurs.

Senator GRASSLEY. So what you are saying is that any lawyer who would come to sit down with a reviewer would be naive if he

didn't think that some of that information that he gives out could be later used by the prosecutor then?

Mr. OLSEN. Well, the admonition would have been made for any conference prior to June of this year that what a lawyer is saying to the Tax Division attorneys in the review process shall constitute, if it is factual, an admission by the client that they represent. And we have had cases in which our attorneys have later on testified in open court about what the lawyer said at the conference.

Now I have changed that procedure, but that has nothing to do with some other concerns. It has to do with what I view as an important way of conducting business. And that is, lawyers ought to be able to talk to lawyers more openly and freely, and that a lawyer shouldn't come into a conference in any stage of the Government, whether it is Tax Division or otherwise, fearful that in the passion of the rhetoric or in the course of an afternoon discussing a case, they may make a slip and say something that could be then used against their client, inadvertently. It just seems to me that that puts too much of a burden. And if what we want to do is have a more open and frank discussion about cases, then dispose of them on a plea basis, which most of them are doing, that we open it up.

Senator ARMSTRONG. But nothing improper in your opinion about having a reviewer then proceed to prosecute the case?

Mr. OLSEN. No.

Senator ARMSTRONG. All right. That satisfies me, Mr. Chairman, on that point. I wanted to pin that down. That is a great contention of Mr. Grossman, that he doesn't think that is proper and Mr. Olsen thinks it is. So we have made that record, and I am ready to move on.

Mr. OLSEN. Were you interested in talking about counsel witnesses before the grand jury?

Senator ARMSTRONG. I have got about 100 questions, but I am just following Senator Grassley's lead.

Senator GRASSLEY. Yes; I will leave that up to Senator Armstrong.

I would like to refer to what some witnesses have called a "national pattern of abuse." Those are their words. The pattern of abuse regarding prosecutorial misconduct in taxpayers' cases. Witnesses have cited their own professional experience in statements made by prosecutors in the *Kilpatrick* case that have been called abuses and that it goes on all the time. In other words, things like the *Kilpatrick* case.

Now, again, I don't want anybody to respond to anything in the *Kilpatrick* case, but do you feel that there has been a pattern of abuse from the standpoint of prosecutorial misconduct as it relates specifically to taxpayers' cases?

Mr. OLSEN. No, Senator, I am not aware of a pervasive or other incidents of abuse. And let me address that, if I might, without regard to any individual cases.

The Department of Justice has an open dialog with the American Bar Association on a regular, frequent basis, institutionally as well as with lawyers individually, through the sections as well as through the committees. I think both of you are aware of the close working relationships that the individual U.S. attorneys from your

States have with the Bar. When something goes awry in our system on the criminal justice side, it is brought to the attention of the Justice Department on a local basis, regional basis, and national basis.

Perhaps one of the reasons why there is more control by the Tax Division over the investigation and prosecution of criminal tax cases is because we recognize—I think everyone recognizes—that tax cases are in some respects different and ought to be treated differently than other criminal cases.

You ask people at a cocktail party whether they fear the FBI. The answer is no. If they ask the same question about the IRS, you get a different reaction. I even got a smile from you, Senator, because it is the tax man. Because we are all similarly situated. We file returns. There are financial matters that we have to summarize and put on a tax return, and, therefore, there is some potential level of exposure. And it perhaps goes back to the time when we were children and the first time you saw the label on a mattress or a pillow. And it says, you know, don't tear off without penalty of prosecution. And I submit to you that people still react in the main to something like that.

Senator ARMSTRONG. Mr. Olsen, since we are proceeding informally let me tell you why it is that people react that way about the IRS. At least I would judge as for the same reason that I smiled when you said that.

I have never, that I can recall, ever heard one person complain of any abuse by an FBI agent. I have never encountered anybody, to the best of my recollection, who said the FBI harassed me, the FBI persecuted me, the FBI hounded me, the FBI treated me unfairly. I am sure there are such people. I have never encountered them.

I encounter people who will say that about the IRS day after day, all the time. I mean if you would go out and talk to the general public, you would find just what you have described. A pervasive sense—which I think by the way is exaggerated. I am not saying I subscribe to it. But a sense that the IRS is unfair, that they use unfair methods, they use unfair tactics. And I think also I would have to say in fairness to the Service that that doesn't square with my own experience. That there is undoubtedly some bad apples in any large barrel. But there is a bedrock feeling that, by gosh, the IRS is out to get you. And there is enough evidence.

I am not trying to paint you in a corner you don't want to be in, but I hope you won't too casually reject the notion of misconduct of these cases. You don't want to comment on the *Kilpatrick* case, and I understand that. But in the *OMNI* case, we have got an admission of falsification of documents involving, by the way, an attorney who was also involved in a similar episode 5 years earlier. We were told last week about a case in Palm Beach which at least on its surface sounds kind of suspicious, sounds kind of strange. There is another case that has come to our attention in which according to a court a Government person encouraged a citizen to go through the public mails. Take somebody's mail. That is, take some material from a neighbor's mailbox. And a number of others.

Mr. OLSEN. That is the *Buffalo* case?

Senator ARMSTRONG. I don't know which one it is. But anyway, the point is that—and this is one of the things we want to get to before this winds down—is what is being done to assure that when these abuses occur that those who are responsible are properly dealt with.

But I interrupted your train of thought, and I didn't mean to do that.

Mr. RANKIN. Senator, I would like to comment on the case you referred to with regard to the mail.

Senator ARMSTRONG. We will get back to you. I will be glad to have you comment on any of them, but I interrupted Mr. Olsen. And I am afraid if you now follow up on my interruption we are going to get into an intellectual cul-de-sac. But your desire is to comment on each of those cases, and I will make a note of it, and we will be happy to have you do so.

Mr. RANKIN. I would like to comment on the case from the Buffalo district.

Senator ARMSTRONG. All right. I am writing you down for Buffalo.

Senator GRASSLEY. Mr. Olsen, would you continue, please?

Mr. OLSEN. Thank you.

I think that you would find that we have more grand jury investigations in the tax area principally directed at tax shelters. Wherever you have organized resistance of the tax laws, you are going to find that you have to change some of your approaches and some of your techniques in the way you conduct investigations.

As a good friend of mine, Dick Wassenaar, Assistant Commissioner of the IRS for Criminal Investigations, says, that in his 25 years with the Service he has never seen or heard of a situation where a taxpayer turned over a double set of books when they got an administrative summons. The only way you are going to get that is off of a search warrant. You are going to get it off of some other compulsory process that changes the direction in which we go.

We have changed some of our focus. With our tax shelter unit, the Office of Special Litigation, we have instituted civil tax injunctive actions against promoters of what we think are abusive shelters at the same time they may be under investigation criminally.

We have had to immunize investors. And we have more recently stated publicly to put some caution in the wind that in appropriate cases we would also prosecute investors. If that means that notwithstanding whatever may have happened, whether it is backdating or side agreements; that is to say two agreements that they have executed, one they give to IRS on audit, the other one they hold up so that they don't have any personal liability. Those cases, we would prosecute them because, quite honestly, it is a problem. Not just a problem with the promoters or the salesmen. We have to approach these things differently.

But I am not aware of incidents of abuse. I also say that these cases are not lightly treated by the Government. They are not because we are held up to a higher standard. It is not a fair play, game, out there. The public, the courts, and everyone else demand that we hold ourselves up to a higher standard than the private citizen. And that there are certain standards that we have to

follow, not only the prosecution but the investigation, in our cases. If we do otherwise, it would just bring disrespect for the law, and then we are going to have more problems further down the road.

But I am not aware of any pervasive areas of abuse.

Senator GRASSLEY. I think we ought to ask Mr. Rankin to comment now.

Mr. RANKIN. Yes. Thank you.

I just wanted to respond to Senator Armstrong's comment a little bit further and to underline perhaps a little bit of what Mr. Olsen said. And that is that we, in Inspection, take very seriously our responsibility to follow up on misconduct allegations and on integrity matters. In that particular case that you spoke of, there was a subsequent prosecution of the individual who certainly violated the procedures and policies of the IRS—not only that, but violated the law in carrying out the conduct which he undertook by causing the mail to be stolen and delivered to him.

That individual is no longer with the Service, has been prosecuted and received a jail sentence in terms of probation and a fine as a result of his activities. So we try in every instance to follow up and to conduct an investigation of all allegations of that sort.

Senator ARMSTRONG. Mr. Rankin, that is very helpful. That is exactly the response I was hoping to hear. And, in fact, as we mentioned, each of a number of people who have been accused of such wrongdoing, I will be hopeful that you or Mr. Olsen, as appropriate, will tell us what happened to them and what actions were taken.

That is really the test of credibility when you get right down to it. It doesn't matter so much whether or not somebody says, well, I think everything is OK and we adhere to a high standard. The question is: When somebody gets accused of wrongdoing, what happens subsequently? What is the process by which that wrong done is evaluated and if proven, what happens then in the way of punishment?

Senator GRASSLEY. Mr. Rankin, along that line, if I could, on page 3 of your testimony you cite 120 current or former IRS employees who were arrested or indicted as a result of inspection investigations. Criminal disposition in fiscal year 1985 resulted in the conviction of 84 employees and the acquittal of nine employees.

I guess I would think that this seems pretty high. Are the number of violations of concern to you?

Mr. RANKIN. Well, certainly they are of concern to us. I don't have the statistics going back several years. I didn't include those. I will be glad to provide them to you so you can make your own determination as to whether it is higher in 1985 than in previous years. But certainly we have a great deal of concern about the integrity of our employees.

[The information from Mr. Rankin follows:]

CRIMINAL ACTION STATISTICS—FISCAL YEAR 1982 TO FISCAL YEAR 1984

Fiscal year	Current/former IRS employees arrested/ indicted	Employees convicted	Employees acquitted/ cases dismissed
1982	272	54	2
1983	84	285	10
1984	144	122	21

The Criminal Action statistics reported above include the results of a nationwide investigation of fraudulent unemployment compensation claims by IRS employees. This investigation was begun within IRS in 1981 and then expanded nationwide throughout the Treasury Department. Virtually all criminal actions resulting from this investigation were completed by the end of FY-84.

Senator GRASSLEY. In regard to the statistics you gave us for this year, was there any criminal prosecution of third parties because of misconduct of this type?

Mr. RANKIN. Of third parties because of misconduct?

Senator GRASSLEY. Yes; in other words, were people prosecuted because of misconduct of IRS employees like the type you list here in your testimony?

Mr. RANKIN. I am not aware of anyone who was brought to trial outside the Government as a result of misconduct, no, sir. There are many third parties who are prosecuted for bribery, threats, and assaults in those types of cases.

I am not sure I exactly follow your question.

Senator GRASSLEY. Well, I think as this hearing—we have had some indication of misconduct of employees and then the wrongful prosecution of some people involved with those investigations, and that is what I am referring to. If you have got it broken down so that any of these investigations would have been for conduct that led to the wrongful prosecution of people that shouldn't have been otherwise prosecuted, I would be interested in that information..

Mr. RANKIN. The one case that I just mentioned was, I believe, disposed of in 1985 concerning the agent in the Buffalo district of New York. So that is one case in 1985 that I know was involved.

Senator GRASSLEY. Mr. Langone.

Mr. LANGONE. I was going to make the same point, Senator. That in that particular instance, the agent that was eventually prosecuted, that the conviction in that case was reversed after the fact because it was determined that there was impropriety on the part of one of the agents involved.

Senator ARMSTRONG. You mean the taxpayer's conviction was reversed?

Mr. LANGONE. Yes, Senator.

Senator ARMSTRONG. The conviction of the agent was not reversed?

Mr. LANGONE. No; that was sustained.

Mr. OLSEN. The conviction of the taxpayer was dismissed on the motion of the U.S. attorney because of the misconduct of the agent. I believe the agent got 6 months in jail in addition to whatever probation and fine.

Senator GRASSLEY. I wonder if you could give us some statistics on that beyond the Buffalo case? I wouldn't expect you to have it

at the tip of your tongue now, but the extent to which you could go back and give us a written response, I would appreciate it.

[The information from Mr. Rankin follows:]

NO INSPECTION RECORD OF OTHER INVESTIGATIONS WHERE TAXPAYERS WERE WRONGFULLY PROSECUTED

The Internal Security Division Management Information System does not have the capability to track investigations of Service employees whose alleged criminal or administrative misconduct led to the wrongful prosecution of individuals that should not have been prosecuted. Other than the "Buffalo" case discussed earlier in my testimony, I am not aware of any other investigation by the Internal Security Division in which misconduct by a Service employee led to the wrongful prosecution of any individual.

Senator ARMSTRONG. Well, let's ask about the *OMNI* case while we are here. It is the same kind of circumstance. In that case, as I recall it, the allegation was—in fact, I think this was found by the court. Am I right about this, Ann, that the court found that the lawyer and the two IRS agents manufactured documentary evidence? Now before you answer let me be sure I have got my facts right. Is that what the court found? Apparently so.

It was reported in a most interesting way by the Washington Post in which, accurately or not, there was an admission that that is exactly what happened, that documents had been altered "to enhance their authenticity." I wasn't sure what that meant.

In any case, what happened to the two IRS agents in that case?

Mr. RANKIN. Well, again, Senator, I can't comment on the *OMNI* case, but we follow up every allegation of misconduct from whatever source it comes. And we are aware of the *OMNI* case, and the opinion of the judge.

Senator ARMSTRONG. Well, what I was really asking was not about the *OMNI* case, but what about the allegation of misconduct by Government employees?

Mr. RANKIN. Well, that is the same matter. The case is pending.

Senator ARMSTRONG. Well, but either some action has been taken to investigate that or to bring charges or to dismiss charges or it hasn't.

Mr. RANKIN. Well, I can't comment on what is ongoing in that case. I can comment on the fact that we——

Senator ARMSTRONG. How about Mr. Olsen? Can you comment on what happened to the attorneys, I believe, employed by the Justice Department? Do I have my facts right on that?

Mr. OLSEN. The admonition that I gave to this subcommittee earlier, Senator, is the same, whether it applies to the *Kilpatrick* case or the *OMNI* case or any other case that is currently pending with the Department of Justice.

Senator ARMSTRONG. I don't think that case is pending with the Department of Justice. I think, in fact, action has been taken with the issue of the misconduct by the attorney in that case. I think the Justice Department has made a determination in that case. Am I mistaken about that?

Mr. OLSEN. I can't comment, Senator.

Senator ARMSTRONG. Well, I will tell you what I think I will do, just to make it easier. I think I will suggest that we pass over it and come back to it another time. Because I am afraid if I push it

at this point, you are going to say something that I don't want you to say and that you don't really want to say.

Mr. OLSEN. I am not going to say anything, Senator.

Senator ARMSTRONG. That is exactly the point.

Mr. OLSEN. And I don't mean to be argumentative or flip about it. I just mean that I am in a position where I am under some other restraints, as are the other witnesses here.

Senator ARMSTRONG. Well, I guess I will think about that.

What I believe has happened—I will just give you what my impression is. It may not be entirely accurate, but it is based on what the courts said and what the newspapers said, and that is about what I know about it.

My impression is that the attorney got caught altering some documents. Specifically, making some documents which were dated a year prior to the time that the paper was manufactured. And I think an investigation was made and a charge made before OPR, and I think the Justice Department moved to dismiss it, and it was dismissed. That is my impression.

And the attorney involved, one Elizabeth Trimble, I believe, was also the subject of a similar controversy 5 years earlier.

Now, Mr. Olsen, the concern which I have here is a very simple one. Did the Department just circle the wagons around this person? Was there misconduct involved? Is it a reflection of what some people have cautioned us about, that the Department simply will not discipline overzealous prosecutors?

Now you can say, well, I can't talk about it, but, of course, if you can't talk about it, if you can't talk about the problem, you can see how difficult it is for this committee to know what is going on.

Mr. OLSEN. I appreciate that, Senator.

Senator ARMSTRONG. Well, I am not sure that we are prepared to let the matter rest there. I am not sure what we can do about it. But I just want to make it plain that that is not satisfactory from an information standpoint. I am not trying to get you to say something that you shouldn't, but I am assuming that that is a matter of public record whether or not, in fact, there has been an investigation and dismissal of any charges of misconduct against Elizabeth Trimble. Is that right or not? Are such matters public record or not?

Mr. OLSEN. They are not, Senator.

Senator ARMSTRONG. Well, we are going to have to find out some way for this committee to learn that because that is the heart of what we are trying to find out.

Senator GRASSLEY. Are you saying they never will be public record? In other words, are you saying now if I were interested in a case that was investigated in 1970 that 15 years later if I wanted to see those records I couldn't see them?

Mr. OLSEN. Senator, I don't know the answer to that precise question. I do know that on all matters that are pending before the Department that we have no comment on pending cases.

Senator ARMSTRONG. Could you check and see if the *OMNI* case is pending? I may be mistaken, but I don't think I am.

Mr. OLSEN. Senator, I could check. I could, and I would be most happy to. I will not report back to this subcommittee, however, what the fruits of my inquiry are.

Senator ARMSTRONG. Why is that? I don't quite understand.

Mr. OLSEN. Because whatever the matters are that are conducted by another component of the Department I am advised are not matters of public record and for which the Tax Division is not in a position to comment one way or the other.

In many of the cases, for example, the Office of Professional Responsibility may conduct an investigation into an allegation that comes to the attention of the Department, and the individual employee, in fact, may never be advised.

Senator ARMSTRONG. Well, in this case I think the individual was advised, if she subscribes to the Washington Post.

Mr. OLSEN. Oh, I don't mean that. What I mean to say is that there is a certain level of protection that is offered.

Senator ARMSTRONG. Well, it isn't my desire, and I am sure it isn't Senator Grassley's desire, to ask you to go beyond your charter. But help us think about this. If you are saying to me that you are not the guy who can answer that question, then fine.

But here is the reality. We have got two Federal judges in Colorado, a Federal judge in Maryland and some other places who in their decisions have referred to extensive abuses. And not just in passing, but have literally excoriated the handling of these two cases. Now we have only mentioned these two. There are some others that we are going to bring up at some other time perhaps.

And the allegation is of unethical conduct, of illegal conduct, of violations of the Constitution with respect to the grand jury, of altering documents. Really serious stuff. And it is our desire to find out not so much the truth of these charges, because as far as I am concerned, that has been disposed of by the courts. The courts found it, and they may or may not be right, but I am prepared to take the court's word for it, whatever their decision was.

Mr. OLSEN. But those cases are not completed, which is why we can't comment on it. And I appreciate the legislative process is different, that it is a fact-finding process trying to pull it together. But we have other constraints that we have to follow.

Senator ARMSTRONG. I understand. I am seeking your advice.

Mr. OLSEN. The fact that I don't answer your question doesn't mean that I agree by implication with the nature of those statements by other people, other witnesses, in any way whatsoever.

Senator ARMSTRONG. I understand. I am not trying to put words in your mouth. I am not trying to get you to do something you don't want to do or shouldn't do.

But I am describing a situation. These are not frivolous issues. These are not something that we read about in the newspaper. In fact, when the publicity began to appear about the *Kilpatrick* case, the *Kilpatrick* case and some others, I guess I received from 50 or 60 sources allegations of serious misconduct from taxpayers or citizens of some other kind. As recently as yesterday, a person who I have known for years and whose veracity I respect told me a story which was absolutely shocking. But we left all of those out. Maybe we made a mistake. We didn't seek to bring before this committee and don't seek to bring before this committee at this time anything which is in that category. We are trying to deal at least at the outset only with cases where there has been a finding by a court.

And that is just an attempt to get rid of all the mood music and get down to the facts.

Mr. OLSEN. Senator, I understand that Judge Winner testified on Thursday that he did not render any findings. Isn't that a correct statement of the record?

Senator ARMSTRONG. I don't think so. I think if you would look at the opinion.

Mr. OLSEN. No, not the opinion. What he testified to on Thursday. That he did not make any findings.

Senator ARMSTRONG. Well, distinguish that for me. Maybe. I don't understand your point.

Mr. OLSEN. I don't know. But that is the information that I have been given by people who attended who have advised me. I don't mean to get into an argument on what Judge Winner said, but simply that his characterization was that they were not findings.

Senator ARMSTRONG. Well, what is the difference between findings and what he said? Mr. Olsen, I am not a lawyer, and don't want to be. So if that is a legal distinction, tell me what the distinction is. I know what he said. He jumped all over your guys in that case. He said that they subverted the Constitution. He said that they subverted grand jury process. He said that they were rude. He said that the Justice Department was way off base. That is not a legal term. They were way off base in trying to suppress his opinion. And, in general, he created in my mind, just as a citizen legislator, just as a businessman who happens to be a Senator for a brief time who doesn't have any desire to be a lawyer, the impression that there was something seriously wrong.

And that taken together with other things that have come to my attention lead me to think that that is probably right. But what I want to know is does anything need to be done about it either by the Department of Justice or the Congress. Or is this impression just off base? Now I don't know what the distinction you are making about findings. Is that a question of an order that he enters or what is the point?

Senator GRASSLEY. It seems to me like it is significant that he found enough to order a new trial. I mean how much that amounts to—I am not a lawyer either. But at least he made that much of a point.

Senator ARMSTRONG. Counsel advises that the distinction is that Judge Winner ordered a new trial and that Judge Kane did enter findings with respect to the prosecutorial abuses. Is that your understanding?

Mr. OLSEN. I believe that is a correct statement, Senator.

Senator ARMSTRONG. Well, my only point is that we are not trying to get into all kinds of hearsay. We are trying to get into things that have been in some way considered by competent officials, judges, attorneys general, whatever.

My question is this: If you were in our situation and it had come to your attention from such sources problems of this character, how would you find out about it and what would you do?

In fact, one of the things I hope we are going to get to in due course is simply to seek your advice about a number of specific recommendations that have come forward. But how should we do it? If

you are the wrong person to ask, I can understand that. Tell me who the right person is.

Mr. OLSEN. Well, I understand that your staff has been in touch with the Office of Professional Responsibility.

Senator ARMSTRONG. Is that the person that we should ask about it?

Mr. OLSEN. OPR has advised the subcommittee what its policy and position are with respect to certain matters. And I had assumed that, therefore, I would not be questioned on those matters.

Senator ARMSTRONG. Fine. If OPR is the entity within Justice that we should ask about that, we will just take it up with them at the right time.

In the meantime, should we go on to some other matters?

Mr. OLSEN. Certainly.

Senator ARMSTRONG. I have a series of questions that are kind of of a similar character. I was going to go through and discuss with you the issues that are raised about the conduct of Jake Snyder and Jerrod Sharp. Unless you want to comment on those. I take it that that is something you would prefer that we take up with OPR.

Mr. OLSEN. Well, I am not stating a preference on how you should proceed, Senator, but I am not in a position to comment on the factual matters relating to either the *Kilpatrick* or the *OMNI* case.

Senator ARMSTRONG. All right. Let me ask you this. I will see if there are any questions that relate to that that seem to be in your bailiwick. Ordinarily, would you send out to prosecute a tax case a person who would brag that they knew little or nothing about tax law?

Let me rephrase that. Would you ordinarily send out a person to prosecute tax cases who were well versed in tax law?

Mr. OLSEN. You want me to only address my response to the latter question?

Senator ARMSTRONG. Either way.

Mr. OLSEN. Well, the answer then is that you find that most criminal prosecutions of tax charges are handled by attorneys who are primarily criminal prosecutors and not substantive tax attorneys. I think that historically speaking you would find the same of the defense bar—that the lawyers who handle criminal tax cases for the defense are not tax attorneys, in the sense that they are comfortable working with the various intricacies of the Internal Revenue Code, but rather that they are looking in tax areas at those things which demonstrate transactions that constitute either fraud or the equivalent of a false statement. Fraud is in the sense that there is omission of income or they have mischaracterized a transaction with the attempt, the criminal attempt, to defect and frustrate the tax laws. Essentially they are criminal cases in nature and not tax cases.

If it were the other way, then what you would find is that the only way you could prosecute a case is to have a jury that was composed of tax specialists.

Senator ARMSTRONG. I am not arguing the case. It is an issue that was raised. I am just trying to make the record. And I understand your response to be that you might well send somebody out to prosecute a tax case who was not particularly knowledgeable in

tax law, and that is not the problem. He needs to be knowledgeable in the prosecution of criminal cases. Is that a fair summary of your answer?

Mr. OLSEN. Yes, Senator.

Senator ARMSTRONG. All right. Go ahead.

Senator GRASSLEY. I want to ask something that admittedly is a problem for Congress because we make congressional policy. But I want to ask your expert judgment about the Jencks Act. The rationale behind it that would prevent defense counsel from acquiring grand jury witness testimony until after the witness has testified at a trial on direct examination and whether or not providing this information prior to trial would give the defense counsel a greater opportunity to discover evidence of grand jury abuse before it is too late, and then would give incentive to the prosecutor to prevent abuse.

In other words, give me your judgment of the Jencks Act, as I stated in my first question, whether or not you think that is good. And then, like I said, changing it to get this information ahead of time as one way of preventing this sort of abuse by prosecutors.

Mr. OLSEN. I, quite candidly, Senator, was not aware that this was going to be a subject of this subcommittee's hearing. Not relating to grand jury activity and not being a subject of, I am aware of, of something of abuse. And, more significantly, I think, is the fact that this is probably an area that you would find there are greater resources in the Criminal Division of the Department of Justice that would address this.

But is your question related solely to tax cases or are you talking about drug cases, organized crime?

Senator GRASSLEY. We are talking just about tax cases at this point.

Mr. OLSEN. Well, I am not aware of any reason at all under the Federal Rules of Criminal Procedure or under the Jencks Act why there should be a different standard for tax cases as compared to other cases. I resist attempting to classify tax cases somehow differently than other Federal crimes. I treat them as I do all essentially nonviolent crimes. Crimes that should be treated the same as others by the courts, by the public and most particularly by the taxpayers.

Senator GRASSLEY. I don't disagree with anything you say, but I am just trying to use your expertise as it relates to charges of prosecutorial abuse.

Mr. OLSEN. I am not aware of any litigation involving prosecutorial abuse in this area, Senator, at all.

Senator GRASSLEY. Senator Armstrong.

Senator ARMSTRONG. Mr. Olsen, in your testimony on page 5 you make the point of the safeguards of material in the grand jury's possession. And you make the comment: "Grand jury material remains under the custody and control of the U.S. attorney, strike force attorney or Tax Division attorney." One of the concerns we have heard expressed is that, in fact, that is not the case. Frequently, there is—well, frequently, it is not held at that level of confidentiality.

Could you describe for us how you assure that? What steps are taken? What kind of training or in other ways you keep that stuff under wraps?

Mr. OLSEN. I am not quite sure what it is that the concern is. Is the concern that there have been unauthorized and illegal disclosures?

Senator ARMSTRONG. That is part of it, yes.

Mr. OLSEN. Or is it that where the voluminous documents are warehoused may not necessarily be kept under the—may not be released by the U.S. attorneys office of the strike force? Is it both? I am sorry. Is it both?

Senator ARMSTRONG. No. I think it is the unauthorized disclosure.

Mr. OLSEN. I am not aware of unauthorized disclosures of grand jury materials. The recent Supreme Court decisions in *Sells Engineering* and *Baggot,* I think, in one sense made it much more difficult for the Government to effectively be able to vindicate a Federal interest, whether it is from the standpoint of a criminal investigation or civil tax audit. The Department of Justice in January of 1984 in response to those two Supreme Court decisions published a guide on rule 6(e), the secrecy provisions, after *Sells* and *Baggot.* That is 84 pages in length, 83 pages in length. I would be more than happy to have that added to the record for your consideration as to whether or not we do have safeguards. There has been some litigation on the question of retroactivity of *Sells* and *Baggot* and things like that.

[The information not available at press time.]

Senator ARMSTRONG. In general, though, in your experience it is simply not a problem?

Mr. OLSEN. No, it is not, and in one recent case where much of the information had to be put on a computer, and the space was a question, what we did was consult with the chief judge in the district and discussed the various options in terms of maintaining the secrecy provisions to the court's satisfaction, and asking of the court if we did certain things, would that satisfy the court's interest in maintaining the secrecy of the grand jury proceeding. And the court instructed us as to which way he preferred us to proceed. We follow that.

It seems to me that it is a managerial problem. It is of great significance because we don't want to step on our toes. And there are some intelligent ways of addressing the problem.

Senator ARMSTRONG. I would like to ask you to just reflect on a series of legislative and administrative proposals that have been presented. And to the extent that you want to, comment on each of them.

One is the proposal which I guess is embodied in the legislation now pending in the House to permit witnesses before the grand jury to have counsel.

Mr. OLSEN. That is a very interesting issue, Senator. On February 26 of this year, the Department of Justice's Criminal Division deputy assistant attorney general, James Knapp, testified on Grand Jury Reform Act of 1985, H.R. 1407, and stated in writing what the position of the Department of Justice was. I would ask that that be added to the record.

Senator ARMSTRONG. It sounds like a good idea.

[The information not available at press time.]

Senator ARMSTRONG. Was he for it or against it?

Mr. OLSEN. I will leave that for your decision, Senator.

Senator ARMSTRONG. Come on, Mr. Olsen.

Mr. OLSEN. There were a number of proposals that were put forth, and he was addressing each of those. In his testimony, he referred to the position taken by the Judicial Conference, and that was submitted to Congressman Conyers on June 10, 1985. And that is in response to the American Bar Association's Model Grand Jury Act and related legislation. That report goes into each one of the different provisions, specifically, and including the issue of witnesses having counsel present before the grand jury. And it was the view of the Judicial Conference, and it is the official view, that that would not be a good idea for a number of reasons.

Senator ARMSTRONG. Well, when you say the "official view," do you mean the view of the Department of Justice?

Mr. OLSEN. No; this is not the U.S. Department of Justice. This is the Judicial Conference. This is the view of the Federal bar. Federal judges, correction.

Senator ARMSTRONG. All right.

Do you have any opinion about it that you wish to express?

Mr. OLSEN. Well, I would like to discuss it in this context. There seems to be a growing view that the Government's ability to conduct investigations must be restricted at all times when there is something material that evidentiary-wise is going to be discovered so that counsel somehow be present. Not counsel for the Government, but that the Government cannot be trusted notwithstanding that fact in the grand jury context there is a transcript and everything is being recorded and written up for a court to review later on for grand jury abuse. That that is something that nevertheless requires the presence of an attorney.

I suppose the question that could be addressed is whether this is something that would be confined simply to tax cases or are you talking about organized crime cases; are you talking about procurement fraud? Would there be a lawyer for a large defense contractor present free of charge for someone who is blowing the whistle on a procurement fraud case?

You begin to develop a set of questions that, I think, have to be answered in terms of whether or not witnesses would intrinsically be more cooperative or less cooperative in disclosing what has historically taken place. And the grand jury is an investigative body. It is not a hearing. It is trying to conduct an investigation.

So I think the answer is that the clear evidence is that it would not be productive; it would generate more delays.

Senator ARMSTRONG. So you would generally not be sympathetic to that?

Mr. OLSEN. That is correct. But also I think that since the grand jury proceedings now are subject to having a written transcript, then there is always the opportunity for a court to review whether or not there has been abuse.

Senator ARMSTRONG. That brings me to the next question. One of the suggestions made by Peter Vira, who is the, I guess, the vice chairman of the Grand Jury Committee of ABA——

Mr. OLSEN. Yes.

Senator ARMSTRONG [continuing]. Is that the entire transcript be turned over to the defense after an indictment is rendered. Are you for that or against it or is that something you wish to comment on?

Mr. OLSEN. I was shocked when I heard that that is what Pete had recommended and surprised at the same time, I suppose, that in the short time since he was on the prosecution team, he is now recommending something as dramatic a change as that.

But, no, I don't think that that is a good idea. Suppose you had witnesses that testified and essentially corroborated what you may have heard from other people who were not going to be called as witnesses to testify? Suppose they had only developed investigative leads from them?

You can't conduct investigations and tell people that what they say is going to be kept confidential, but that if we are successful, we are going to turn everything over to the other side. That is not going to work in our cases.

It wouldn't work on whistle-blowers. It wouldn't work where we institutionally have to set up some safeguards so that we encourage people to come in. The hotlines and things like that.

If instead what we do is simply open up the door, then I think what you are going to find is that grand jury proceedings by themselves are not going to be as secret as historically they have been.

Senator ARMSTRONG. At this point, let me inquire of Mr. Olsen, Mr. Rankin, and Mr. Langone of your convenience. It is 12:15. We have got a distance to go. In fact, my hope is that either this afternoon or on another occasion, whichever is the most convenient for you, that I could elicit from each of you to the extent it is appropriate to comment on each of several specific proposals. One of the by-products of the, or I guess the main product, of the hearings on Thursday and Friday was a laundry list of proposals for primarily legislative but to some extent administrative action. It would be helpful if we just had a statement of position.

It looks like at the rate we are going that will take a while. So my question is this: Is it convenient for you to come back this afternoon or would you like to reschedule for another time or what?

Mr. OLSEN. It would be convenient to be back this afternoon or anytime that is convenient to this subcommittee, Senator.

Senator ARMSTRONG. Is that good for you as well?

Mr. LANGONE. Yes.

Mr. RANKIN. Yes.

Senator ARMSTRONG. Why don't we do this then. It is 12:15. Why don't we just recess and come back at 2 and clean this up this afternoon?

Mr. OLSEN. Thank you.

[Whereupon, at 12:15 p.m., the hearing was recessed and scheduled to reconvene at 2 p.m. on Monday, June 23, 1986.]

AFTERNOON SESSION

Senator ARMSTRONG. Good afternoon, gentlemen. I appreciate you coming. And my hope is we can dispose of kind of just a laundry list of things fairly rapidly.

Could we just start to kind of finish up one dang'ng loose end from this morning? Mr. Olsen, you have pointed out that you are the wrong one to ask about questions relating to professional practices of attorneys in the Justice Department; that that is under another division. And that in any case to the extent that it involves matters that are still under litigation or appeal or whatever that it wouldn't be appropriate for you to do so in any case.

Could you, just for the record—and I have already explained that this is an area about which I know little but would like to know enough to just be comfortable with it. Could you explain the nature of those restraints and whether they are legal restraints or whether or not they are ethical considerations or Department policy or all of the above? Could you just give us the ground rules? And that would be helpful to me so that as I approach the Department to try to do my job I would do it in a way that was consistent with their efforts to do their own job.

Mr. OLSEN. Certainly, Senator. I regret, however, that I don't know all the particularities and the scope of limitations on the ability of the Department of Justice to respond to congressional inquiries regarding misconduct or allegations of misconduct by Department of Justice employees.

I do know some of the basic rules with respect to that. One is that whatever our scope and authority is with respect to any disciplinary action, such matters are only viable in terms of the ability of the Department to react while a particular employee is still an employee with the Department. If they have departed, there is a separation of service, then we have no jurisdiction.

Senator ARMSTRONG. Unless it was a criminal matter.

Mr. OLSEN. The Office of Professional Responsibility, however, also has very different authority than does any watchdog agency such as an IG's office. It has the ability and the authority to conduct a grand jury investigation itself. They have that authority.

Now there is an obvious interdepartmental working relationship between the comoonents—say it is a division or U.S. attorneys office or the FBI or some other part of the Department—with the Office of Professional Responsibility, because, obviously, not all the matters that would come up under the area of misconduct are criminal in nature. And so there are a whole host of remedies that can follow from administrative leave, to separation from service, from asking a person to consider whether or not they still believe they have got a career with the Department of Justice, and that the choice is theirs but that after some reasonable period of time if they have chosen to stay with the Department then the Department may see fit to institute separation proceedings.

That is just generally what happens.

Senator ARMSTRONG. When you mentioned that the jurisdiction of the Department would only apply if the person involved was still working with the Department, that, of course, would not pertain to an alleged criminal violation.

Mr. OLSEN. That is right. If it were criminal, it wouldn't make any difference whether the person——

Senator ARMSTRONG. It would be only if they are still working.

Mr. OLSEN. That is right. When a component becomes aware of any misconduct, we are under a—within the Department of Jus-

tice. And I assume the same is the case with the IRS—that we are under an obligation to immediately report whatever has come to the attention of the managers in those, say, divisions or the U.S. attorneys office. We are under a mandate to report that immediately to OPR. And that is how OPR usually becomes aware of it. Sometimes it may come up in a different context, such as a court proceeding where something has been put on notice to the Department through an ongoing court proceeding.

Senator ARMSTRONG. Well, I appreciate that. And I think it is pretty clear that we need to take this up with OPR or maybe with someone else at the Justice Department. We will explore that.

Mr. OLSEN. Well, let me add to that. OPR reports to the Deputy Attorney General and the Attorney General. They don't report to any of the Assistant Attorneys General.

Senator ARMSTRONG. I understand.

Mr. OLSEN. Or to the Associate Attorney General.

Senator ARMSTRONG. We will try and work our way through that so that when we come back to this issue that we approach the right person. Our desire is simply to take a look at the cases that have come to our attention, and to find out in much the same way as Mr. Rankin mentioned this morning what happened so that we can draw some conclusions.

If we look at a number of cases and it is clear that the Department has investigated them and has either suspended or fined or punished or indicted or exonerated the people involved, then they have been dealt with, and we can draw some conclusion about how they have been dealt with. For example, in the case he mentioned this morning, I think he said that the person who was involved in mail tampering was dismissed and prosecuted and went to jail for 6 months. So that certainly indicates that it has been taken care of without getting into the merits of the case.

But, anyway, that is not in your bailiwick. But just so you don't misunderstand, the reason why that is important from the committee's standpoint, the Senate's standpoint, is not to try to play cops and robbers. That isn't our business at all. And it isn't our function to try to determine the guilt or innocence of any of these people. Our function is to determine whether or not the system is working, and that the process is being managed in a way that is suitable and is calculated to protect the rights of everybody involved, including taxpayers, or other citizens who come into contact with the Department.

But I will take that up with someone else. I think that is just beyond what really is your bailiwick.

I do want to turn, however, to a series of real recommendations that came to us from various sources, and just as a policy matter, invite your comments on them. Some of them, at least, seem superficially attractive.

One other matter before I get to those. I made a note. One of the witnesses in testifying last week made the assertion that there were people who had been convicted under the same kind of offenses as were present in the *Kilpatrick* case, charges which were later dismissed as not constituting a Federal crime. Now understanding that is still on appeal—I am not trying to get into the *Kilpatrick* case particularly—my question is this——

Mr. OLSEN. Pardon me. What is on appeal is, therefore, something that prevents me from even by indirection referring to. That is the problem. So when they say, well, there are cases that are comparable, I can't disouss those cases as if they are comparable without assuming that, in fact, they are.

So I will be happy to discuss other cases, but I want to make sure the record is clear that I am not addressing——

Senator ARMSTRONG. I understand.

Mr. OLSEN [continuing]. That assumption.

Senator ARMSTRONG. I understand. While we are there, though, let me just ask this: When you say you can't discuss it—I started to ask and we got sidetracked—is the prohibition on your speaking on such matters—is that a matter of law or matter of policy or matter of professional ethics or maybe all of the foregoing?

In other words, is there a statute that precludes you from answering?

Mr. OLSEN. Well, depending on the case. For example, in part of the *Kilpatrick* case I understand that some of the trial court briefs are still under seal by order of the district courts. It would either be Judge Winner or Judge Kane. It may be that some of the information has not been made a part of the public record, in which case it may either constitute confidential information under 6(e) of the Federal Rules of Criminal Procedures or constitute taxpayer information under section 6103 of the Internal Revenue Code.

There are also canons of ethics which address the propriety of prosecutors discussing cases while they are pending, having to do with constitutional safeguards designed to protect those people who are still presumed, and should be, presumed innocent until there has been final adjudication. And to try to attempt to change that, not by necessarily inflaming the public but simply by releasing information has a cumulative effect of swaying a community—may end up with the same egregious result.

And I think that for a prosecutor—I have always believed that you do your best speaking in the courtroom. Let the evidence speak for itself.

So it is all those reasons, Senator.

Senator ARMSTRONG. Well, with respect to any matter that had been sealed by the court, obviously, you couldn't speak about that or anything that was confidential taxpayer information. That is governed by statute. I am not sure I know exactly what the status of the ethical consideration is, and there is no need particularly to pursue it at this point. I guess I will just try to inform myself a little better so that the next time I try and get a handle on this, I will be in a position to do so in a better informed manner.

It isn't my purpose at all to try to degrade those considerations. On the contrary, I would agree with the notion behind them. But, on the other hand, you can see unless we are prepared to just ignore the problem that has been so forcefully brought to my attention and the attention of others, we have to find out some way to make an evaluation of what is going on. And I am open to what that process ought to be.

Let me then turn to the question that I was starting to ask. And let me see if I can rephrase it in a way that doesn't cause you any concern.

In the event a case is dismissed because the offenses which are mentioned don't constitute an offense under Federal law, and if persons have been already convicted, pled guilty and then convicted or been convicted in some way or another for similar offenses, what is their status?

In other words, if some guy is in jail someplace or on probation someplace, having pled guilty to an offense which later is determined not to be a Federal crime, what is his status?

Mr. OLSEN. Well, I am not sure that I quite understand the question, but if the facts of both cases are for prosecution purposes based on an identical set of circumstances and one jurisdiction has found that they do not constitute a crime and another jurisdiction, and it could be a circuit court, would have the opportunity to review that——

Senator ARMSTRONG. Could you pull the microphone just a little closer? I didn't quite understand that.

Mr. OLSEN. I am trying to think of the factual situation where this could occur.

Senator ARMSTRONG. Suppose you had several defendants in the same case?

Mr. OLSEN. If you had a tax shelter promoter that was operating in one district and had members of the same identical conspiracy operating in another district, they are successfully prosecuted in the different districts, and on appeal one court says that whatever was charged did not constitute a crime under all the tests used by the courts under Federal law, and the identical similarly situated taxpayer in the other district then on appeal had a circuit court that concluded just the opposite, I think the standard that the court would use on re-review, rehearing or that the U.S. Supreme Court would consider—or it could be a district court—is whether or not there is a sufficient basis, in fact or in a law, for causing the conviction of the one that has been upheld to somehow be overturned.

Senator Armstrong. How would that come to their attention?

Mr. OLSEN. How would it come to the court's attention?

Senator ARMSTRONG. Yes.

Mr. OLSEN. It could come from a variety of means and methods. It could be that—I am drawing on theoretically because I have never seen the situation or heard of it coming up.

Senator ARMSTRONG. I understand. We are deliberately avoiding dealing with specific cases and dealing with theoretical situations. So let me just pose a theoretical situation. It is much simpler.

Let us suppose that you have a group of defendants all in the same case. So, clearly, the facts and the law is going to be the same. That they all happen to be residents of the same circuit and, in fact, the same judicial district. But a couple of them plead guilty and are sentenced, and one of them says, nothing doing, I am going to fight it; and fights it, and the case is then dismissed. The judge says, look at what they were charged with isn't a crime. My question is: What happens to those poor devils that are in the jug?

Mr. OLSEN. Well, it depends on the facts. Because the defendant that was charged, that the court later determines legally there was insufficient evidence to convict him, he did not have the sufficient criminal intent, or that as a matter of law, whatever that defend-

ant did did not constitute a crime, would not mean necessarily that the other people did not engage in a conspiracy or engage in conduct that was criminal at the time.

In a conspiracy, you may have someone that did the financial statements, faked some numbers that are inaccurate, and that may have been a crime. The promoter may not have known that the figures were altered or changed. You may have someone that falsified the tax return, and the promotion of the shelter is otherwise the same.

The case, though, that you started to postulate is the one where a little closer—which is what you are saying is that you have identical facts, you have different circuits and in one circuit the court says as a matter of law that is not a crime. That is not one I am——

Senator ARMSTRONG. Well, that is one I did have in mind, which we won't mention since we don't want to put you in a compromise position. It is that they all were all in the same district and were all in the same circuit, and the judge didn't find the matter of lack of evidence. He just says the thing you have charged these guys with doing isn't a crime.

What I was hoping you might say and what I hope you would at least think about doing is taking a look at the guys who in this particular case—and maybe there are others. I am told there are others, but I don't know that—that you take a look at them and see if justice has been done. If it hasn't, maybe the Department on its own initiative would do whatever it thinks justice requires.

I have a kind of a sensation that if what we were told is true and there are some people that are in this fix, that it would be a proper gesture for the Justice Department itself to make some effort to set it right. If they are still in jail, to get them out. If they are on probation, to get them off or whatever is the right thing.

Mr. OLSEN. Well, I certainly agree with that, Senator, that that should be the case. I am not aware of any defense attorneys or anyone that has been in that hypothetical situation having raised that with the Department of Justice or the Tax Division.

Senator ARMSTRONG. I don't know whether it has been raised. It came to my attention last week in testimony here, and we can sure furnish that.

Ann, will you be sure that Mr. Olsen gets it?

I don't know whether it is true, but that is what we were told, that in at least one or two specific cases exactly those facts I have outlined were the case. I am pleased that you feel at least that the Department could look at it and see whether or not it holds up under examination.

Mr. OLSEN. It makes no difference whether or not we put in 100 hours or 100 years, justice is simply never served when anyone makes an attempt to unjustly either accuse or convict someone of a crime.

Senator ARMSTRONG. It may be that at least for the one or two people involved the most important outcome of this day's activities is that someone will take a look at their case and maybe fix it up.

Could I ask you this question? It is mostly for the record, because I am confident what you will respond. We are told that at least in some cases the real motive of prosecution is to scare people in a

certain tax shelter business. That by merely bringing an indictment it will convince people this is a business they shouldn't be in even though it may be within the law, if it is not popular with the people who are enforcing the tax laws.

I am assuming you are not going to agree with that, but since it is on the record, I would like to have your response.

Mr. OLSEN. I categorically reject that statement as having even a scintilla of truth to it, Senator.

Senator ARMSTRONG. All right. Fair enough.

We talked about statistics on pocket immunity, and I believe you said that it seemed reasonable to you that we begin to collect those statistics.

Mr. OLSEN. Well, I think I pointed out that I had not sought the clearance of my boss, the Attorney General of the United States, or, for that matter, of OMB. I think that, therefore, my comments were strictly of a personal nature. But I think that is something that perhaps this subcommittee may wish to pursue further with the Department of Justice.

Senator ARMSTRONG. Could I ask: Does that require a statutory change or could the Department just begin to do that?

Mr. OLSEN. I don't have the slightest idea how things like that are really done.

Senator ARMSTRONG. All right.

Again, we are noting that, and we will try to follow up on that.

Mr. OLSEN. Sometimes legislation is required. I really couldn't say.

Senator ARMSTRONG. All right. Among the suggestions that we have heard is the idea that in criminal cases where the prosecution is found to have improperly conducted itself, the actual attorneys fees expended in defense of the defendant should be reimbursed to him.

There is some precedent for that, I guess, in the Internal Revenue Code. What is your reaction? Is that a good idea or not?

Mr. OLSEN. Well, again, subject to the same caveat with respect to not having discussed this at all with anyone in a senior position in the Department or with OMB, let me address it in this fashion.

If by your proposal there would be in all cases in which an individual were not convicted, then I think the standard is, obviously, just simply too broad. Because there are many cases in which individuals, for one reason or another, may not be convicted. They may—it happens. In the case of *Lowell Anderson*, for example, Lowell Anderson passed away in the last couple of months after the Tenth Circuit Court of Appeals' decision came down while the case was pending. Would you award attorneys fees in a case simply because the individual was not ever convicted? That is one standard.

If the next standard is that, well, they may have been tried and acquitted, would the standard, therefore, be one of compensating for attorneys fees? I think there you also have a problem. To convict someone, the standard of proof is beyond a reasonable doubt, if there is any doubt at all, for whatever reason. There may be jury nullification. You may find cases, and they occur, where the evidence seems to be substantial; nevertheless, the individual is not convicted. It may even be a hung jury.

If though you are talking about the case where you get into what I call the "hard of factual situation," where you can't find any basis in fact or in law, then what is the remedy? I think we would all be bothered by a system that simply said that under no circumstances would anyone ever recover where they had been—even where they had been unjustly accused, satisfying all tests of whether they had been unjustly accused, and had to suffer the humiliation of being unfairly, unjustly charged; perhaps their reputation in the community ruined, their assets depleted, and then only at the point in time what you would call the moment of truth before trial or during trial it turns out there was no case in the first place.

Those are very tough cases in terms of whether or not you can craft a remedy.

Absent, though, those situations—and I haven't thought more about the question of whether you would have the remedy applied to the individual employees of the Government or the Government itself—it seems to me that the better way to go is, if you did it, would be that it would be the Government itself; not the individual employees of the Government.

When the case goes forward, the criminal case goes forward, it is not an AUSA, assistant U.S. attorney; it is not a Tax Division attorney; it is not the IRS; it is the United States of America.

Senator ARMSTRONG. In that case, would you say only the Government should be liable? You made it plain that you would only favor this if very high standards were set. Very high threshold, I guess, is the word. But would you say that the person involved should be exempt or should he or she also be liable?

Mr. OLSEN. I have thought in terms of the development of other civil liabilities that this administration has been pushing in the direction—and I may be wrong, but I thought pushed in the direction of having the claim against the United States as opposed to the individual agents and employees.

I know that in tax cases we tend to try to get the correct parties identified for the court early on no matter what the plaintiff has done. It seems to me if we are talking about what someone did within the scope of their duties or if there was an abuse of process so that it couldn't be construed in any way, or where you had someone that, as we were talking about before—this case where someone had apparently baked up some information, did things during the course of an investigation that then caused irreparable injury and harm, the Buffalo situation, it seems to me that if there is no remedy now—I would assume that there is, but if there isn't, then there is no reason in the world why anybody ought to get away with that. I mean if we have the authority to criminally prosecute the individuals, then it seems to me that the government has recognized the harm itself.

Senator ARMSTRONG. Well, I appreciate that. I think that is a helpful response.

This theme, this idea that in some way or another that defendants should have under certain circumstances, even with a high threshold, which I would agree with, by the way, access to sue for attorneys fees and even for damages seems to me a recurring

theme and a reasonable one; particularly, if you get the extreme circumstances of the *Buffalo* case.

So it is helpful to have your thoughts on that.

You mentioned, if I may just sidetrack from the legislative proposals, you mentioned the issue of humiliation. I was surprised to learn that at least one of the defendants in one of these cases that has come to my attention who was prosecuted on a tax charge of some kind was taken to the courthouse and before he was permitted to enter the courtroom was put in handcuffs and leg irons. Would that be a regular—and apparently, so was said, at the request of the prosecuting attorney. Would that be a normal thing? Would a person who was accused of that kind of a crime ordinarly be handcuffed and leg-ironed?

Mr. OLSEN. Well, I think that matters like that are really more appropriately addressed by the people that are responsible for the custody of prisoners in and out of courtrooms and the handling of the Federal prisoners. That would be the U.S. Marshal Service.

Of course, a great deal of what they do is set by the tone or the request or the instructions or the policy of the local court. And I dare say that if there was a situation of abuse in a courtroom that a sitting federal judge would correct it immediately. Now if they didn't, I would assume that that is standard procedure in the courtroom.

Senator ARMSTRONG. You mean for the judge to supervise the situation in his court?

Mr. OLSEN. That is right.

Senator ARMSTRONG. In other words, if he thought someone was brought in that needed to be handcuffed and wasn't, he would order it? And if somebody was brought in in handcuffs who didn't need to be, he would order them removed?

Mr. OLSEN. Or in anticipation of the individuals coming before the court, have a standard set of guidelines.

Senator ARMSTRONG. Well, I was really just asking a more general question. Obviously, I guess a Federal judge can do darn near anything he wants in his own courtroom or any place else. But I was just asking from your experience in dealing with cases of this kind is it a common thing for defendants in this kind of case to be restrained in that way?

Mr. OLSEN. I really can't say, Senator. I don't know the answer to that. I do know that unfortunately with the disposition of cases, criminal tax cases, most people don't go to jail at all in all too frequent situations. So whether they are handcuffed in a courtroom, I don't know the answer to that.

Senator ARMSTRONG. Have you prosecuted a lot of these cases?

Mr. OLSEN. Yes.

Senator ARMSTRONG. Fifty of them? One hundred?

Mr. OLSEN. Oh, you mean me individually since I have been with the Tax Division?

Senator ARMSTRONG. Yes.

Mr. OLSEN. No; I am in a supervisory position.

Senator ARMSTRONG. Oh, I see. You haven't prosecuted.

Mr. OLSEN. I wouldn't have any opportunity to.

Senator ARMSTRONG. I see. Have you defended such cases?

Mr. OLSEN. Yes; When I was a prosecutor in the Alameda County district attorney's office, Oakland, CA.

Senator ARMSTRONG. But those wouldn't be tax cases?

Mr. OLSEN. No.

Senator ARMSTRONG. I was just curious. You apparently have not——

Mr. OLSEN. Oh, I have seen people in courtrooms that have been brought in that have been handcuffed, yes.

Senator ARMSTRONG. On tax cases, would that be a regular thing?

Mr. OLSEN. Well, I can't say they were tax cases.

Senator ARMSTRONG. I see. I will have to elicit that from somebody else. I was just surprised, and it came to mind because you mentioned humiliation as a thought.

We have talked about counsel for the grand jury witnesses, and you have indicated that is not something you would favor.

Did we discuss whether or not the entire transcript should be turned over? I think we did, and that you indicated also that you did not favor that as a suggestion.

Mr. OLSEN. That is correct.

Senator ARMSTRONG. I think you responded to Senator Grassley on the Jenck Act.

What I am about to ask you may be something that you would rather defer to someone else within the Department, but since it has come before us, let me ask that also.

One suggestion which was presented—and I believe again by Mr. Vira—was the notion that the OPR operation should be given the status of an inspector general comparable to that that is enjoyed by inspectors general in other departments. Is that something that you would care to comment on?

Mr. OLSEN. I believe the position of the Department of Justice is opposed to that, Senator.

Senator ARMSTRONG. Is opposed to that?

Mr. OLSEN. It is opposed.

Senator ARMSTRONG. All right.

Mr. OLSEN. And I would point out that if you consider that an Inspector General's office is primarily a civil function, not a criminal function, then what you would see immediately is that having the ability as OPR does to conduct grand jury investigations gives them far greater authority and latitude than any Inspector General's office.

Senator ARMSTRONG. One of the witnesses, Mr. Russell, indicated that what he really wanted, if not the entire transcript of the grand jury proceeding, was access to summary evidence that had been presented to the grand jurors. He seemed to attach great significance to that proposal. What is your thought about that?

Mr. OLSEN. I hadn't heard that was something that had come up during the hearings. And I apologize because I am not prepared to respond to it, but I would certainly be glad to communicate back to the subcommittee in writing to express my views on that.

Senator ARMSTRONG. Would you? That would be very helpful.

[The information from Mr. Olsen follows:]

My testimony in response to questions outlined the reasons why providing defense counsel with the entire grand jury transcript was objectionable. Upon reflection, the

same types of problems would exist in connection with providing defense counsel with a summary of evidence. Moreover, defense counsel say they need the transcript to detect grand jury abuses. Such abuses would hardly be set out in a summary of evidence.

Senator ARMSTRONG. We heard quite a bit about the *Mechanick* case. I suppose that must be familiar to you. In general, I understand what that says is that if somebody is convicted, the fact that there may have been serious abuses of the grand jury process is not to be taken into account on appeal; it is not enough to overturn the conviction. Is that a fair summary of the *Mechanick* case?

Mr. OLSEN. I don't believe that it is.

Senator ARMSTRONG. Oh. Well, I am glad that I asked then. Could you tell me what the *Mechanick* case means, then?

Mr. OLSEN. Well, in part it stands for the proposition that the mere presence of unauthorized individuals before the grand jury, by itself without a greater showing of prejudice to the defendants, will not be the basis for a criminal conviction to be overturned.

I think that when we talk about grand jury abuse, prejudicial misconduct or prosecutorial misconduct, what you need to focus on is whether or not we are talking about error-free investigations, and whether or not there is going to be strict liability that is attached to the Government simply because there may have been some technical errors made in the investigation of the cases.

If there are errors, then I think the question that needs to follow from that is whether or not this has somehow impaired the ability of the grand jury's function, constitutional function, and has that in someway prejudiced the rights of defendants.

If what we do is in our system create a standard that says that is not a Miranda standard, not a basic substantive constitutional right type of an issue that the courts have addressed, but rather that a violation of a Federal rule of criminal procedure constitutes a per se violation that means that there has to be a reversal, there is no way for the Government to recoup that, no way for the Government to remedy that, and we are going to set aside all the convictions.

And I think that when you look at these cases in terms of whether it is 6(d), which in the *Mechanick* case, or 6(e), which is the *Lowell Anderson* case and other cases, that what you see is that the courts are developing a line of authority standing for the proposition that without a showing of prejudice that a violation, technical violation, without more, may be the subject of some other action, like disciplinary action or something else.

But in terms of what the effect is on the criminal case, it will not affect the ability of the Government to successfully prosecute that case.

Senator ARMSTRONG. Your summation of the meaning of that case is markedly at variance with my understanding of the testimony of David Russell, who is president of the National Association of Criminal Defense Lawyers.

I don't want to argue the issue. I mean you know more.

Mr. OLSEN. It is understandable why we would interpret the case differently.

Senator ARMSTRONG. Well, it really isn't to me. Let me just read you the paragraph that is relevant to my understanding. And I

guess that is why we are asking you to testify as well as asking Mr. Russell.

Here is what he states. And he comes to really quite a flatly different opinion, if I understand the point. He says:

> The reason for this remarkable result would be that the Mechanick case where the Supreme Court held that any violation of procedural protection before the Grand Jury is automatically rendered harmless and irrelevant once the defendant has been convicted. The court was quite candid about the Catch-22 situation it was creating for defendants, noting that "although the defendants appear to have been reasonably diligent in attempting to discover any error at the Grand Jury proceeding, they did not acquire the transcript showing the error until the second week of trial."

And it goes on, but he sums up in this way: 'No analysis of the egregiousness of the violation or the extent of actual prejudice is necessary. The conviction automatically purges any and all taint." He says with greater precision what I thought I was saying at the outset, which is if there is something wrong with the grand jury proceeding, you can't get a reversal on it once the verdict is in.

Is that right? Or are we still not in agreement as to the meaning of that case?

Mr. OLSEN. Well, I think there still is some disagreement, but I would suggest that the *Mechanick* case does speak for itself. The facts are fairly clear. They are not, as I understand them, analogous to any case that this subcommittee is focusing on.

Senator ARMSTRONG. And it isn't your belief that the meaning of that case is to prevent somebody getting a reversal of a conviction on grounds of errors in the grand jury?

Mr. OLSEN. Well, it is only a specific kind of error. Not all errors, but only the errors that were addressed by the court in that case.

Senator ARMSTRONG. All right. We will see if we can get one of our legal scholars to pin that down. That isn't what this seems to say.

Mr. OLSEN. Senator, I think you are going to find that you have people across the spectrum discussing what the meaning and the impact of that case is.

Senator ARMSTRONG. All right.

Mr. OLSEN. It is not a case where I think you are going to find that there is an absolutely clear——

Senator ARMSTRONG. All right. Well, let us get off that analysis of what it means, and let me ask you to address the policy issue involved. Can you give me a standard? If the committee wanted to write something or if somebody wanted to write a bill to address this issue, what kind of a standard should they follow, if legislation is necessary? It may not be. But where should the line go? Are there any errors before the grand jury that should permit a reversal of a conviction?

Mr. OLSEN. I happen to think that the courts are the best judge of whether or not someone's substantial and fundamental rights have been affected by errors or mistakes in an individual setting before the grand jury.

Senator ARMSTRONG. In other words, you don't think any legislation is necessary? That the courts will enforce the constitution, and that is enough, I take it?

Mr. OLSEN. No, I am not aware of any legislative vehicle. And I do have a great deal of contact with the private bar, the American Bar Association.

Senator ARMSTRONG. All right. Again, that is helpful because it poses the issue. The defense attorneys may be just reflecting their professional concerns where basically it is unanimous that they thought something had to be done to overturn the *Mechanick* case. And you have made it clear that you don't feel that way. Even though there is some disagreement about what it means, the part that is clear is that you don't think legislation is necessary, and they do. So that is an area for further thought, I guess.

Could we go back for a moment to the question of the Department's position on the publication of Judge Winner's decision? Your testimony was perfectly forthright, I thought. You said that the Department did try to suppress publication, and the decision to do so was not cleared at the highest levels. And when the higher levels heard about it, they reversed it, and it was a mistake.

However, upon reflection I think Judge Winner told us last week that that case is still pending in the tenth circuit. Could that be right?

Mr. OLSEN. I had heard the same thing last week. I think the issue moot in the truest sense because the issue in a more technical sense had more to do with printing and publication than with publication. Because Judge Winner's opinion, when it was released, was immediately published. And, therefore, it became immediately available to all of the commercial publications and was available to anyone to cite it as authority.

There is a written bound edition put out by West Publishing Co. It is entitled "Federal Supplement." And the motion that was filed and what was attempted not only at the district court level and then at the court of appeals level was to prevent Judge Winner's opinion from being printed in a permanent bound edition of West Publishing Co.'s "Federal Supplement," whichever that one would have been in terms of sequence.

That has already occurred. I am not sure mechanically what anybody would do—go out and take a razor blade to every "Federal Supplement" volume that is out there. It is a dead issue.

Senator ARMSTRONG. So there is no need for the Department to withdraw its motion or whatever it needs to do?

Mr. OLSEN. I appreciate what he said. And I will certainly take a look at whatever may still be lingering there for the reason that if by leaving a motion dangling there is a suggestion that we have somehow hidden agenda or we are going to change our mind or anything else, our answer is, "No."

Senator ARMSTRONG. Well, I am not speaking for him, of course, but my guess is that he would be glad to get that kind of loose end taken care of.

Could we turn to a question that was raised—I have forgotten exactly who. It may have been Mr. Waller who raised this question, but it is an interesting one. That his concern is that there is sort of a temptation to take a complex area of tax law interpretative question, a question about which perhaps reasonable persons could disagree, and to sort of preempt the whole thing by making it a criminal case.

Could you just partly in response to that tell us how you decide when you look at a tax shelter business and somebody comes in and says, boy, that stinks; we ought to do something about it—how do you decide? What are the guidelines as to whether or not that is a civil enforcement matter or whether or not it rises to the level of a criminal case?

Is it a matter of intent? Or what are the standards that you use?

Mr. OLSEN. Well, it is a very complex area of the law in one sense. It is complex because one has to understand the criminal system. That regardless of what you may think, the ultimate moment of truth comes when you have to persuade a jury of peers, and they are not tax attorneys, and they are not prosecutors, and they may not be filing their own returns, and more likely than not they don't prepare their own returns; have apprehensions about the tax laws and perhaps the IRS; and you have to persuade them beyond a reasonable doubt that an individual that you are considering charging is guilty beyond a reasonable doubt.

And that should you have any doubt about the merits of the case factually, that to the extent that those matters would come out in court and reveal a weakness in your case, that the judge may independently of the jury conclude that there was no basis for proceeding. That is the end result, and you have to be thinking about that because you have to be mindful that whatever you do is going to end up in that forum.

And then you have a body of case laws. It is in the courts of appeals and the district courts and by the Supreme Court that address general constitutional standards such as what a reasonable man would have to guess as to the meaning of his or her conduct so that they didn't know whether or not what they were doing bordered on a criminal offense.

The test that we use in most shelter cases is whether or not there is fraud as that term is used in a common law sense; that there is a false statement. You break that down on a shelter case, and it is something like this:

Were there any underlying assets that are the basis of the shelter that are nonexistent? So that even if everything they said in the perspectus is true, if in truth and in fact they didn't have any economic interest in a coal mine, they didn't have any coal reserves, no matter what else happens, it is fraud. And that directs us to the area where what we see in most of these cases in that the investor is defrauded just the same as the United States is defrauded on the tax side. The investor is duped into believing that something was going to be an entitlement to them in a tax sense that they were not entitled to because factually they didn't satisfy it.

Senator ARMSTRONG. Does it turn on criminal intent? Is that the notion that we are talking about here?

Mr. OLSEN. If you have someone that is back dating documents and saying in January 1985 I will sell you an interest in a shelter and you will get your deduction in 1984 because we will back date the documents to December 1984, it is——

Senator ARMSTRONG. That is very simple criminal intent.

Mr. OLSEN. That is a very simple case.

Senator ARMSTRONG. That is wrongdoing.

Mr. OLSEN. And it is a test that looks at all the facts and circumstances, the intent of the promoters, the intent of the individuals that were selling it, the attorneys. Attorneys may be our witnesses. They may come in and say, sure I gave that opinion, but I was told that these were the facts; you are telling me that those were not the facts. Well, I have some written correspondence from the promoter telling me these are the facts which were the basis for my being retained to write the opinion. That is another set of circumstances.

Senator ARMSTRONG. That is where the promoter actually gets an opinion that the tax shelter proposal is legitimate from a reputable law firm by, in effect, defrauding them as to the fact.

Mr. OLSEN. Misleading them. That is correct.

Senator ARMSTRONG. All right. I got that.

Mr. OLSEN. Could be that you have a set of facts relating to circular financing where in fact what has happened is what appears on paper to be a legitimate arm's-length method of financing a particular shelter or promotion, that, in fact, what you have is through a series of seemingly unrelated but actually predestined events that there is a chain of money that flows back and forth, creating the appearance that there is a substantial amount of money and financing that is actually involved and is available to the promoter and the investors to generate the deductions.

Senator ARMSTRONG. It, basically, comes down, though, to intent. If it is just a dispute over a legal interpretation of the meaning of some provision of the Tax Code, if it is a good-faith dispute of that kind, it wouldn't be the intention ordinarily of the Justice Department to undertake a criminal prosecution. Is that a horseback understanding?

Mr. OLSEN. That is correct. There is very little reason for us to prosecute cases that are on a border line between civil and criminal. One, there is a sense of fairness. Two, there is a sense of whether or not it is appropriate to bring into the criminal court. Three, if we are not sure about criminal intent but it satisfies the other requirements, it may have a false statement—there may be a false statement in there through a lot of ineptitude, through a lot of other things. We have the ability in the shelter side to seek an injunction. The Service also has the ability to impose a variety of penalties that have been made available to the Government from TEFRA on forward. We have other means of generating corrective conduct.

You don't need to prosecute everybody. And if you do impose a penalty against, for example, an investor for a deduction that they thought they were entitled to but they weren't, well, the effect may be that they seek recourse through civil dispute resolution with the promoter. So it may be private litigation.

Senator ARMSTRONG. Again, I appreciate your answer because it sort of establishes the parameters for further consideration. Because it seems to me it would be very hard for a thoughtful person to disagree with what you have said. But it is the testimony of at least one of the lawyers before the committee that, in fact, the common practice of the Department is to take an area of the tax law that is complex and technical and just sort of deliberately escalate it into a criminal matter.

Now I don't have any way to evaluate that, but that is the opposite of what you have said. You said if it is that kind of a situation, you would have no incentive to do so; that you would take it the other way, both for reasons of fairness and for practical reasons as well.

So I don't know how we will ever resolve that question. I am going to try to think of some way to resolve it. In fact, I would entertain any suggestions about that.

How would you resolve questions like that? What would you do if you were me? This whole hearing is full of questions just like that, where people who are insofar as I can determine serious, reputable, experienced people who come in and say, look, this situation is really a mess. And representatives of the IRS and the Justice Department, who I have every reason to have confidence in, come in and say, nah, it is not that way at all. How do I make a determination of that?

Mr. OLSEN. Well, I suppose you start with the complete record in the cases that they are talking about, seeing what is available in public record and finding out whether or not if what they say to you is as they were represented or testified to before the court. I realize that that may be a burden. On the other hand, there are different motivations of individuals when the cases are currently pending before them. I don't want to cast any reflection on anyone that may have come up and testified here.

But, quite candidly, there is a difference. And I think also that in terms of looking at whether or not something is a persuasive practice that you have to ask for the cases themself and find out how it is that the courts address them. And if the courts—if it is a case on appeal, then there are probably a whole host of things that happened at the district court level where this whole matter came up to the attention of at least one other member of the bench, a district court judge, and that judge made a decision that there was sufficient evidence and compliance with the law by the prosecution to go forward. That usually occurs at the pretrial level. It certainly will occur after the trial when we have convicted someone.

That is one way. I think you have to look at why it is that individuals use offshore financial institutions, as if there is something wrong or there is some benefit to be gained by using them over a domestic one. In those cases, I always tell practitioners, ask yourself this question: What is the legitimate business purpose in using an offshore entity? If what you are going to do is generate deductions or credits for individuals who are going to claim those on their returns, everything is going to come out in the open anyway, isn't it?

I mean the first thing the IRS is going to say is you have claimed these deductions; now tell me why you are entitled to them.

I think that with pending cases you run into more obstacles. I think that is where the legislative process kind of runs into the criminal justice system in a different, unique way. The rules of confidentiality on taxpayer information and grand jury information are not designed to eventually have the information become public in many respects. We may have an individual under investigation. We may have the greatest case in the world. That individual could die the day before we are going to return an indictment, and yet

we can't release that information to show that what we did was legitimate, was justified, or that there may be a continuing harm that exists.

We could conduct an investigation in an environmental area and find that there may not be anything criminal, and yet there is a potential environmental harm—couldn't release it. The IRS may come across evidence of crimes, nontax crimes, in the course of an audit or an investigation. Unless they are able to go forward with an investigation somehow with the Department of Justice. That information will not be imparted to us.

So there are limitations out there, very real ones, that we have to live with every day.

Senator ARMSTRONG. Maybe I am asking you something that by its very nature is not something you are able to answer. I was really asking what time it was, and you told me how to make a watch.

I was just referring to the far more practical problem that I face. Like you, I work long hours. Like you, I've got maybe 100 different projects on my hot list. All I want to know is how to do justice in this case and get on to other things.

And my concerns are, first, that some reputable people have expressed concerns. A Federal judge has expressed those concerns. At least four attorneys, two of whom were involved in a case but two of whom were not, representing professional associations have expressed concerns. And at least one person who is a defendant has expressed a concern. In addition, I have got over at my office a footlocker full of correspondence and phone messages of other people.

So I want to be sure those don't get swept under the rug. On the other hand, the last thing I want to do is fly off the handle and recommend legislative course of action that would be injurious to the Department or that would hamstring prosecution.

And then, finally, I want to do it in some way that doesn't become so consuming for me personally that it interferes with what my main job around here is which isn't this. And so what I was really asking you was for a more practical thought.

Honestly, if you think about that—if you have any thoughts—I mean this isn't your job. You are not here to give me legal advice, but if you have got any thoughts now or after the hearing or tomorrow or a week from now, it would be helpful. I am horsing around with a lot of ideas about sending out a task force or hiring special counsel or something, but what I want is some simple way to be sure that the legitimate—that the concerns that have been raised, if they are legitimate, are dealt with in a way that doesn't prejudice the Government's work and that doesn't involve me in a quagmire that I can't cope with. That's really all I will ask.

Mr. OLSEN. Well, a lot of it is timing, though, Senator, because it is much easier to deal with the discussion of a case, such as the Buffalo example where it is closed, than it is with one that is currently pending, which creates a whole host of limitations on the ability of the different components of the Government to exchange the information and discuss what is going on.

Senator ARMSTRONG. All right.

Mr. OLSEN. If there is a major tax loss that is ongoing on a shelter investigation, we are not necessarily entitled to share that information with the civil side. There are limitations, and we deal with them every day. And they are very real problems.

Anytime that there are in one sense arbitrary, that may be based on other policies, limitations on the Government to exchange information fully, then you are going to have some unfortunate and perhaps unjust results.

On the other hand, that may be because in the long run countervailing policies having to do with confidentiality and secrecy warrant and demand that we maintain them.

Senator ARMSTRONG. I don't think you are talking about it being real easy.

Mr. OLSEN. You say what about giving a grand jury a transcript as soon as we return an indictment. Well, the next question is: Why don't you give them a transcript as soon as you get the transcript prepared while you are conducting the investigation? That is the next step.

And you start saying, well, wait a minute, it is one thing to say we are going to share that information after we have made a decision to prosecute and there has been an indictment. It is quite another to say we want to share the fruits of an investigation with you before we have completed our investigation. Some people say there is nothing wrong with that. I dare say if we did that, we would never prosecute anybody in this country for narcotics, organized crime.

Senator ARMSTRONG. That is not the recommendation that has been made to this committee. The recommendation that——

Mr. OLSEN. Just give us everything.

Senator ARMSTRONG. Sir?

Mr. OLSEN. The recommendation is that on day one give us everything from the grand jury.

Senator ARMSTRONG. Yes. That is the recommendation, although in fairness to the person who recommended that he did admit to this caveat: That if there was a reason why specific portions of it should not be revealed, that the prosecution should have a right to make that case and let the judge decide. It is a question of whether the presumption was that you get the transcript or not.

Let me move on. One of the recommendations we have heard—and I would ask really the opinion of all three of our panelists—is the following: That Congress should take the criminal investigative function away from the Internal Revenue Service and place it with the FBI. The notion, and let me just quote from the recommendation: "This would ensure that all criminal investigations are conducted independently, free of any improper considerations of civil enforcement. The FBI has the expertise and ability to investigate these types of crimes."

Any comments on that?

Mr. LANGONE. Senator, let me conment on that first.

Mr. OLSEN. Let me ask a question. Is that a recommendation by all four of the witnesses?

Senator ARMSTRONG. No.

Mr. OLSEN. Then it is not a position taken by the American Bar Association?

Senator ARMSTRONG. It may be, but I don't know that. It is a recommendation of William C. Waller. And if the bar association has commented on that, I am not aware of it.

Mr. LANGONE. Senator, let me say that I feel that I represent probably the most effective financial criminal investigative agency in the Government. And I think that it has been identified as one of the most effective investigative agencies by many independent sources.

I think that it would be totally inappropriate to consider placing the investigation of criminal tax crimes in any other agency but within the Internal Revenue Service. Most of our investigations are independently conducted administrative investigations, that tie in very effectively with a total program to assure voluntary compliance by effective and particular tax prosecution. So that I don't think that is a very effective idea.

Senator ARMSTRONG. Mr. Rankin.

Mr. RANKIN. I would just add that the statutory prohibitions of sharing tax information under section 6103 would create quite a problem in that regard. And, of course, that one of the reasons for enacting that statute was to assure the American public that information they disclosed on their tax return would achieve a level of privacy.

To relocate criminal investigation into another agency would abridge that considerably.

Senator ARMSTRONG. Thank you.

Mr. Olsen, before you respond, let me elaborate a bit further on the ABA's position. What I said was correct. I am not aware of what the ABA's position is, but in checking the notes I mabe when Mr. Vaira was here, I noted that he personally disagrees with the idea of moving the criminal investigative function to the FBI. Whether the ABA has taken a position, I still don't know. But I recall now that I look at that note that he was very straightforward about that. He endorsed a number of other proposals that had been presented, but that was not one that he did.

Mr. OLSEN. Let me just summarily say that I don't think it is a very good idea, and I don't think it is a well-thought-out proposal. And I think it has more detriment than it has any possible beneficial effect, which I see as none.

Senator ARMSTRONG. All right. Fair enough.

I think that all or at least most of the remaining issues that I want to raise are issues which, in fact, need to be taken up with OPR or at least with somebody else because they involve the question of what happened to people who have been accused of improper tactics in prosecution or ethical violations or manufacturing evidence or whatever it might be.

I think the only other remaining question I might direct to Mr. Olsen, and then I would invite anybody who wants to have the last word to do so, is this: You mentioned that you didn't think it was worthwhile to inflame public opinion and that the best speaking that lawyers can do is in court. And in that connection, I wonder if you could tell me something about what the Department's policy is on press releases and those kind of things with respect to cases like the ones we have talked about.

Mr. OLSEN. Well, the divisions function somewhat differently because of the nature of what it is that they do. Let me share with you what the Tax Division does. The only press releases that we cause to be released in the civil side are cases in which the Tax Division has caused a complaint to be filed for injunctive relief in the abusive shelter area.

On the criminal side, that parallels very closely more of what the U.S. attorneys' practice is, although I don't hold press conferences on criminal tax cases. Rather, where the Tax Division has been the lead in conducting an investigation, then we will cause a press release to be issued together with a copy of an indictment. And the information that is on the press release flows from the information that is on the indictment. And that is the scope and the extent of what we make available.

I think that the Supreme Court's decisions in the *Sells* and *Baggot* decisions have created a greater awareness in terms of what can be disclosed at the time that an indictment has been returned.

And since we have taken a position that you can't admit or deny the existence of an investigation, because if they ask you do you have an investigation, and you say no, and that is the truth, that is fine for that case, the next time they come in and the press asks you do you have a case under investigation, unless you tell them no, then they say, ah, then you must have one. So the rule is you are better off saying nothing.

Senator ARMSTRONG. Not only to the press, but do I understand that really your policy is that if you have got an investigation going that you don't tell anybody about it?

Mr. OLSEN. I'm sorry. Is that——

Senator ARMSTRONG. Yes. Is that the point? That if you have got an investigation going, it is not only that you don't tell the press about it, you don't respond to their questions about it, but, in fact, you keep it under wraps insofar as everybody is concerned—Congress, other interested citizens, whatever?

Mr. OLSEN. The identity of an individual that is a target of an investigation constitutes 6(e) information.

Senator ARMSTRONG. What kind of information?

Mr. OLSEN. 6(e). That is to say, the identity of who it is that you have under investigation as well as the nature of what it is that you are investigating is itself grand jury information. If you disclose what it was that you were investigating or who it was you were investigating, you don't have to be very specific. It becomes very obvious what it is that you are doing. The answer is, yes, we don't make those disclosures.

If the IRS is conducting an investigation administratively, not with the grand jury, administratively, before they complete their investigation, refer it to us, they are legally bound not to make any disclosures about that case to us. They won't telegraph and say we have got this case; it is coming over in 3 months. They can't do that. That is prohibited.

Senator ARMSTRONG. Then what about the stories that we have heard of letters going out to the clients of firms that are under investigation? Or in one case that came to my attention, it was told to me that Telexes went out to—I didn't know there was such a

thing as Telex anymore. I thought that had been superseded—but Telexes went out to the customers of a certain firm, and, in effect, they said we are checking this outfit and what do you know about them. How could that be?

Mr. OLSEN. There you are talking about a piece of this question of disclosure, in the context of how you conduct an investigation so that you get the information in some reasonably efficient fashion. In the case of a tax shelter, the way you find out what exactly the individual promoters have done or said in the case of a promotion of a shelter is to talk to the investors. They are the other side of the transaction.

How do you contact them and elicit the information from them for the investigative grand jury without asking them that precise question? It is a very easy way to do that. You take the investor list, 1,000 investors, and you say I am not going to ask any of those investors any questions at all. I am going to give them a grand jury subpoena. The grand jury subpoena is going to have attached to it a schedule about itemization of what documents we want those witnesses to bring to the grand jury. Of course, they are all going to say it is with respect to the ABC tax shelter promotion, and we want to see all your books and records, all your documents, all your cancelled checks, anything and everything you have gote Now we don't want to talk to you because you may be completely innocent. But what we want you to do—and we will have 1,000 people lined up waiting to go in before the grand jury, and then have them come in and say, are you the witness; did you bring those documents with you, and get the information from the witnesses in that fashion.

That seems, to me, to be a little overreaching. It is a little unreasonable. Of course, it is an extreme example. But the question I am trying to focus on is do we have to bring every individual before a grand jury to give us any information at all, or can we have a more intelligent appreciation of the rights of privacy of individuals but also get the information in more efficient fashion.

How you do that is a different issue, because what you could say to the witnesses is: We are assisting the grand jury in the conducting of a criminal investigation; we would like to ask you some question; but we want to ask you questions about your investment in this shelter; who did you talk to, et cetera. Now you could say it orally. You could force them to say it before the grand jury, or you could say it in the letter that goes out.

Perhaps the better practice is not to simply advertise it across the face of the Telex or a letter, but to say it in a little more indirect fashion. Nevertheless, in order to get that information, you have to make some type of a disclosure. When the witness leaves the grand jury room, they are perfectly free to discuss what was asked of them. And they frequently do. And sophisticated defense attorneys will tell you that one of the most effective ways of finding out what the grand jury is doing is to wait outside that grand jury room. As if that is the grand jury room there and as the witnesses walk out, you say to them: How do you do? My name is Bill Jones. I am an attorney, and I would like to ask you some questions about what was just asked of you.

And that is perfectly in the context of that hypothetical. By itself, perfectly legitimate. And the witness can disclose.

So I mean there is a process by which in one sense the information is confidential, but, quite obviously, it is going to come out.

Senator ARMSTRONG. Do you understand the concern that was raised that motivates the question that I asked?

Mr. OLSEN. Well, sure. If an individual were the subject of a grand jury investigation and that individual really had nothing to do with the case or the case was really with further investigation not criminal and you send out 500 letters and you say we are investigating this SOB—you don't have to say SOB, you say something else—that sort of a broad-brush approach can be devastating to somebody's reputation in a community. And regardless of what happens in the criminal case, they may never recover.

That is—I think we do have to be sensitive in terms of what it is we are trying to do and figure out is our investigative approach a measured approach in terms of what it is we need and in light of the interest, legitimate interest, of individuals to maintain privacy and their reputations.

Senator ARMSTRONG. As a practical matter for somebody in the investment business, sending out such a letter to any kind of a large number of people would put them out of business, I assume. I don't know that. But it is hard for me to imagine that if your business is selling limited partnerships or stock or whatever it is and a letter goes out from a grand jury or Justice Department or the IRS or the Food and Drug Administration or from anybody that says we are checking up on the activities of John Doe or John Doe's company, can you answer any questions about it, my guess is that would put a stop to that business pretty fast.

Mr. OLSEN. I have gotten a number of calls from lawyers who have applauded us because they represented investors, and the result of getting those invitations was that they realized that they had a class action on their hands, and that their clients had been defrauded by the promoter. And the way they found out was when the Government initiated its investigation, began contacting investors.

Senator ARMSTRONG. It might also be that an investigation would be conducted by that means, among others, the result of which would be to exonerate the person under investigation but nonetheless put him out of business.

Mr. OLSEN. Which would be an unfortunate result.

Senator ARMSTRONG. If that happened, should that person, in your opinion, have a right to collect damages?

Mr. OLSEN. I think it goes back to the facts that we talked about before.

Senator ARMSTRONG. Let us take that as kind of an interesting policy, hypothetical. Even assuming there wasn't any illegal activity, even assuming it was all in good faith, even assuming, you know, that there were reasonable grounds for the investigation, if, in fact, the result is that an innocent person, a person who may never be indicted but who just in some way became the target of an investigation, loses his business over it or loses his reputation or loses his job or loses his wife or whatever it is, should that person have some way to be made whole?

Mr. OLSEN. Well, this hearing has given an opportunity for individuals to make accusations against others. And I would ask you if the mere fact that they made accusations should cause an investigation to be generated. And we did it in good faith; does that mean that the individuals that may be the target of the accusation that are found to be completely innocent of any wrongdoing, would they then have a cause of action against us?

You see, most investigations start because somebody tips off the Government one way or another. All the cases don't come to us from the civil tax audit side. You may have a whistle-blower.

Now if the Government initiates an investigation on a whistle-blower, does that mean in each and every case if it is found to be unwarranted or unjustified that the Government therefore would have to make that individual whole?

Senator ARMSTRONG. I don't know. I am asking you.

Mr. OLSEN. It seems to me that that puts a high price on trying to preserve the integrity of our Federal procurement system, tax system, perhaps the safety of our streets, organized crime. It seems to me that it is too much overreaction, and you are overreaching.

Senator ARMSTRONG. Well, somebody may be. I haven't decided yet whether I favor that proposal. I must say that I am impressed by the seriousness of the problem. In real life, I am a businessman, and I am very sensitive to how even relatively benign actions of the Government can prejudice the rights of people who are in business. And in a couple of quite specific cases that have come to my attention, including some that have never been mentioned here today which I do not mention because I have been asked specifically by the lawyers involved not to mention it, in a couple of those cases the facts are, at least as they portray them to me, is that broad-brush investigations were conducted, the final result of which was no conviction, but the guy is out of business anyway.

Now as a practical matter, if there are overzealous prosecutors and if they can put people out of business without convicting them or indicting them, just by conducting that kind of an investigation, it is a problem.

Now what you have mentioned is a problem, too. And I don't dispute that. I am just saying it concerns me. And I would be a little more reassured if somebody down at the Justice Department was thinking about it. I don't know, maybe there is. I don't know who would be in on that kind of stuff, but it would be reassuring to me if I knew somebody who was staying awake at night once in a while wondering about the rights of people who have that kind of contact with the Government.

Have you been with the Government a long time?

Mr. OLSEN. Since November 1981.

Senator ARMSTRONG. Well, that is a time. But I am sure you can recall from your private practice almost the terror that a lot of people feel when they come in contact with the Government, any branch of government—the sheriff's office, even zoning authorities, let alone the IRS and Justice Department. So I don't think it is an unreasonable thought.

Gentlemen, I am grateful to you. I am ready to quit. The things that I need to do next are related to other people. I am frustrated. I have learned some things, but I am not sure what to do with what

I have learned. Now one thing we are going to do is make up a little spread sheet which is going to address 20 or 30 issues, and try to put down on the spread sheet what each of the people has said about that issue: Should we have counsel for witnesses at a grand jury? And who said yes and who said no, and to try to summarize why.

But my larger concern is the one I mentioned to you. Mr. Olsen. I don't know quite how to process this problem. By merely having these hearings, I have fulfilled a promise I made when a guy came to me and said I'm about to be indicted; it is going to put me out of business; and I am not guilty; and, in fact, what I was charged with isn't a crime, which is what the court subsequently said.

And I told him I couldn't do anything, but at least I would give him a chance to have the problem aired. Well, we have done that, and there is enough concern that something more has got to be done, but it is hard to know exactly what.

Anybody want the last word? Anybody got a parting thought?

Mr. OLSEN. No. But, Senator, I would appreciate that because we have pending matters that we be furnished with a copy of the transcript as well as a copy of the video tape in the event that this is a matter that comes to the attention of the courts that have those matters pending to determine the extent to which the United States or anyone else may have publicly participated in discussing a pending case.

Senator ARMSTRONG. Well, we can sure furnish you a copy of the transcript. I can't vouch for the video tape, but the transcript, I guess, in due course will be in 5 days. In 5 days, they say, the transcript will be available. In 5 days, the transcript will be available and we will routinely——

Mr. OLSEN. Why not the video tape?

Senator ARMSTRONG. I don't know about that. Who are you shooting for, and do you make transcripts available? You will have to ask him about that.

Mr. OLSEN. Then I will say something. That I am surprised. Perhaps it was my own negligence in not ascertaining beforehand that a U.S. Senate committee hearing that was being video taped is being done so by someone who is a defendant in a pending criminal case, which goes to the very point that we have been making today.

And I, therefore, am going to reiterate my request, and would like to attempt to have it resolved on the record today, if that is possible.

Senator ARMSTRONG. The request for a copy of the video tape?

Mr. OLSEN. Yes.

Senator ARMSTRONG. I can't resolve that. And I will say to you, Mr. Olsen, that I didn't know who they were shooting for. We come in here every day and have hearings, and there are people video taping and sometimes it is CBS and sometimes it is CNN. Are you an independent video company? What's the name of your company? Have you taped in here before? Pretty boring stuff, isn't it?

I am sorry, Mr. Olsen, I can't help you with that.

Mr. OLSEN. Will it be possible, then, to get a copy at the Government's own expense?

Senator ARMSTRONG. Anything else?

[No response.]

Senator ARMSTRONG. Gentlemen, we thank you. Thank you all.

[Whereupon, at 3:25 p.m., the hearing was concluded.]

[By direction of the chairman the following communications were made a part of the hearing record:]

STATEMENT BY CRAIG B. FORNEY TO SENATE FINANCE
OVERSIGHT SUBCOMMITTEE ON INTERNAL REVENUE SERVICE

Ladies and Gentlemen , I thank you for the opportunity to submit testimony on a subject I know to be of a critical value to America's survival. My testimony is similar to Mr. William A. Kilpatrick's testimony in that I also was working through Mr. Kilpatrick's companies marketing legal, authorized tax-shelters to the public that Congress has authorized. My case is different in that I like thousands of other salesman have been "shut down" by the gustapol like tactics of the Internal Revenue Service. You might think, impossible in a free country to be "shut down" or forced out of business by government agents whose main concern is to serve the people.

In my case like Mr. Kilpatrick's case I was tried, convicted, and hung before I ever was served any papers or went to trial. How do I know, you might ask? Well, the Internal Revenue Service does not cover their tracks permanently, nor can they always bury their evidence so that it doesn't surface again. My case is very simple. The Congress in its wisdom passes a tax law to benefit the country at large, attornies write opinions as to the nature and breathe of the law, promoters operate within this framework, and salesman sell the end product. Unfortunately, our country has not always lived up to its word, and in the final analysis the huge debt that each of us are faced with has cause irreparable harm to all in that we cannot be honest and forthright and pay our just dues. In the case of the Internal Revenue Service, pressure has been placed to get the revenues in regardless of any constitutional right, law, or due process. Employees are given incentives and raises based on how much can be collected, not on how much justice can be served.

Who then bears the ultimate cost of this tax system, but the taxpayer and salesmen of the products created by the promoters, outlined by the attornies and mandated by the Congress. If something goes wrong with the system, we the taxpayer end up paying the debt plus the interest and then some.

In my individual case I earned a bachelor of science degree in business administration, was an operating stockbroker, insurance agent and finally passed my degree in financial planning (certified) and then set up my own private practice. This has always been the American dream to be self-employed and pay one's own way. In this process I sold products that the public wanted, needed and were entirely legal and ethical. My biggest problem was two fold. First I was associated with Mr. Kilpatrick who became a paycheck to possibly hundreds of I.R.S. agents, and secondly, I became important because I was a leading seller, if not the biggest seller in Omaha, Nebraska, of tax sheltered investments. This in itself under the I.R.S.'s practice is enough to convict you of some heinous crime.

When my case first started is anyone's guess unless you are the Internal Revenue Service, but my knowledge was that it was early in 1982 with a personal tax audit. This was my second audit in ten years so it was not strange to become audited, but what transpired after this was not ordinary in the least. My audit grew, and grew and grew into a corporate and other audits. I needed to acquire the services of an enrolled agent and then a tax attorney to defend myself against what? The Internal Revenue Service! In the process of the audit, one of my salesmen in out-state Nebraska called and told me that IRS's agents were lying about us and that I should call one of the accountants for his prospective client. The accountant confirmed to me that he was told by the agent that our company was being "investigated" and that all our tax shelters were going to be disallowed, and that they were no good. I called up my accountant who was meeting with the IRS agent and he denied that we were being investigated. And so it all began. The Internal Revenue Service operated covertly to destroy my business and as said by one of their leaders that "we are going to put Forney out of business and in jail". Without as much as any evidence, information or lawful means I was targeted on their hit list and planned for extinction. My crime was simply selling tax shelters. When has it been a crime to sell something legal and within the Congressional guidelines?

After spending thousands of dollars on attornies, the IRS used other tactics which I cannot discuss at this time to put me out of business like other government agencies and newspaper articles, but I can at least allow to surface to my knowledge at least two "sting" operations designed to entrap me into a serious crime so that a conviction could be obtained. They first contacted clients of mine, but could uncover nothing illegal or immoral. They could have found more with a mirror.

The first "sting" on citizen Forney was an IRS agent posing as an investor and trying to buy a product for a December last minute problem. This investor just couldn't make it into my office until early January when he wanted me to just back date the documents so that he could get a tax write-off. It would be very interesting to hear what I said on this taped conversation as it was played to one of my clients with the hope of getting some muck on me. This first "sting" was clearly unsuccessful in many respects. I simply said no thank you as that was illegal and offered the informate IRS undercover man some good business ethics as well as some personal beliefs that didn't conform to his or the IRS's belief structure. This was the first place where my personal beliefs in God played a major part in that it formed the next "sting" attempt.

Lator that year, another undercover IRS informat tried to persuade my associate in another business operation to overvalue a sound recording by a Christian artist so that to help both the artist and his client. This fell on deaf ears and the entire scheme blew up in their faces as shown in "The Sunday Oklahoman" newspaper. I wonder what if any scheme is not unaccpetable to the Internal Revenue Service to bag their prey.

In my case I have been subject to two "stings" by operatives of the Internal Revenue Service, had my mail openned and reviewed by the I.R.S., had mail "missent to the IRS" in order to hastle potential clients, had disinformation sent to my Congressmen that contained little white lies, had newspaper articles printed with only their story with a fact sheet used to print their side only, had numerous articles printed that had the truth sag that it was buried in its own weight of half-truth and lies, had my clients harassed until they would not do business with me or my company and even were instructed to sue me, and many others simply to put Mr. Craig B. Forney out of busines and in jail.

I for one value our freedom and the rights guaranteed to its citizens of the freedom of religion, speech, and press. Why are our own rights that our ancestors fought and died for today trampled on and ignored?The answer is too simple to even comment on here today.

The major difference in my case and Mr. Kilpatrick's case is that I am one of thousands who fought and spent my entire earnings of my life defending myself until it was all gone. Is it fair, is it legal, is it moral that one's government can be so repressive that our country's pledge is no longer valid. When will "with liberty and justice for all" have any true meaning for this country's people? Can one government agency be so powerful as to be above the law?

Today, my blood is on the floor for my businesses have all failed, I am incapable to earn a decent living for my family in my chosen profession because of continual government interference, and my family is held together by the thin threads of a God that doesn't fail. Yes, today I speak for thousands of Americans that are simply fed up with a system that honors those who have enough money to buy their way out of the system or who "go along to get along" and allow our country to slip ever increasingly down into the pit of destruction and despair. "We the people, hold these truths to be self-evident" that our government shouldn't be above the law or the desires of its people. Must our country slide into oblivion in order for us today to mandate a change in actions of this separate government agency.

Let us not forget today, that thousands of entrepreneurial salesmen are ready to strike, millions of God-fearing Americans are fed up with a system that is bent on its own preservation, and more are becoming beyond hope for a better day tomorrow. We, today, need men and women of courage to do what must be done in spite of the consequences in order that we can preserve the very union - the life giving thread that sparked this country. We need men and women who will make changes to protect Americans everywhere of a tyrannical government agency that too many fear. As God's book states, "the beginning of wisdom is to fear the Lord." Today, is that day where each of us must take stock of themselves and say 'am I going to serve God or greed, become selfish or selfless'. As for me I am willing to submit myself to the everpresent ears of the IRS in order that someday, some way, our country can be returned to those great souls who are called Americans.

After being attacked for four and a half years and seeing all my personal possessions being ransacked, my family being intimidated and pushed around by IRS bullies, my business partners attacked and threatened, many friends and clients economically destroyed by IRS tactics, and situations too repugnant to mention, I say enough is enough. Somebody needs to move quickly and swiftly while America still is American!

I trust that today is the beginning of the end of any governmental agency setting itself above the law and its people. I pray that Americans everywhere can start to make progress to tomorrow to instill in themselves the rights conferred upon them and accepted by all government agencies regardless of power or privilege. Let us once again hold these truths to be self-evident and the rights of the individual citizen above government agencies be noted as fact and substance.

My story continues into the Tax Court and other courts of jurisdiction where and when necessary as one citizen learns to defend himself pro se without the privilege of a paid attorney. May God grant to you wisdom and understanding to see the truth and to move this day to restore justice to those who do not possess the fortitude or staying power of a modern day Kilpatrick.

I thank you ladies and gentlemen for your time and patience this day for allowing me to enter this testimony on the record. I stand ready and willing to name names, dates and situations that I briefed today in order that justice can be served.

I remain,

Craig B. Forney
PO BOX 2302
Cedar Park, TX 78613

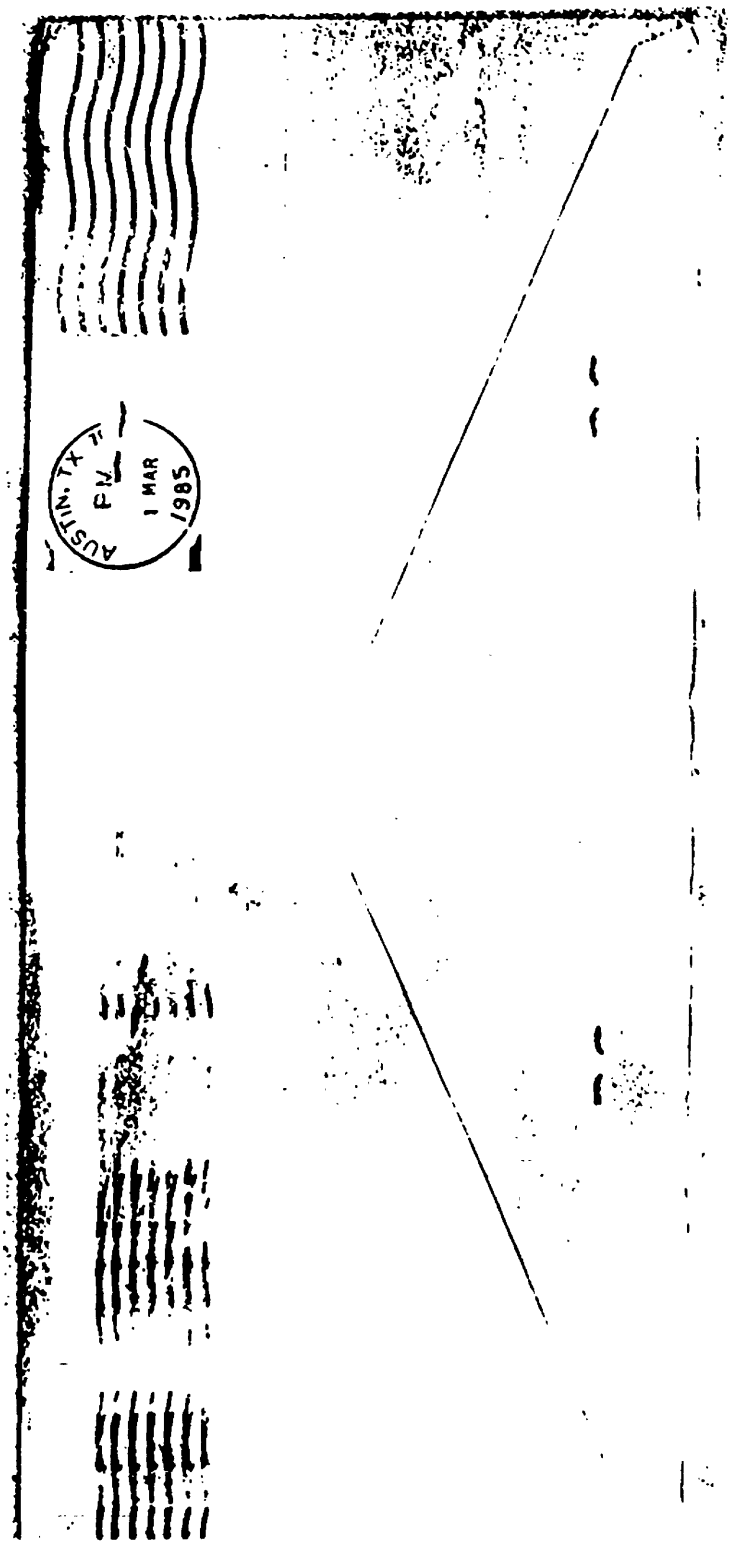
STATE OF TEXAS)
) SS.
COUNTY OF WILLIAMSON)

Appeared before me on this day personally Craig B. Forney to be the person whose name is declared in the foregoing document and declared that the statements therein contained are true and correct. Given under my hand and seal of office this 5th day of September, A.D., 1986.

Notary Public

Richard L Spencer
1435 East 2nd
Alliance Ne 69301

Spinning Gold Corp.
American Bank Tower
221 West 6th, Suite 300
Austin Tx 78701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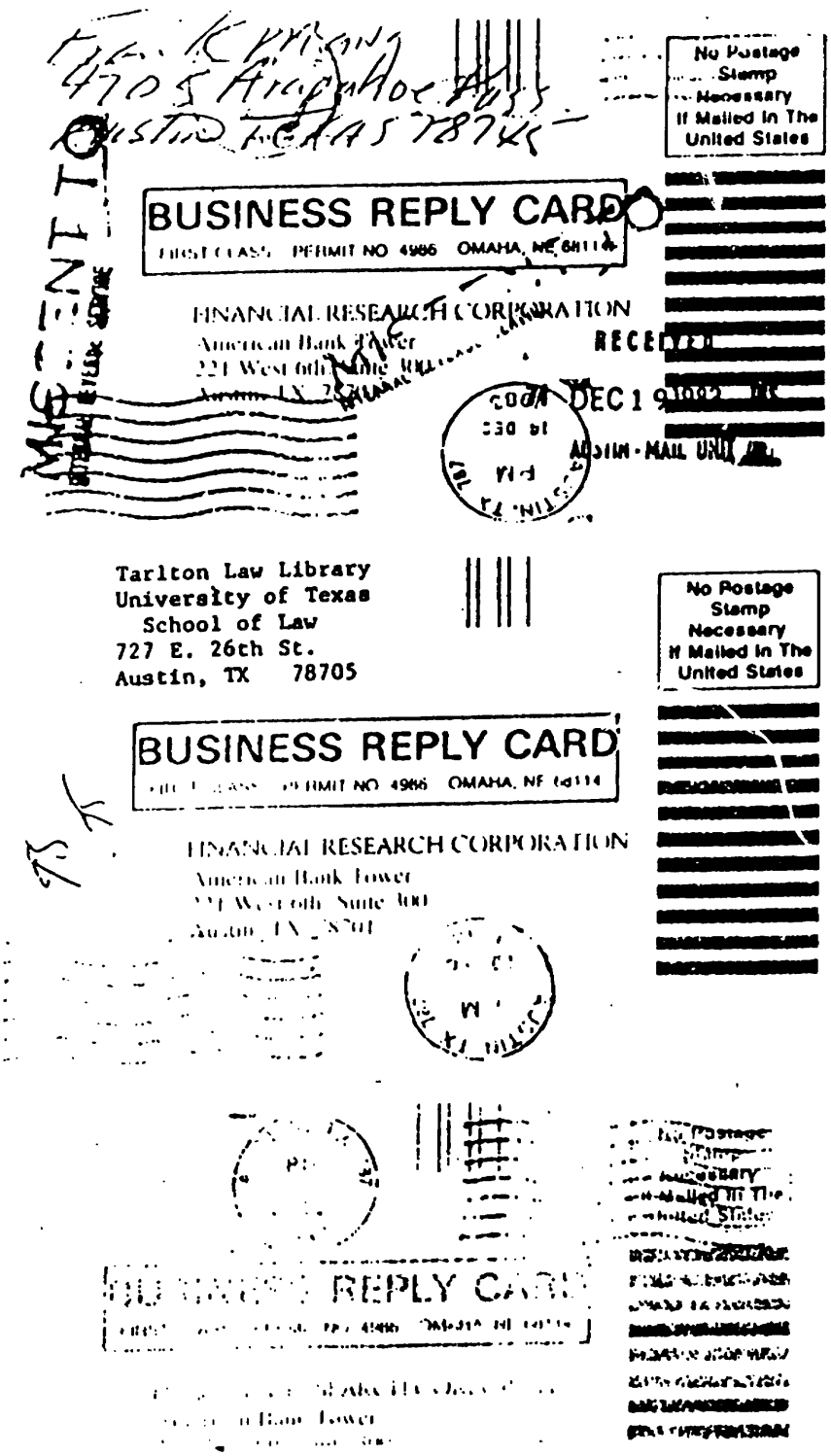


#8

Internal Revenue Service

District Director

15th and Dodge Sts., Omaha, Nebr. 68102

DEC 30 1983

RECEIVED 1984

The Honorable Hal Daub
6424 Federal Building
215 North 17th Street
Omaha, Nebraska 68102

Dear Congressman Daub:

I have reviewed information related to the correspondence, dated December 9, 1983, that you recently received from Mr. Craig B. Forney, President of The Financial Planning Corporation of America. In response to your request, the following information is provided.

The Internal Revenue Service has requested a copy of each of a number of master recording tapes for independent appraisal regarding Mr. Forney's investment clubs. In addition, supporting documentation including copies of appraisals provided by the lessor to the investment clubs have been requested. However, there are many items we have requested that have not been provided by Mr. Forney, including appraisals obtained from the lessor and the appraisal Mr. Forney claims he obtained that he has decided not to provide the Internal Revenue Service.

The identity of a contracted independent appraiser is not revealed in advance to protect the independence of the appraiser and the appraisal. This information was previously provided to Mr. Forney. A review of our records indicates that we have not refused to provide the investment clubs with the results of independent appraisals.

Correct Internal Revenue Manual notification procedures have been followed in contacting the parties involved. Mr. Forney and the managing partners were not provided investor/partner examination reports to avoid federal disclosure violations.

Mr. Forney's request for assignment of another revenue agent was previously reviewed and found to be without merit.

Should you have any further questions, do not hesitate to contact us.

Sincerely,

Mitchell E. Premis
District Director

#3

Internal Revenue Service

Department of the Treasury

MAY 16 1984

Mr. George I. Qualley
3400 Pierce Street
Sioux City, Iowa 51105

T. Thurman
(402) 221-3747
ED:EB:GP5:TT:cls/tdm
May 11, 1984

Dear Mr. Qualley:

I apologize for the delay in this response to your prior letters of 2-14-84 and 3-15-84. I thought they were previously answered. In those letters, you presented a formal demand for copies of appraisals forming the basis for adjustments proposed in the partnership examinations of Profits Diversified, Elektron Ltd., Design Ltd., Sound Concepts Ltd., Sound Dimensions Ltd., Monetary Growth Ltd., and New Horizon Ltd.

It is the Service's position that the appraisals will not be made available at this time. The provisions of 5 USC Section 552(b)(7) and ICRS 6103(e)(7) are cited as authorities for nondisclosure of the appraisals at this time.

Of the subject entities, the Monetary Growth Ltd. return was not examined by the Omaha District and the examination of New Horizon Ltd. resulted in no change being recommended to that return. The five remaining entities are either assigned to or enroute to the Omaha Appeals Office. Your formal demand for copies of the relevant master recording appraisals has been referred to the Omaha Appeals Office.

Your reference to the Director's letter to Congressman Daub in which you quote one sentence of the paragraph was reviewed. The paragraph as a whole states the position I have given here without cites. It was conveying the position we hold, the information given to Mr. Forney, and that the clubs had not asked for appraisals. We apologize if our failure to distinguish between Mr. Forney who requested the appraisals and the clubs who did not caused confusion as to application of the policy. In either case, we are following the policies as stated above.

Should you require amplification of the above cited authorities, you should contact either Mr. Raymond Geiger (402-221-3691) in the Omaha Appeals Office or Mr. J. Anthony Hoefer (402-221-3733) in the Office of the Omaha District Counsel.

Sincerely,

Michael W. Bilgere

Michael W. Bilgere
Chief, Examination Division

Austin residents countersue in IRS tax shelter case

Page D7

Business

Austin American-Statesman Tuesday, February 19, 1985

3 Austin residents join group suing IRS in tax shelter case

By Kirk Ladendorf
American-Statesman Staff

Three Austin residents are part of a group that has countersued the Internal Revenue Service for $40 million in actual and punitive damages, claiming the IRS has harassed their clients and hurt their business reputations during its crackdown on tax shelter promotions.

Craig and Kathleen Forney, and Jeffrey Petry of Austin, along with Raymond Basili of Omaha, Neb., were all sued by the IRS, which sought a court order barring them from future promotions of abusive tax shelters.

The four, along with five related companies, have filed a countersuit in U.S. District Court in Omaha, denying the IRS charges and claiming the IRS conducted a publicity campaign to discredit them. The companies named in the suit include Spinning Gold Corp., an Austin record company run by Petry.

The countersuit by Forney and the other defendants says the IRS illegally released information from their tax returns without authorization, and threatened their former tax-shelter investment customers with tax audits.

THE SUIT ALSO says the IRS "harassed and intimidated" clients and business associates of theirs and "deliberately publicized its action in filing its complain in news, television and radio releases."

Such actions by the IRS, their suit says, caused the four to suffer "severe mental distress, outrage and shock."

Tax shelters are investments that generate substantial tax deductions to investors. Real estate and oil and gas limited partnerships are common tax shelter investments. "Abusive tax shelters," according to the IRS, are those investments that falsely overvalue the investment in order to create inflated investment tax credits and deductions for investors.

The IRS says the Forneys, Petry and Basili were involved in selling "master recordings" of various musicians to investors for inflated prices as part of an abusive tax shelter promotion. The IRS says investments sold by the four cost the U.S. Treasury $4.1 million in lost tax revenue.

The IRS had no comment on the countersuit.

THE SUNDAY OKLAHOMAN

The State Newspaper Since 1907

OKLAHOMA CITY, OK | SUNDAY, FEBRUARY 10, 1985 | 318 PAGES | 75c

Names of 2 State Officials Used by IRS in Sting Operation

By Judy Pennell
Staff Writer

The names of Lt. Gov. Spencer Bernard and state Supreme Court Justice Alma Wilson have been used without their knowledge in an undercover Internal Revenue Service "sting" operation against abusive tax shelters, *The Oklahoman* has learned.

Complimentary letters of support written by Bernard and Wilson to Oklahoma City gospel singer Ginger Boles, along with a tape recording Mrs. Boles made of several religious songs, have been used as bait in at least one attempt by the IRS to obtain evidence against targets of the "sting."

Copies of the letters, a photocopy of the tape and Mrs. Boles' photograph were obtained by *The Oklahoman* last week from an IRS target in Austin, Texas, who was approached by government operatives last summer.

Told of their indirect role in the plan, Bernard, Wilson and Boles reacted with surprise and dismay, saying they had never been contacted by the IRS, nor had they given their permission for their names, letters nor the tape to be used in any type of undercover operation.

The link between the letters and tape and the sting operation is Maurice Hildebrand, a Norman businessman and convicted felon who has been hired by the IRS at a reported $2,000 per month salary to work as an informant.

Hildebrand has been quoted as saying he received $40,000 within the last few years for his work as informant for the FBI and IRS.

Hildebrand's wife, Norma Jean, is an evangelist who conducts services with Mrs. Boles. Mrs. Boles said the letters she has received from Bernard, who is also from her hometown of Rush Springs, and a single letter from Justice Wilson were in her "portfolio."

She said Mrs. Hildebrand, and therefore Maurice Hildebrand, had access to that portfolio. She described herself and the Hildebrands as "very good friends," and said "Hildebrand is "a very fine man."

Mrs. Boles said Hildebrand "helped me get started" in the music business a number of years ago by arranging to have her tape produced, but that she never gave Hildebrand authority to use her portfolio or to represent himself in any capacity as her agent.

The expressed outrage at a report

See STING, Page 9-A

Sting

From Page 1-A

that as recently as Wednesday, Bernard's office received a telephone request from a mystery caller asking if one of the letters in the portfolio, a 1981 letter of recommendation for Mrs. Boire, was still valid. The caller identified himself to a secretary as a "Mr. Green and said he was from the Justice Department," an employee of Bernard's said.

The caller was placed on hold while the secretary checked with Bernard, but had hung up by the time she returned to the phone.

Bernard, referring to that 1981 letter, said, "It was not written for that (undercover) reason or intention at all, and I don't agree with using it that way at all. They had no authority to do so, and certainly I wouldn't have written it if I'd known it was going to be used this way."

Another letter from Bernard referred to Mrs. Boire' appearance at the 1979 Rush Springs watermelon festival.

The single-sentence letter from Justice Wilson thanked Mrs Boire for a copy of the tape, which had been given to her during a Capitol prayer breakfast.

Other letters in the packet were from Trinity Broadcasting, an Oklahoma City minister and from fans who had heard Mrs Boire sing.

The letters, most of them written on the sender's letterhead stationery, are believed to have been used to lend status and credibility to the undercover operations' stories.

Bruce Miller, chief of the Criminal Investigation Division of the Oklahoma City IRS office, responded repeatedly with "no comment" to a series of questions posed by *The Oklahoman* about the sting operation and the use of the Boire-related letters and tape.

He cited laws which prohibit the IRS from discussing individual cases.

Miller did, however, explain the use of the sting-type undercover operation as the most effective way to detect the use of backdating by buyers and sellers of illegal tax shelters. He said backdating is virtually impossible to detect by usual auditing techniques.

The known sting operation in which the Boire tape and letters were used is part of a year-long undercover IRS operation which has, to date, resulted in a half-dozen lawsuits filed in late November against eight persons, two of them accountants and one an attorney, who sold allegedly fraudulent tax shelters.

Civil proceedings against the two accountants have ended after they agreed to accept permanent injunctions against them. As part of that agreement, they will not be charged with criminal violations, their attorney said.

However, a federal grand jury in Oklahoma City is continuing its look at alleged evidence obtained from the year-long "sting."

The ongoing sting or "shopping" operation, as it is known in IRS parlance, involved the secret videotaping of targets who were allegedly willing to backdate documents to shelter income from previous tax years and forgive the debts incurred on promissory notes used as investments.

Documents on file in the Oklahoma City federal courthouse and other information provided to *The Oklahoman* shed considerable light on the IRS undercover operation and the alleged activities of their targets.

The IRS agent working with Hildebrand is dark-haired, moustachioed IRS investigator Jim Climer.

Climer, using the pseudonyms Jim Collins and Jim Taylor, has operated out of a Norman office that was the purported home of a fictitious firm called Universal Oilfield Service.

Among the oil derrick replicas decorating the office in "Oklahoma tacky" were hidden videotape cameras, which recorded actions and conversations between Climer, Hildebrand and their targets.

Female IRS employees reportedly portrayed the phony firm's secretaries.

Climer's role in the undercover operation was to play a wealthy "ellie" in desperate need of a tax shelter for $700,000 to $600,000 in income from a previous year.

To help Climer look the part, the IRS reportedly rented expensive automobiles such as a Cadillac and a Lincoln Continental Mark VII for him to drive.

In the one "sting" known to involve the Boire materials, the IRS target in Austin, an audio tape firm, refused to backdate documents. The proposal reportedly made by Hildebrand and "Collins" was that for a $90,000 investment by Agent Climer, the Austin firm would give the Boires tape a market value of $2 million and Climer would take an illegal 10 percent or $200,000 investment tax credit.

The IRS revealed in documents seeking permanent injunctions against the targets it used that Hildebrand and Climer made contact late in 1983 when Hildebrand first passed along the name or names of potential "sting" targets.

Soon, with Hildebrand making the initial contact in each case, "Collins" (and, on at least one occasion, "Taylor") was making allegedly fraudulent tax sheltered investments in horses, fertilizer and audio recordings such as the one for which Mrs. Boires' tape would be used.

Another agent, Robert Elliott, posed as "Collins" in investing in a California kiwi fruit farm because Climer was already known to one of the targets of that sting.

In each of the alleged schemes, "Collins" allegedly received documents from the shelter seller that had been backdated to indicate his investment had been made the previous year.

In most of the alleged schemes, the agent paid part of his investment by check and the remainder by promissory note, having already made a side agreement with the seller that the note would never have to be paid.

Once the documents were signed, Hildebrand would contact the seller to explain that "Collins" had changed his mind. Payment of the checks — which in one instance was for $175,000 — was stopped.

On only one reported occasion did Climer and Hildebrand run into any potential trouble from their "sting."

Kenneth J. Foster, a Californian who promoted a tax shelter program involving audio tape recordings, was videotaped on March 29 telling the two undercover operatives:

"Before I close, if you f—e aren't for real, I've got two friends I want you to meet. The old shoe business."

After identifying his friends as "Blackie" and "Guido," Foster told Climer and Hildebrand, "Remember what I said.

"Yeah, in the event that you f—e aren't for real, and we sign some papers and then I get strange phone calls and strange visitors, Blackie and Guido will be here. And they fit you in cement boots. Okay?"

"You're not threatening us, are you?" Climer asked.

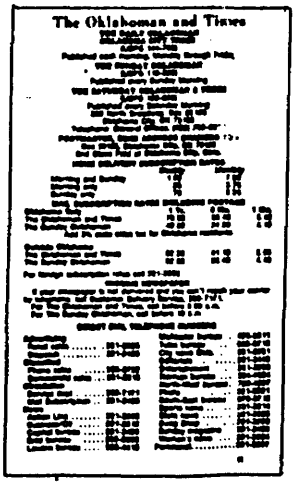
"No, sir," Foster replied.

Attorneys for Foster and several of the undercover probe's other targets have filed countersuits seeking millions of dollars from the IRS, accusing the agents of entrapment by luring innocent people into committing crimes.

CID chief Miller countered that the sting targeted only those believed to have been "predisposed" to cooperating with the proposed fraudulent shelter and who "do this (illegal sheltering) every day."

Miller said the targets weren't forced to break the law but rather "were given the opportunity" to break it.

However, Oklahoma City attorney Tom Parrott, a former IRS investigator, claims it was the IRS that broke a variety of laws. Parrott said it was illegal for agents Climer and Elliott to file false financial statements for "Collins" and "Taylor" with local banks and to write worthless checks for their investments.


The Oklahoman and Times

FACT SHEET

Re: United States v. Craig B. Forney, et al.

A suit was filed by the United States government in the United States District Court in Omaha today 1-2-85 against current and former Omaha residents involved in selling tax shelters.

Craig Forney and his wife Kathleen who moved from Omaha to Austin, Texas, in 1984 are defendants along with Raymond Basili of Omaha and Jeffrey Petry of Austin, Texas. Also named are five corporations operated by these individuals. The complaint says the defendants have organized and sold partnership interests for investments in master recordings. The master recording would involve exclusive rights to a set of 10 songs or instrumental pieces to create an LP album or cassette tape.

The government says the recording deals marketed by defendants are fraudulently overvalued in order to create inflated investment tax credits for the investors.

The partnerships sold by the defendants since 1980 have cost an estimated $4.1 million in lost tax revenues, the suit claimed.

The suit says that those who have invested in these schemes (sometimes with their lifetime savings) stand to lose their investments and will owe the government for taxes, penalties and interests.

For additional information, see the complaint.

A prior news article concerning one of the defendants is attached.

Business

Austin American-Statesman Saturday, January 12, 1985

Section E

IRS tax shelter suit names Austin residents

By KIRK LADENDORF
American-Statesman Staff

Three Austin residents and an Austin recording company have been named in a federal lawsuit accusing them of promoting and selling abusive tax shelter investments. The lawsuit seeks a federal court injunction barring the four from future tax shelter promotions involving master recordings.

An abusive tax shelter is a promotion involving an investment that is greatly inflated in value for the purpose of generating excessive tax credits and deductions.

Craig Forney; his wife, Kathleen; and Jeffrey Petry, all of Austin; and Raymond Basili of Omaha, Neb., are accused of organizing and selling fraudulently overvalued investments in master recordings. Master recordings are original musical recordings that may or may not be turned into the record albums and tapes to be sold in record stores.

The suit, filed in U.S. District Court in Omaha, also names Spinning Gold Corp., an Austin record company, as a defendant.

The IRS claims it lost $4.1 million in tax revenue because investments sold by the defendants created inflated investment tax credits for investors.

The suit is the first involving an accused Austin tax shelter promoter to be bought by the IRS. IRS officials have said they are making a concerted effort to clamp down on abusive tax shelter investments nationwide.

The IRS says investors, many of them Nebraskans, who bought into the tax shelters, stand to lose both their investment and the tax savings they claimed.

The suit says Forney and the other defendants organized and sold partnerships in various master recordings of 10 songs or instrumental pieces for creation of a record album or tape.

In November 1982, the suit says, Forney and Petry formed Spinning Gold Corp. to buy and lease master recordings.

The suit says Spinning Gold acquired records for minimal cash down payments and notes that "are totally lacking in economic substance." Those promissory notes, the IRS alleges in the suit, were used to inflate the claimed value of the master recording in order to create large investment tax credits and depreciation for investors.

Forney denied he had ever sold abusive tax shelter investments. He said he stopped selling any tax shelter investments two years ago.

"It's asinine," Forney said. "This is just a publicity trick (by the IRS). It's just their way of putting something into print to scare investors."

Forney said he is now a fee-only financial

See IRS, E8

Raking in the cash

Total deposits for 43 banks in Travis Country last year rose 33 percent — to $5.5 billion.

Future study

A California think tank says 'disturbing trends' are developing as Austin continues to grow. *Sunday*

IRS

From E1

planner, who does not earn commission from selling investments. His wife, he said, who formerly ran a business involved with Forney's investment work, is now a homemaker.

Forney denied he is a part owner of Spinning Gold Corp., asserting the IRS claims in its suit. The IRS said Forney's business to be Spinning Gold is important because such a relationship "requires the requirements of fair dealings and arm-length transactions between its three related arrangements."

Petry, president of Spinning Gold, said his firm has produced records for several different musicians, including Nashville Country and Western singer Glen Barber.

ONE SPINNING GOLD produced record, Barber's *Fire Love Feelings*, was No. 83 on the Cash Box magazine country singles chart last fall, Petry said.

Petry said he could not comment on the lawsuit because he hasn't seen it. "Whatever they might say is totally unfounded as far as the Spinning Gold Corp. is concerned," he said. "Spinning Gold is merely a company that does the recording and takes care of business."

IRS District Director Gary Booth said his agency is pushing hard against tax shelter abuses and is discouraging investors from becoming involved in shelter investments claiming excessive credits and deductions.

He said investors, many of them middle-income earners, can lose both the money they put into a tax shelter as well as back taxes, and penalties. In some flagrant cases, he said, investors can face criminal charges.

His advice to potential shelter investors: "If it looks too good to be true, it probably is. The first time I went out a long time ago

REGULATORY ISSUES

IRS Hit List

Abusive tax shelter promoters now have one more thing to worry about — the "sting" operation. The doctor or lawyer across the desk may actually be an IRS agent. Recently, undercover agents posed as potential investors in video-taped meetings with tax shelter promoters. The result to date: Seven suits for injunctions against promoters of shelters ranging from kiwi fruit farming and horse breeding to record masters and nuclear waste disposal research.

Master recording deals accounted for about one-third of all injunctions sought by the Justice Department in 1984. Here's how these shelters usually work: You put up a modest amount of cash to buy a "master" recording, with the balance of the purchase price financed by your recourse notes. In abusive deals, the price of the "master" is grossly inflated relative to potential future record sales. You're promised high multiple write-offs, based on depreciation of the overvalued "master," and investment tax credits. The promoter says you'll never have to pay up on your recourse notes. The IRS says you'll pay taxes, interest and penalties because the transaction is a sham. Watch out!

The "hit list" on the following pages details recent suits filed by the Department of Justice against alleged "abusive" tax shelters. The common element in most of these deals, as in master recordings, is alleged overvaluation of assets resulting in overstatements of deductions and investment tax credits.

IRS HIT LIST

• *The list below presents complaints filed and injunctions obtained by the Department of Justice from November 6, 1984 through January 17, 1985.*

Promoter/Sponsor	Investment/ Partnership(s)	Type of Shelter	Principal Alleged Violation(s)	Court Reference	Status
Southern Music Corporation, Dr. J W Burks, Edward Tucker, Marilyn Gale Yost, John Burks, Charles M. Daniel, and Master Placement Service, Inc.	Southern Music Corporation Master Sound Recording Lease Program	Equipment Leasing - master sound recordings	Gross valuation overstatements resulting in inflated investment tax credits.	M.D. TN 11/6/84	Injunction entered by consent.
Thomas F. Sacher and Classic Masters, Inc.	Classic Masters, Inc	Equipment Leasing — master recording tapes	Gross valuation overstatements resulting in inflated investment tax credits and deductions.	W.D. NY 11/16/84	Case pending.
Neuro-Electro Dynamics, Inc., Nelson Gross, Electrocare Medical Services, Inc., Safe and Natural Soccer Distributors, Inc., Charles W. Lane, S.D. Leasing, William L. Tucker, Theoretical Leasing Co., Inc., John Paul Savage, Medic Leasing, Inc., Harry L. Abercrombie, Lyncrest Leasing Company, Ronald B. Meyers	Electrocare XE-II Equipment Leasing Program	Equipment Leasing — electronic pain-killing devices	Gross valuation overstatements and false statements resulting in inflated tax credits and deductions.	C.D. CA 11/30/84	Case pending.

IRS HIT LIST (Continued)

Promoter/Sponsor	Investment/ Partnership(s)	Type of Shelter	Principal Alleged Violation(s)	Court Reference	Status
Australian Mining and Exploration Company, Inc., Trans Asia America Trading Corporation, Kenneth Hetland and Delbert Oswald	Australian Mining and Exploration Company, Inc.	Charitable contribution of opals	False or fraudulent statements and gross valuation overstatements resulting in understatement of tax liability	W D PA 12/21/84	Case pending.
Mainframe Systems Corporation, Data Art Corporation, Michael D Hastings and William D Burns	Mainframe Systems Corporation Computer Timesharing Service	Sale and leasing of computer systems	False or fraudulent statements and gross valuation overstatements resulting in understatement of tax liability.	C D CA 12/27/84	Case pending
Wisconsin Shelter, Inc., Timothy E Podulske and Russell V Watrous	Philatelic Leasing Ltd., Century Concepts, Inc., Oxford Productions Corporation and Strategic Metals Mining Purchase Program	Printing plates, video game computer tape software, master recordings and mining exploration programs	Gross valuation overstatements resulting in understatement of tax liability.	E D WI 12/28/84	Obtained permanent injunction
Craig B Forney, Kathleen F Forney, Jeffrey C Perry, Raymond Basili, Financial Planning Corporation of America, Certified Financial Planners of America, Ltd., Abaris Republic Corporation, Spinning Gold Corporation, and Financial Research Corporation	Landmark Profits, Ltd. Midwest Monetary, Ltd. Rushmore Investment Group, Tri-State Investment Clerk, Western Investment Group, Capital Resources, Ltd., Int'l Monetary Funding	Equipment leasing — master recordings	False or fraudulent statements and gross valuation overstatements resulting in inflated tax credits and deductions.	NE 1/2/85	Case pending
Edward J Roy, Reinhard P. Mueller, and A T Bliss and Company, Inc., a Massachusetts Corporation	Solar-Bliss 83, Ltd Bliss-Solar '83, Ltd Bliss Partners '83, California-Bliss '83, Ltd.	Equipment leasing — solar hot water heating systems	False or fraudulent statements and gross valuation overstatements resulting in inflated tax credits and deductions	NE 1/2/85	Case pending
George D Sprague, d/b/a Professional Business Consultants, and Mary Sue McClure, d/b/a Charleston Accounting Services	International Dynamics, Inc	Tax avoidance payroll scheme	False or fraudulent statements resulting in understatement of tax liability	SC 1/17/85	Sprague: Case pending McClure Injunction entered by consent

FACT SHEET

United States v. Craig B. Forney, et al

85-0-3

On February 4, 1985 a counterclaim for $40 million was filed in the United States District Court in Omaha against the Internal Revenue Service (United States of America) for unconstitutional and illegal acts.

The counterclaim states that the IRS through its agents made public disclosures of "return information" in direct, willful and intentional violation of law.

The IRS harassed and intimidated defendants' business associates and clients by advising that defendants' actions were "illegal and improper" before such allegations had been proven.

Defendants' Constitutional Right of Due Process (as guaranteed under the Fifth Amendment) was violated as well as IRS policies, procedures and regulations.

Property valuations were based on full recourse notes and appraisals made by independent experts, who coincidentally are also under contract with the IRS.

The original complaint for injunctive relief from future selling of "abusive tax shelters" was overly broad, unenforceable and constitutionally impermissible.

Additional IRS claims are "barred by laches" in that defendants have not participated in the sale of tax shelter plans since 1983.

Lastly, the IRS has "unclean hands" in that, among other things, they have issued lengthy statements to the press without affording defendants any notice or hearing.

For additional or more specific information, see the attached Original

The Original & Still #1 Voice of the 2nd American Tax Freedom Movement.

THE JUSTICE TIMES

Vol 16 No. 4 April, 1985 A National Monthly Publication

1.5 Billion Lawsuit Against IRS

IRS And Justice Dept. "Rigging" Juries

Seven-term U.S. Congressman George Hansen, speaking in support of the IRS whistleblowers' coalition, called for an end to IRS management's abuse of employees and taxpayers.

Inside This Issue

IRS Whistleblowers

Judge Acquits Attorney

Names of Two State Officials Used By IRS In Sting Operation

Names of 2 State Officials Used by IRS in Sting Operation

By Judy Fossett From The Oklahoman, Oklahoma City

The names of Lt. Gov. Spencer Bernard and state Supreme Court Justice Alma Wilson have been used without their knowledge in an undercover Internal Revenue Service "Sting" operation against abusive tax shelters.

Complimentary letters of support written by Bernard and Wilson to Oklahoma City gospel singer Ginger Boles, along with a tape recording Mrs. Boles made of several religious songs, have been used as bait in at least one attempt by the IRS to obtain evidence against targets of the "Sting".

Copies of the letters, a photocopy of the tape and Mrs. Boles' photograph were obtained by The Oklahoman last week from an IRS target in Austin, Texas, who was approached by government operatives last summer.

Told of their indirect role in the plan, Bernard, Wilson and Boles reacted with surprise and dismay, saying they had never been contacted the IRS, nor had they given their permission for their names, letters nor the tape to be used in any type of undercover operation.

The link between the letters and tape and the "sting" operation is Maurice Hildebrand, a Norman businessman and convicted felon who has been hired by the IRS at a reported $2,000 per month salary to work as an informant.

Hildebrand has been quoted as saying he received $40,000 within the last few years for his work as informant for the FBI and IRS.

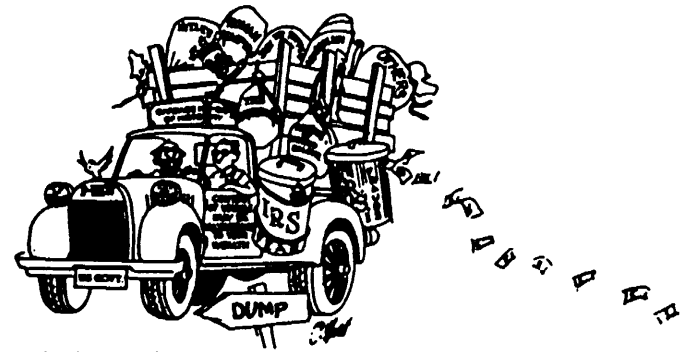
Hildebrand's wife, Norma Jean, is an evangelist who conducts services with Mrs. Boles. Mrs. Boles said the letters she has received from Bernard, who is also from her hometown of Rush Springs, and a single letter from Justice Wilson were in her "portfolio".

She said Mrs. Hildebrand, and therefore Maurice Hildebrand, had access to that portfolio. She described herself and the Hildebrands as "very good friends," and said Hildebrand is "a very fine man."

Mrs. Boles said Hildebrand "helped me get started" in the music business a number of years ago by arranging to have her tape produced, but that she never gave Hildebrand authority to use her portfolio or to represent himself in any capacity as her agent.

She expressed outrage at a report that as recently as Wednesday, Bernard's office received a telephone request from a mystery caller asking if one of the letters in the portfolio, a 1981 letter of recommendation for Mrs. Boles, was still valid. The caller identified himself to a secretary as a "Mr. Green and said he was from the Justice Department," an employee of Bernard's said.

The caller was placed on hold whiles the secretary checked with Bernard, but had hung up by the time she returned to the phone.



Bernard, referring to that 1981 letter, said, "It was not written for that (undercover) reason or intention at all, and I don't agree with using it that way at all. They had no authority to do so, and certainly I wouldn't have written it if I'd known it was going to be used this way."

Another letter from Bernard referred to Mrs. Boles' appearance at the 1979 Rush Springs watermelon festival.

The single-sentence letter from Justice Wilson thanked Mrs. Boles for a copy of the tape, which had been given to her during a Capitol prayer breakfast.

Other letters in the packet were from Trinity Broadcasting, an Oklahoma City minister and from fans who had heard Mrs. Boles sing.

The letters, most of them written on the sender's letterhead stationery, are believed to have been used to lend status and credibility to the undercover operatives' stories.

Bruce Miller, chief of the Criminal Investigation Division of the Oklahoma City IRS office, responded repeatedly with "no comment" to a series of questions posed by The Oklahoman about the sting operation and the use of the Boles-related letters and tape.

He cited laws which prohibit the IRS from discussing individual cases.

Miller did, however, explain the use of the sting-type undercover operation as the most effective way to detect the use of backdating by buyers and sellers of illegal tax shelters. He said backdating is virtually impossible to detect by usual auditing techniques.

The known sting operation in which the Boles tape and letters were used is part of a year-long undercover IRS operation which has, to date, resulted in a half-dozen lawsuits filed in late November against eight persons, two of them accountants and one an attorney, who sold allegedly fraudulent tax shelters.

Civil proceedings against the two accountants have ended after they agreed to accept permanent injunctions against them. As part of that agreement, they will not be charged with criminal violations, their attorney said.

Saturday, December 28, 1985 The Rapid City Journal

...ermarket strike ...rejects pact

[illegible] (AP) — A violent, ...eek-old strike-lockout at ... California supermarkets ...ed likely Friday to stretch into ... after meat cutters refused to ... Teamsters in ratifying tentative ... that included conces- ... to employers.

"... think we got railroaded," meat ... Ernie McGinnis said after he ... ballot against the contract ... night in Los Angeles. "I'm ... angry about it."

Members of six Southern Califor- ... of the meat cutters union, United Food and Commercial ... rejected the pact by a ... percent to 45 percent. ... 2,940 against the agree- ... 1,640 in favor.

..., the other union involved ... dispute, the Teamsters, ... approved a separate ... settlement that called for ... make fewer concessions than ...

... Teamsters reported to work ... they refused to make ... in stores where meat cut- ... picket lines, a union official ... During the strike, pickets were ... only at Vons ...

... unions struck together on ... pledging that neither would ... both had agreements. It ... how that would be inter- ... Friday, however, since ... for the meat cutters had ... tentative agreement.

... said the Teamsters ... strategy with the ... on how to support the ... butchers' walkout.

... negotiations between the ... and the markets were ...

... has been marked by ... violence and apparent ... including stink bombs in ... fired into trucks of non- ... and an anonymous ... to inject produce at some ... non-lethal doses of ...

... stoppage is the longest ... Southern California ...

Donohue

In weights, how heavy is heavy?

Dear Dr. Donohue: I know you can't tell me in actual pounds, but when the exercise books talk about using "heavy" weights, what do they mean by heavy? Does that mean weights so heavy you can barely lift them at all? — B.H.

No. By heavy, they mean weights you can lift only six consecutive times without a pause between each lift. In the language of weightlifting that translates as "six reps." The weight you can lift only once is called the "one-rep max." The weight one ordinarily uses for muscle-building exercise is two thirds of that one-rep max.

Dear Dr. Donohue: What's the purpose of doing a bench press with the back of the bench tilted up? Is it any different, really, from doing it with your back flat on the bench? — Mrs. R.L.

Can we let non-iron-pumpers in on what you are asking?

A bench press isn't a tool-and-die machine. It's an exercise done with weights. It's usually done lying flat on a bench. The person lifts the weight straight up from the body, then lowers it.

Most benches can be adjusted so that the exercise can be done in a semi-seated position. The question, then, is: Does this form of the exercise offer any different benefits?

The answer is, yes, it does. And the question lets me point out a very important fact about exercise in general.

It is that a very minor alteration in body position, grip, or motion produces a profound change in the muscles used. If you want to prove this, try doing a chin-up, first with the hands close together, then with the hands far apart.

The same alteration in muscle use happens when you use the inclined bench for the bench press exercise. That tilt of the back causes a shift in muscles used. Specifically, the front part of the upper shoulder muscle (the anterior deltoid) gets a better workout in this position. Altering the bench into various positions introduces variety into exercise while permitting use of different muscles and different parts of the same muscles.

Dear Dr. Donohue: I am pregnant. My doctor says it's all right for me to exercise. But when I asked him how much, he couldn't answer. Can I do the same as before my pregnancy? — Mrs. E.N.Z.

No. In fact, you have to DECREASE the intensity of your exercise below the pre-pregnancy level by at least 25 percent.

Here's an example: If you jogged two miles a day, you now should jog only 1 1/2 miles. Whatever the exercise, your pulse rate should never get higher than 140 beats per minute. I say that because there is agreement now that overheating the body may cause harm to the fetus.

Drink lots of water when exercising. Your joints, you will find, are looser during pregnancy, so you must be careful not to tax them or greatly twist them. And you must be aware of the fact that the growth of your uterus and the fetus alters your center of gravity. You can be thrown off balance more easily. Be prepared for this bit of unsteadiness. Otherwise, exercise during pregnancy within these guidelines is good for the mother's general well being.

Dear Dr. Donohue: Is there any significance in having colorless urine? Mine is occasionally as colorless as water. — E.P.

Urine color roughly indicates the degree of body hydration — how much water it has. A very pale urine means the body is getting rid of lots of fluid. Pale urine on an occasional basis is not likely to indicate any real trouble.

In illnesses where there is a lot of urine produced, as in either type of diabetes, the urine will be continually pale. Some kidney ailments will cause a pale color, so can alcohol.

You can mention your concern to your doctor. A few simple tests will rule out serious causes of pale urine. You ask for material. The booklet "Your Kidneys: Facts You Need To Know About Them" discusses this.

false misleading

IRS files injunction against four partnerships

ABERDEEN — The Internal Revenue Service has filed an injunction against four partnerships operating in Rapid City and other locations as tax shelter investment groups.

Named in an abusive tax shelter injunction in the U.S. District Court at Omaha, Neb., were Rushmore Investment Group, Tri-State Investment Club, Western Investment Group and Capital Resources Ltd.

Information about the injunction was released in a statement Thursday.

Three individuals were specifically named in the injunction, which prevents them from selling further interests in these organizations, said Virgil Ford, public affairs officer for the IRS district office in Aberdeen.

Ford said the individuals named are Craig B. and Kathleen F. Forney and Jeffrey C. Petry, all of unknown addresses. He said they had operated in South Dakota and Nebraska and probably other states.

Ford said the companies were selling tax shelters: "termed illegal tax avoidance schemes, to people, something that uses inflated appraisals, unrealistic allocations, nonrecourse loans. The primary purpose of the shelter is not to make a profit but rather to defeat taxes," he said.

According to Ford, people who have used the shelters available through these programs "stand eventually to lose all the deductions that they took on their tax return as a result of the shelter."

He said the IRS conducted an investigation and filed the injunction Sept. 17 in U.S. District Court at Omaha, Neb. "There was an investigation, but no trial that I know of," said Ford. "The method of enforcing this is through a penalty, under section 6700 of the IRS code."

Ford did not know the dates the organizations were operating in the Rapid City area but said the order prevents their taking any action to run the organizations any longer or sell or lease their interest in the partnerships to others.

A statement issued by Ford's office said, "the IRS has increased its investigation of illegal tax avoidance schemes. Generally, such schemes are designed only to avoid taxes and have no profit making potential...If it sounds too good to be true, it probably is."

F-2420280

IN THE UNITED STATES DISTRICT COURT FOR THE

DISTRICT OF NEBRASKA

UNITED STATES OF AMERICA, Plaintiff, v. CRAIG B. FORNEY, KATHLEEN F. FORNEY, JEFFREY C. PETRY, RAYMOND BASILI, FINANCIAL PLANNING CORPORATION OF AMERICA, CERTIFIED FINANCIAL PLANNERS OF AMERICA, LTD., ABARIS REPUBLIC CORPORATION, SPINNING GOLD CORPORATION, and FINANCIAL RESEARCH CORPORATION, Defendants.	)	CIVIL NO. 85-0-3

ORIGINAL ANSWER AND COUNTERCLAIM OF DEFENDANTS

TO THE HONORABLE JUDGE OF SAID COURT:

NOW COME CRAIG B. FORNEY, KATHLEEN F. FORNEY, JEFFREY C. PETRY, RAYMOND BASILI, FINANCIAL PLANNING CORPORATION OF AMERICA, CERTIFIED FINANCIAL PLANNERS OF AMERICA, LTD., ABARIS REPUBLIC CORPORATION, AND FINANCIAL RESEARCH CORPORATION, Defendants in the above-entitled and numbered cause (hereinafter collectively referred to as "Defendants"), and file this their Original Answer and Counterclaim to the Complaint for Permanent Injunction and Other Equitable Relief of the United States of

America (the "Complaint") previously filed in the above-entitled and numbered cause, and for answer and counterclaim would respectfully show unto the Court as follows, responding to each of the numbered paragraphs of the Complaint:

1. Defendants admit that this is a civil action to permanently enjoin Defendants as stated in Paragraph 1 of the Complaint, except that Defendants deny any inference arising from the use of the terms "abusive tax shelters" and "tax shelter plans or arrangements" that Defendants' conduct is subject to penalty under Int. Rev. Code of 1954, §6700 [hereinafter cited as "Code"] or substantially interferes with the proper administration of the internal revenue laws.

2. Defendants are without sufficient information or belief to admit or deny the allegations of Paragraph 2.

3. Defendants admit the allegations of Paragraph 3.

4. Defendants deny the allegations of Paragraph 4; Defendants allege that none of the, Defendants either individually or collectively, has been involved in the direct or indirect promotion or sale of any type of tax shelter or partnership offering at any time since December 31, 1983.

5. Defendants deny the allegations of Paragraph 5.

6. Defendants deny the allegations of Paragraph 6.

7. a. Defendants deny that Defendant Forney is a 50 percent owner of Spinning Gold Corporation and further deny that he uses an office for Spinning Gold Corporation; Defendants admit the remaining allegations of subparagraph a. of Paragraph 7.

b. Defendants deny that Defendant Kathleen F. Forney is the president of Abaris Republic Corporation; Defendants admit the remaining allegations of subparagraph b. of Paragraph 7; Defendants allege that Abaris Republic Corporation is a defunct corporation.

c. Defendants admit that Defendant Jeffrey C. Petry is president of Spinning Gold Corporation and uses the office of Spinning Gold Corporation, Suite 312, American Bank Building, 221 West 6th Street, Austin, Texas.

d. to g. inclusive. Defendants admit the allegations contained in subparagraphs d to g, inclusive of Paragraph 7.

h. Defendants deny that Defendant Forney is an owner of Spinning Gold Corporation; Defendants admit the remaining allegations of subparagraph h of paragraph 7.

i. Defendants admit the allegations of subparagraph i of Paragraph 7.

8. Defendants admit that Defendants Forney and Kathleen Forney resided at 9218 Leavenworth Street, Omaha, Nebraska, and elsewhere in Omaha, Nebraska, for a period of approximately 14 years and that they moved to Texas in 1984; Defendants deny the remaining allegations of Paragraph 8.

9. Defendants admit that the Defendant Craig B. Forney, both prior to and after September 3, 1982, has organized, participated in the organization of, sold or participated in sales of tax shelters involving master audio recordings.

Defendants further admit that the aforesaid master recordings generally consisted of 10 individual songs or instrumental pieces sufficient to comprise one LP album or tape. Defendants deny the remaining allegations of Paragraph 9.

10. Defendants admit that the master recording shelters start with a lessor who owns publication rights for a master recording, admit that Defendants Craig Forney and Raymond Basili leased properties from Music Leasing Company. Admit that Defendant Craig Forney leased properties from UM Leasing Corporaton. Admit that on November 24, 1982, Defendants Forney and Petry formed Spinning Gold Corporation. Defendants deny the remaining allegations of Paragraph 10.

11. Defendants deny the allegations of Paragraph 11.

First unnumbered paragraph following Paragraph 11. Defendants admit the allegations contained in the first unnumbered paragraph following paragraph 11.

12. Defendants deny the allegations of Paragraph 12.

13. Defendants deny the allegations of Paragraph 13.

14. Defendants deny the allegations of Paragraph 14.

15. Defendants deny the allegations of Paragraph 15.

16. Defendants deny that they "knew or have reason to know that there is no profit potential in these plans or arrangements"; Defendants admit the remaining allegations of Paragraph 16

17. Defendants deny the allegations of Paragraph 17.

18. Defendants deny the allegations of Paragraph 18. Defendants allege that at no time after December 31, 1983 have any of the Defendants, either collectively or individually, been in any way involved in the organization, promotion or sale of any tax shelter plan or arrangement.

19. Defendants admit that Paragraph 19 incorporates by reference the allegations contained in Paragraphs 1 through 18 of the Complaint, and Defendants incorporate by reference their corresponding responses herein. Defendants deny the remaining allegations of Paragraph 19.

a. Defendants admit the allegations of subparagraph (a) of Paragraph 19.

b. and c. Defendants deny the allegations of subparagraphs (b) and (c) of Paragraph 19.

20. Defendants deny the allegations of Paragraph 20.

21. Defendants admit that Paragraph 21 incorporates by reference the allegations contained in Paragraphs 1 through 20 of the Complaint, and Defendants incorporate by reference their corresponding responses herein. Defendants deny the remaining allegations of Paragraph 21.

22. Defendants deny the allegations of Paragraph 22.

23. Defendants deny the allegations of Paragraph 23.

a. and b. Defendants deny the allegations of subparagraphs (a) and (b) of Paragraph 23.

24. Defendants deny the allegations of Paragraph 24.

a. and b. Defendants deny the allegations of subparagraphs (a) and (b) of Paragraph 24.

25. Defendants deny the allegations of Paragraph 25.

a. Defendants deny the allegations of subparagraph (a) of Paragraph 25.

b. Defendants admit that on August 31, 1984 in Civil Action No. 3-84-1486F in the Northern District of Texas, a permanent injunction was entered against Shelter Leasing Corporation and its president, Brandon Rigney. Defendants deny the remaining allegations of subparagraph b of Paragraph 25.

c. Defendants deny the allegations of subparagraph c of Paragraph 25

26. Defendants deny the allegations of Paragraph 26.

27. Defendants deny each of the allegations of the Prayer for Relief and any other matter not expressly admitted herein.

FIRST AFFIRMATIVE DEFENSE

The Complaint fails to state a claim upon which relief can be granted against Defendants in that, among other things:

a. With respect to Counts I and II it fails to allege sufficient ultimate facts demonstrating that (i) in the absence of injunctive relief, Plaintiff would sustain irreparable harm or have an inadequate remedy at law, (ii) injunctive relief would be in the public interest, and (iii) the benefit of injunctive relief

to Plaintiff outweighs potential harm to Defendants.

b. With respect to Count I, it fails to allege sufficient ultimate facts to demonstrate that Defendants have engaged in conduct subject to penalty under Section 6700 of the Code.

c. Withrespect to Count I, it fails to allege sufficient ultimate facts to demonstrate that injunctive relief is appropriate to prevent recurrence of conduct subject to penalty under Section 6700 of the Code.

d. With respect to Counts I and II, the requested injunction would be overly broad, unenforceable and constitutionally impermissible under, among other things, the due process clause of the Fifth Amendment.

SECOND AFFIRMATIVE DEFENSE

Defendants would show that the claims set forth in the Complaint are barred by laches in that they have not participated in the organization or sale of any tax shelter plan or arrangement since 1983, tax returns with respect to 1982 and 1983 have been filed by investors, and Plaintiff has delayed in bringing this action for 1 year after notice was received by Defendant Craig B. Forney that an investigation under Sections 6700 and 7408 was in progress.

THIRD AFFIRMATIVE DEFENSE

Defendants would show that Plaintiff is not entitled to

an injunction in this cause because Plaintiff has unclean hands in that, among other things, Plaintiff's actions through its agency, the Internal Revenue Service, in instituting this action against Defendants and issuing lengthy statements to the press without affording Defendants any notice or hearing or a meaningful interchange of information were in violation of its own procedures as set forth in Rev. Proc. 83-78, 1983-2 C.B. 595 and deprived Defendants of property, namely, Defendants' personal reputation, business reputation, and goodwill and business relationships, without due process of law. Defendants would further show that the actions of Plaintiff, even if in compliance with Rev. Proc. 83-78, denied Defendants due process of law in that Rev. Proc. 83-78 is invalid under the due process clause of the United States Constitution and the Administrative Procedure Act, 5 U.S.C. §500 et seq. Plaintiff's unclean hands are further demonstrated by the fact that Plaintiff, through its agency, the Internal Revenue Service, has made numerous willful or grossly negligent disclosures of return information with respect to a taxpayer in direct violation of Code, §§ 6103, 7213(a)(1) and 7431.

FOURTH AFFIRMATIVE DEFENSE

Defendants would show that injunctive relief may not be granted in this case under Counts I and II because Defendants have not engaged in conduct "subject to penalty" under Section

6700 of the Code since, without admitting that a valuation overstatement was made, any valuation statement by Defendants was made with a reasonable basis and in good faith under Section 6700(b)(2) of the Code and failure to waive the penalty would be an abuse of Internal Revenue Service discretion. Defendants would further show that the Internal Revenue Service has failed to exercise its discretion under Section 6700(b)(2) to waive the penalty.

FIFTH AFFIRMATIVE DEFENSE

Defendants would show that injunctive relief may not be granted in this case because this case is moot in that, without admitting the existence of conduct subject to penalty under Section 6700 of the Code, the conduct sought to be enjoined is no longer occurring, Defendants do not have the means or intent to continue such conduct, and the applicable federal tax laws provide Plaintiff with adequate remedies to identify, investigate and audit allegedly abusive investment arrangements.

SIXTH AFFIRMATIVE DEFENSE

Defendants would show that injunctive relief may not be granted under Count II because Plaintiff has not notified Defendants of the specific conduct which constitutes unlawful interference with the internal revenue laws, Plaintiff has not issued regulations, rulings, administrative procedures or any

other guidelines under Section 7402 of the Code defining such conduct or affording Defendants administrative remedies or a hearing with respect to such conduct and the absence of such procedures deprives Defendants of property as stated above without due process of law.

Defendants have not had adequate opportunity to investigate the claims against them and reserve the right to amend their pleadings to assert additional affirmative defenses and/or counterclaims that may be available to them upon further investigation and discovery.

COUNTERCLAIM

COME NOW DEFENDANTS, CRAIG B. FORNEY, KATHLEEN F. FORNEY, JEFFREY C. PETRY, RAYMOND BASILI, FINANCIAL PLANNING CORPORATION OF AMERICA, CERTIFIED FINANCIAL PLANNERS OF AMERICA, LTD., ABARIS REPUBLIC CORPORATION, SPINNING GOLD CORPORATION, and FINANCIAL RESEARCH CORPORATION, by and through their attorneys of record, T. Geoffrey Lieben and Tom G. Parrott, for their Counterclaim against Plaintiff, United States of America, allege and state:

JURISDICTION

1. This Counterclaim arises out of the transaction and occurrences of Plaintiff's claims for relief and is therefore, compulsory within the meaning of Federal Rules of Civil Procedure 13(a).

2. Jurisdiction is conferred upon this Honorable Court by 26 U.S.C. §§7431 and 7214; The Federal Tort Claims Act [28 USC §§ 1346(b), 2671-2680]; and 28 USC §1331.

FACTS

3. On October 19, 1983 [in IR-83-129], the Internal Revenue Service (IRS) released procedural details of a new nationawide program to identify and investigate abusive tax shelters. Complete details on the procedures to be utilized in said new program were published in Revenue Procedure 83-78, 1983-2 C.B. 595 (hereinafter cited as "Rev. Proc. 83-78").

4. Section 4.01 of Rev. Proc. 83-78 provides that the I.R.S. "will advise the promoter by letter that it is considering

possible penalties and/or injunction action under Sections 6700 and 7408 of the Code for promoting an abusive tax shelter." Said section further provides that "the promoter will be afforded the opportunity of a meeting to present any facts or legal arguments that the promoter believes indicate that action should not be taken."

5. All of the Defendants herein have not been afforded the opportunity of a meeting as required by Section 4.01.

6. Plaintiff, by and through its agency, the Internal Revenue Service, has made contact with numberous clients and business associates of Defendants wherein the following statements or disclosures, inter alia, were made:

a. That Defendants are currently subject to an audit or investigation to determine whether they have been guilty of tne organization, promotion or sale of an abusive tax shelter;

b. That Defendants have been determined to be guilty of the organization, promotion or sale of an abusive tax shelter;

c. That all clients who invested with Defendants will be audited by the I.R.S.;

d. That upon audit, all deductions claimed by clients with respect to investments made with Defendants will be disallowed; and

e. That all clients of Defendants will be required to pay deficiencies in tax plus penalties and interest.

7. The Plaintiff, by and through its agency, the Internal Revenue Service, has made public press releases wherein it has stated, inter alia, that Defendants' clients, "many of them Nebraskans, who bought into the tax shelters, stand to lose both their investment and the tax savings they claimed."

8. The Plaintiff, by and through its agency, the Internal Revenue Service, has mailed to numerous clients, who have invested with Defendants, pre-filing notification letters pursuant to Section 6 of Rev. Proc. 83-78, 1983-2 C.B. 595. Said pre-filing notification letters advised the recipients thereof, inter alia, as follows:

a. That the Defendants were the subject to an audit or investigation by the I.R.S.;

b. That the I.R.S. had determined that the Defendants were guilty of participating in the organization, promotion or sale of abusive tax shelters;

c. That the I.R.S. had determined that the Defendants were guilty of conduct prohibited by Code, § 6700; and

d. That if an investor claimed income tax deductions or credits based upon an investment with Defendants, the I.R.S. would disallow such deductions or credits.

9. All of the aforesaid public statements by officers, agents and employees of Plaintiff, as set forth in Paragraphs 6, 7 and 8, above, constitute disclosures of "return information" as that term is defined in 26 USC § 6103(b)(2). All of the

aforesaid disclosures of return information were made in direct, willful and intentional contravention of 26 U.S.C. §§ 6103, 7213(a)(1), and 7431.

10. Plaintiff, by and through its officers, agents and employees, has harassed and intimidated business associates of Defendants and has advised them that Defendants have been engaged in illegal and improper conduct, which conduct on the part of Plaintiff has caused Defendants to suffer both business and personal losses.

11. Plaintiff, by and through its officers, agents and employees, has deliberately publicized its action in filing its Complaint in news, television, and radio releases expressly alleging that Defendants were engaged in promoting "abusive tax shelters".

COUNT I

UNAUTHORIZED DISCLOSURE OF RETURN INFORMATION

12. For their first counterclaim against Plaintiff, Defendants repeat and reallege each and every allegation made in the foregoing paragraphs of this Counterclaim as though the same has been fully rewritten herein verbatim.

13. The foregoing conduct of Plaintiff constitutes the willful or grossly negligent disclosure of return information with respect to a taxpayer in direct violation of 26 USC §§ 6103, 7213(a((1) and 7431.

14. The foregoing conduct of Plaintiff has damaged Defendants each in the sum of approximately $1,000,000.00

with the exact sum to be determined as of the date of judgment herein plus interest, attorney fees, and costs.

COUNT II

ABUSE OF PROCESS

15. For their second Counterclaim against Plaintiff, Defendants repeat and reallege each and every allegation made in the foregoing paragraphs of this Counterclaim as though the same has been fully rewritten herein verbatim.

16. Plaintiff's foregoing conduct in violationg its own published policies, procedures, and regulations violated Defendants' Constitutional Right of Due Process guaranteed under the Fifth Amendment to the Constitution of the United States and such action by Plaintiff as herein described through its officers, agents, and employees amounts to an abuse of process to Defendants' detriment.

17. The foregoing conduct of Plaintiff has damaged Defendants each in the sum of approximately $1,000,000.00 with the exact sum to be determined as of the date of judgment herein plus interest, attorney fees, and costs.

COUNT III

INTENTIONAL INFLICTION OF EMOTIONAL DISTRESS

18. For their third Counterclaim against Plaintiff, Defendants, Craig B. Forney, Kathleen F. Forney and Jeffrey C. Petry, repeat and reallege each and every allegation made in the foregoing paragraphs of this counterclaim as though the

the same has been fully rewritten herein verbatim.

19. Plaintiff's conduct in violating its own policies rules, procedures and regulations and by intentionally publicizing its activities through press conferences, press notices and publication to third parties did intentionally inflict on the aforesaid Defendants and cause them to suffer severe mental distress, outrage, and shock.

20. The foregoing conduct of Plaintiff has damaged the aforesaid Defendants each in the sum of approximately $1,000,000.00 with the exact sum to be determined as of the date of judgement herein plus interest, attorney fees and costs.

COUNT IV

PUNITIVE DAMAGES

21. For their fourth Counterclaim against Plaintiff, Defendants repeat and reallege each and every allegation made in the foregoing paragraphs of this Counterclaim as though the same has been fully rewritten herein verbatim.

22. Plaintiff's conduct in revealing Defendants' identity as a taxpayer and by revealing Defendants were under I.R.S. investigation, in violation of 26 USC § 6103 and 26 USC § 7431, was done willfully or though gross negligence.

23. As a result of the foregoing conduct of Plaintiff, Defendants are entitled to punitive damages and pursuant to 26 USC § 7431(c)(1)(B)(ii) in the amount of $2,000,000.00 plus interest, attorney fees and costs.

PRAYER FOR RELIEF

WHEREFORE, Defendants pray that this Court enter judgement in their favor as follows:

1. Plaintiff take nothing by its Complaint and said Complaint be dismissed.

2. Under Count I, Defendants each be awarded damages in the amount of approximately $1,000,000.00 with the exact sum to be determined as of the date of judgement plus interest, attorney fees, and costs.

3. Under Count II, Defendants each be awarded damages in the amount of approximately $1,000,000.00 with the exact sum to be determined as of the date of judgement herein plus interest, attorney fees, and costs.

4. Under Count III, Defendants, Craig Forney, Kathleen Fourney, Raymond Basili, and Jeffrey Petry each be awarded damages in the amount of approximately $1,000,000.00 with the exact sum to be determined as of the date of judgement plus interest, attorney fees and costs.

5. Under Count IV, Defendants be awarded punitive damages in the amount of $2,000,000.00 plus interest, attorney fees and costs.

6. For such other and further relief as the Court deems proper.

Respectfully submitted,

FITZGERALD, BROWN, LEAHY, STROM, SCHORR AND BARMETTLER

By: _____
T. GEOFFREY LIEBEN

1000 Woodmen Tower
Omaha, Nebraska 68102

and

SPECK, PHILBIN, FLEIG, TRUDGEON
& LUTZ

By:_____
TOM G. PARROTT

800 First City Place
Oklahoma City, Oklahoma 73102
(405) 235-1603

ATTORNEYS FOR CRAIG B. FORNEY, KATHLEEEN F. FORNEY, JEFFREY C. PETRY, RAYMOND BASILI, FINANCIAL PLANNING CORPORATION OF AMERICA, CERTIFIED FINANCIAL PLANNERS OF AMERICA, LTD., ABARIS REPUBLIC CORPORATION, SPINNING GOLD CORPORATION, AND FINANCIAL RESEARCH CORPORATION

CERTIFICATE OF SERVICE

I certify that on the ____ day of _____, 1985, a true and exact copy of the foregoing Answer and Counterclaim was deposited, postage prepaid, in the United States mail addressed to:

Douglas R. Semisch
Assistant United States Attorney
P. O. Box 1228, DTS
Omaha, NE 68101

Larry Meuwissen
Trial Attorney
Office of Special Litigation
Tax Division
U.S. Department of Justice
P.O. Box 7238
Washington, D.C. 20044

_____
TOM G. PARROTT

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF NEBRASKA

UNITED STATES OF AMERICA, Plaintiff, v. CRAIG B. FORNEY, KATHLEEN F. FORNEY, JEFFREY C. PETRY, FINANCIAL PLANNING CORPORATION OF AMERICA, CERTIFIED FINANCIAL PLANNERS OF AMERICA, LTD., ABARIS REPUBLIC CORPORATION, AND SPINNING GOLD CORPORATION, Defendants.	Civil Action No. 85-0-3 CONSENT OF CRAIG B. FORNEY KATHLEEN F. FORNEY, FINANCIAL PLANNING CORPORATION OF AMERICA, CERTIFIED FINANCIAL PLANNERS OF AMERICA, LTD., AND ABARIS REPUBLIC CORPORATION

1. Defendants Craig B. Forney and Financial Planning Corporation of America, and Certified Financial Planners of America Ltd., by their authorized representative, Craig B. Forney and Abaris Republic Corporation by its authorized representative, Kathleen F. Forney (hereinafter defendants) hereby enter a general appearance and admit the jurisdiction of this court over them and over the subject matter of this action and the service upon them of the complaint of the United States of America in this action.

2. Defendants, without admitting or denying the allegations of the Complaint except as stated in paragraph 1 above, hereby consent to the entry, without further notice, of the annexed Final Judgment of Permanent Injunction.

3. Defendants hereby waive the entry of findings of fact and conclusions of law pursuant to Rule 52 of the Federal Rules of Civil Procedure.

4. Defendants waive any right they may have to appeal from the Final Judgment annexed hereto.

5. Defendants state that they enter into this Consent voluntarily.

6. Defendants agree that this Court shall retain jurisdiction over them for the purpose of implementing and enforcing the Final Judgment pursuant to the terms contained therein.

Dated: 5/15/85

CRAIG B. FORNEY

Financial Planning Corporation of America

By: CRAIG B. FORNEY, its President

Certified Financial Planners of America, Ltd.

By: CRAIG B. FORNEY, its President

KATHLEEN F. FORNEY

Arabis Republic Corporation

By: KATHLEEN F. FORNEY, its President

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF NEBRASKA

UNITED STATES OF AMERICA, Plaintiff, v. CRAIG B. FORNEY, KATHLEEN F. FORNEY, JEFFREY C. PETRY, FINANCIAL PLANNING CORPORATION OF AMERICA, CERTIFIED FINANCIAL PLANNERS OF AMERICA, LTD., ABARIS REPUBLIC CORPORATION, AND SPINNING GOLD CORPORATION, Defendants.	Civil Action No. 85-0-3 FINAL JUDGMENT OF PERMANENT INJUNCTION AGAINST DEFENDANTS CRAIG B. FORNEY, KATHLEEN F. FORNEY, FINANCIAL PLANNING CORPORATION OF AMERICA, CERTIFIED FINANCIAL PLANNERS OF AMERICA, LTD., AND ABARIS REPUBLIC CORPORATION

Plaintiff, the United States of America, having filed a Complaint for Permanent Injunction in this matter and the defendants Craig B. Forney, Kathleen F. Forney, Financial Planning Corporation of America, Certified Financial Planners of America and Abaris Republic Corporation (hereinafter referred to as the "defendants"), having filed a consent to judgment herein, having entered a general appearance, having waived the entry of findings of fact and conclusions of law, having neither admitted nor denied the allegations of the Complaint, and having consented to the entry of this Final Judgment of Permanent Injunction, it is hereby ORDERED, ADJUDGED AND DECREED:

1. The Court has jurisdiction of this action pursuant to Sections 1340 and 1345 of Title 28 of the United States Code, and Sections 7402 and 7408 of the Internal Revenue Code of 1954, as amended (26 U.S.C.).

2. The Court finds that defendants have neither admitted nor denied the Government's allegations that they have engaged in conduct which is subject to penalty under Section 6700 of the Internal Revenue Code and which interferes with the enforcement of the internal revenue laws.

3. The Court finds that defendants have consented to the entry of judgment for injunctive relief pursuant to Sections 7402(a) and 7408 of the Internal Revenue Code to prevent them from (a) engaging in conduct subject to penalty under Section 6700 of the Internal Revenue Code, and (b) organizing, promoting and selling interests in tax shelter plans or arrangements involving the production, leasing or sale of master recordings or other tax shelter plans or arrangements as defined in paragraph 7 herein, having abusive characteristics.

4. It is further ORDERED, ADJUDGED AND DECREED that the defendants and their agents and attorneys, servants and employees, those acting in concert with them, and each of them be, and hereby are, permanently enjoined and restrained from directly or indirectly, by the use of any means or instrumentalities:

(a) Taking any action in furtherance of the organization, promotion, advertising, marketing, selling, leasing, or offering for lease or sale of any interest in the following entities hereinafter collectively described as the master recording tax shelters: Landmark Profits, Ltd.; Midwest

Monetary, Ltd.; Rushmore Investment Group; Tri-State Investment Club; Western Investment Group; Capital Resources, Ltd.; International Monetary Funding; Shelter Leasing Corporation; and Spinning Gold Corporation.

(b) Advising any investor in any of the master recording tax shelters that such investor will be entitled to deductions or credits, for federal income tax purposes by reason of his participation in such tax shelters.

(c) Organizing or assisting in the organization of, or selling or participating in the sale of interests in, any partnership, trust, entity, investment plan, or other plan or arrangement which purports to entitle participants to tax benefits based upon any of the following:

(1) any representation of value of any asset or interest therein to be sold, unless a complete appraisal using costs of production or replacement, comparable sales and/or other methods of valuation commonly recognized in the trade has been obtained from an appraiser who is certified by the American Society of Real Estate Appraisers or the American Society of Appraisers, or who has similar professional credentials;

(2) any method for the accrual or calculation of interest on indebtedness in excess

66-526 O - 87 - 7

of the amount of the economic accrual of interest; or

(3) a transaction or series of transactions which the defendants know or have reason to know by reason of specific statements contained in the prospectus or other offering materials or by reason of training or experience,

(i) lacks economic substance; or

(ii) depends upon financing that is nonrecourse either expressly or because of any tacit understanding or an unreasonably long repayment period, except where expressly permitted by the Internal Revenue Code; or

(iii) depends upon financing techniques which do not conform to standard commercial business practices; or

(iv) depends upon a market for services or the productivity of property that

cannot reasonably be expected to exist.

(d) Making or furnishing a statement in connection with organizing, assisting in the organization of, selling or participating in the sale of an interest in a partnership, entity, investment plan or any other plan or arrangement

(1) with respect to the allowability of any deduction or credit, the excludability of any income, or the securing of any other tax benefit by reason of holding an interest in the entity or participating in the plan or arrangement which the defendants know or have reason to know is false or fraudulent as to any material matter; or

(2) as to the value of property or services if the value directly relates to the amount of a deduction or credit for Federal income tax purposes and if the value so stated exceeds 200 percent of the correct value.

5. The defendants shall provide to the District Director of the Internal Revenue Service, Omaha District, within two months of the date of entry of this Order the following: (a) a list of all individuals or entities that purchased from defendants or

sold interests in master recording tax shelters listed in paragraph 4(a), above; (b) a list of all tax shelters, as defined in paragraph 7, below, which defendant has sold, promoted or invested in or in which sales, promotions or investments were attempted by defendant; and (c) a list of all individuals or entities that purchased from defendants or sold interests in the tax shelters referred to in subparagraph 5(b), above.

6. It is further ORDERED, ADJUDGED, AND DECREED that if the defendants, acting individually or through any corporation or other business entity now in existence or hereafter formed, in which they have a controlling interest or if the defendants acting indirectly or in any other manner, organize, assist in the organization of, or participate in the sale of any tax shelter, as defined in paragraph 7, below, such defendant shall, for a period of three years from the date of this order:

(a) Prominently disclose the existence and nature of this Order in any and all materials or media used to offer for sale such tax shelter; and shall promptly

(b) Notify the Internal Revenue Service (through the District Director of the Internal Revenue Service District wherein the defendant resides) of his participation in the organization or sale of such tax shelter;

(c) Provide the District Director with complete and true copies of all offering

documents, appraisals, tax opinions, and other promotional material with respect to the tax shelter;

(d) Wait a period of 30 days from the date such material is delivered to the District Director before beginning the sale of such tax shelter; and

(e) Refrain from making any claim or statement that such notification or any failure by the Internal Revenue Service to comment or take action with respect to the material implies approval of the tax shelter by the Internal Revenue Service.

7. "A Tax Shelter," is any investment:

a. which

(1) is expected to be offered to 5 or more individuals,

(2) is expected to have an aggregate total investment in excess of $250,000, or

(3) is required to be registered under Federal or State laws regulating securities, and

b. which provides for or reasonably appears to provide for federal tax deductions and/or federal tax credits and the sum of

(1) such federal income tax deductions and

(2) 200 percent of such federal tax credits

totals for any year an amount in excess of 200 percent of the amount of money plus the adjusted basis of other property (reduced by any liability with respect to such other property) contributed by any investor as of the close of such year. Other property contributed by any investor does not include any amount to be held in cash equivalent or marketable securities nor any amount borrowed from any person who participated in the organization, sale or management of the investment or who is recommended, solicited or arranged as a borrower by any person participating in the organization, sale or management of the investment.

8. It is further ORDERED, ADJUDGED AND DECREED that this Court shall retain jurisdiction of this action for the purpose of implementing and enforcing this Final Judgment and all additional decrees and orders necessary and appropriate to the public interest.

There being no just reason for delay, the Clerk is directed to enter this Final Judgment forthwith.

So ORDERED this 17 day of September, 1985

UNITED STATES DISTRICT JUDGE

National Coalition of IRS Whistleblowers

P. O. BOX 7750, NEW YORK, NEW YORK 10116
(202) 546-8345 (212) 921-5371

STATEMENT OF PAUL J. DES FOSSES, RETIRED IRS SENIOR AGENT AND PRESIDENT OF THE NATIONAL COALITION OF IRS WHISTLEBLOWERS

To the Senate Finance Oversight Committee on the Internal Revenue Service.

Honorable members of the Oversight Subcommittee on the Internal Revenue Service, I am Paul J. DesFosses, and I am a Certified Public Accountant with current membership in both the Idaho Society and the American Institute of Certified Public Accountants.

I spent nearly twenty (20) years as an Internal Revenue Agent and was the Senior Revenue Agent for Eastern Idaho when I retired in 1984.

I am making this statement as President of the National Coalition of IRS Whistleblowers, and I wish to speak, not only for the members of my organization - most of whom are current or former IRS employees - but also for those individuals and groups who could not appear before these hearings to speak for themselves and tell of the alleged abuses they have suffered at the hands of the IRS, and this is all too often abuse committed with the full complicity of the Department of Justice.

It is common for the IRS to avoid the legal limitations Congress has placed upon the IRS investigative powers and administrative proceedings; and then to use illegal means to silence those employees, individuals, groups, and selected officials who might expose or oppose IRS abuses.

Examples of such illegal IRS acts investigated and documented by the National Coalition of IRS Whistleblowers include the following:

A) Grand Jury investigative powers are subverted to achieve IRS civil investigative goals in direct violation of the law as indicated in the Kilpatrick and OMNI cases, as well as in the Dahlstrom and American Law Association cases, and many other cases.

B) The threat of a Grand Jury investigation, carried out with the full complicity of the Department of Justice, is used to silence IRS employees who might otherwise blow the whistle on criminal actions of the IRS. Such misuse of the Grand Jury

process to effect an IRS cover-up is evident in the Senator Joseph Montoya and Representative George Hansen election rigging incidents.

C) In direct violation of the protections granted in the Privacy Act, lawful organizations and religions are routinely infiltrated by IRS agents for the prupose of amassing illegal information files on members and sabotaging from within the legitimate operations of those organizations. Such an example is found in the decades long illegal IRS attack on the Church of Scientology. (see Senate testimony of Reverend John Stanard of the Church of Scientology)

D) The use of strawmen lawsuits instigated by the IRS in which a cooperating organization files suit against the IRS demanding that the IRS withdraw the tax exempt status of an organization or church group. The IRS directed suit against itself is carried out by the strawman organization for the purpose of intimidating the targeted religious group. Examples of this are found in the New York Federal Court suits currently threatening tax exempt status of the Knights of Columbus and the Catholic Church.

E) Disallowance by the IRS of contributions made to churches and religious educational institutions (Exibit #1) and the classifying of those who support such institutions as "tax protesters" due to their religious contributions. Often the disallowance is made in direct violation of protective prohibitions added to the law by Congress in the form of riders to treasury appropriations bills. (Exhibit 2) Such illegal tactics, which violate Congressional prohibitions, have been used by the IRS against supporters of the religious universities of a number of legitimate American Churches including those of the Baptists and the Mormons (Church of Jesus Christ of Latter Day Saints). (Exhibit #3)

F) Following the pattern established by the IRS during the Watergate era, the IRS has recently used IRS data banks and procedures to illegally target and harass individuals and groups critical of big government in general, and of the IRS in particular. Examples of legitimate groups so victimized by the IRS include AMWAY, (Exhibit #4), the American Law Association, the American Freeman Association and others.

G) The IRS has used the press to destroy those elected officials who dared to investigate or criticize illegal IRS actions. Information, including mis-information, was leaked by the IRS to the press in efforts to rig the elections of former Senator Joseph Montoya and former Congressman George Hansen. By unseating them, the IRS hoped to silence them and cover-up the illegal IRS activities which they had exposed and criticized. It might be noted that the illegal IRS election finally succeeded in unseating and silencing these critics of IRS abuse.

H) The IRS has conducted an illegal campaign since the February

26, 1973 memo of IRS Western Region Commissioner Homer O. Croasman directing his subordinates to "educate" and influence U.S. Attorneys and Federal Judges, including Judge Crocker of San Francisco. One potential witness before these hearings, former Congressman George Hansen of Idaho, was prevented from appearing through the apparently IRS induced frenzy of fear so obvious in Judge Joyce Hans Greens actions of June 19, 1986.

I) The silencing of witnesses in the illegal election tampering of the IRS did not end with the actions of Judge Green. During the same week, four IRS employees who knew of or had witnessed criminal actions of the IRS in it's illegal attempts to unseat and silence former Congressman George Hansen were advised by the IRS that all pay and rank increases would be withheld pending their "improved" cooperation and that, if they fail to cooperate with IRS efforts, they would be terminated. Such silencing of potential employee whistleblowing is a continuing IRS effort.

J) The routine use of perjury by IRS agents and witnesses, at the direction of the IRS, is clearly documented in both the OMNI and Kilpatrick cases. Such IRS directed perjury is clearly evident in the video taped statements of IRS undercover agent Gerald Armstrong whom the IRS had assigned to infiltrate and destroy the Church of Scientology.

K) In the same example c'ted above involving the Church of Scientology, the IRS tactic of attacking a church through seizure of its assets is clearly documented, and such action had been planned against the Church. Another identical example of IRS efforts to control a church by seizing its assets and altering its leadership and direction is seen in the IRS orchestrated 1985 attack against the re-organized LDS Church's day care and youth camp programs.

L) The use by the IRS of illegal mail opening, done with the full cooperation and collusion of both the U.S. Post Office and the Department of Justice, is clearly evidenced in the now infamous October 28, 1983 letter from the IRS to Glenn L. Archer Jr., who was removed as head of the Tax Division of the Justice Department in February of this year.

M) The outrageous and blatent misconduct culminated in the January 1986 issuance by the IRS Criminal Investigation Division of a secret document, "The Tax Protester Information Book", in which the IRS declares "spurious Christianity" to include any church that believes in the second coming of Christ (see statement of Dr. Greg Dixon, President of the National Coalition of Unregistered Churches) and any church that believes any people other than Jews, are included in "Gods Chosen People". (Exhibit #5)

It is the ardent plea of all those groups and individuals who cannot be here, as it is of those who are here, that proper Congressional efforts be immediately undertaken to bring about a halt to these horribly unconscionable actions by the IRS.

All of the more than 3000 members of the National Coalition of IRS Whistleblowers know, perhaps better than any others, the alarming increase in both the unchecked power of the IRS and its willingness to use illegal means to achieve its goals and silence it's critics.

We belive that, unless immediate Congressional controls over the IRS are established, this may well be the last legitimate opportunity any of us will have to question the abusive power of the IRS and curb the illegal acts it carries out with impunity against the citizens, organizations, religions and elected officials of this nation.

DATED: June 23, 1986

PAUL J. DES FOSSES

COURT CASES CITED:

U.S. vs. Kilpatrick, 594 F Supp 1325

U.S. vs. Omin International Corp., D. Md. May 15, 1986

U.S. vs. Dahlstrom, CR 81-116R

Nordbrock, etal., vs. IRS Filed Feb. 1986, Colorado

Abortion Rights Mobilization vs. IRS Filed 1986, New York

Internal Revenue Service

District
Director

Department of the Treasury

400 N. 8th St., Richmond, VA 23240

Person to Contact: G. Wright

Telephone Number: (703) 756-6668

Refer Reply to E:E:1204:GW

Date 11/16/84

Dear Mr Disbrow:

I did not send you the pub with the reports because you are not entitled to appeal rights within IRS. As I explained to you you have been identified as an illegal tax protestor, due to your contributions deductions. IRS is not hearing appeals from tax protestors. If you do not accept our findings you may request a statutory letter of disallowance. Upon receipt of the letter you will have 90 days to file for a trial in tax court.
As I told you, if you do go to tax court IRS will request that the frivolous appeal penalty be asserted.
This penalty is $5000.00.
If I do not hear from you within 10 days I will close the case out for statutory letter of disallowance.

Yours Truly

Grace Wright
Internal Revenue Agent

Internal Revenue Service

RECEIVED
OFFICE OF THE
REGIONAL COMMISSIONER
JAN 24 1980
WESTERN REGION

cc:APC(RM)

date: JAN 18 1980

to: All Regional Commissioners, District Directors, Service Center Directors, Regional Counsel, and District Counsel
Attn:

from: Assistant Commissioner (Compliance)

subject: House Amendments to Treasury Appropriations Bill--P.L. 96-74, 9/29/79

A House amendment to the Treasury Appropriations Bill (P.L. 96-74, approved September 29, 1979) barred the use of appropriated funds in connection with certain income tax matters. The purpose of this memorandum is to provide you with information and guidance concerning the effect of the amendment on field operations.

Under section 614 of P.L. 96-74, appropriations for the fiscal year ending September 30, 1980, may not be used to carry out any revenue ruling (such as Rev. Rul. 79-99, 1979-1 C.B. 108) which holds that a taxpayer is not entitled to a charitable deduction for general purpose contributions that are used for educational purposes by a tax-exempt religious organization.

Because of the effect of P.L. 96-74, no adverse action should be taken to deny a charitable deduction to a taxpayer making a general purpose contribution to an exempt religious organization which uses such contribution for educational purposes during the fiscal year ending September 30, 1980.

Please take the appropriate steps to inform Examination and Appeals technical personnel and managers of the position taken in this memorandum. Questions regarding the interpretation of the House Amendment may be referred to the National Office, Attention: CP:E:E:E, for further guidance or you may have a member of your staff contact J. J. Thomassen at 566-6466.

We are taking the necessary steps to incorporate the pertinent portions of this memorandum into IRM 45(11)0.

The Office of the Chief Counsel is in agreement with the contents of this memorandum.

2039
(Rev. 11-78)

Summons

Department of the Treasury
Internal Revenue Service

In the matter of the tax liability of JOHN DOES, donors of gifts in kind to Brigham Young University

Internal Revenue District of Salt Lake City, Utah Periods 1976, 1977, and 1978

The Commissioner of Internal Revenue

To Brigham Young University and Mr. Dallin Oaks, as President of Brigham Young University

At Provo, Utah

You are hereby summoned and required to appear before James L. Oys, an officer of the Internal Revenue Service, and to bring with you and produce for examination the following books, records, papers, and other data:

Books, documents or other records showing the names and addresses of all contributors, including individuals and corporations or other business entities, of charitable contributions in kind, excluding securities, to Brigham Young University during the period January 1, 1976, to December 31, 1978.

Business address and telephone number of Internal Revenue Service officer named above:

Internal Revenue Service, 465 South 4th East, Salt Lake City, Utah 524-5836

Place and time for appearance:

at Brigham Young University, office of the President, Provo, Utah

on the 3rd day of December, 1979 at 10:00 o'clock A. M.

Issued under authority of the Internal Revenue Code this 28th day of November, 1979

Richard V. Wilde — Signature of Issuing Officer — District Director — Title

Signature of Approving Officer (if applicable) — Title

Original to be kept by IRS

EXHIBIT "C"

(11-78)

Internal Revenue Service

memorandum

date: SEP 21 1981

to: All ARC's (Examination) E

from: ARC (Examination) E
Central Region

subject: Amway Distributors of Amway Corporation - Identified Schemes Used By Distributors To Offset Expenses Against Earned Income

The purpose of this memorandum is to alert you to Schemes of non-compliance being used by Amway distributors identified by the Detroit District through examination of Amway Corporation. Amway Corporation has been identified as having distributors taking business Schedule C deductions which contain substantial amounts of personal non-business expense. The examinations of the distributors have disclosed that the adjustments have produced significant results in the disallowance of the losses.

The DIF score of the returns examined and classified ranges from 250 to 600. While some of the returns will not fall into a DIF score range noteworthy of examination, we believe these returns to require examination due to the substantial loss of revenue and non-compliance with the law.

We have forwarded a copy of this information to the National Office along with a request for consideration of a national project, since it has nationwide impact involving some 350,000 distributors. We believe this scheme to be widespread.

All the distributors are treated as individual contractors by Amway Corporation. The primary purpose of a distributor is not to retail the companies product door-to-door, but to develop a network of distributors under his/her sponsorship. Distributors receive a percentage of all sales from their network.

We have attached for your information a copy of two memorandums from the Chief, Examination Division, Detroit District, which discuss the schemes used by part-time Amway distributors on their individual returns throughout the country. Also, included you will find in the attachment the applicable tax law in the areas of non-compliance which should aid you in the identification and examination of these returns. For the sake of uniformity in these examinations we recommend the disallowance of the deduction under Sections 162 and 274 of the IRC.

the AMERICAN COALITION *of* UNREGISTERED CHURCHES

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June 20, 1986

FOR IMMEDIATE RELEASE

The release of an IRS Religious Hit List called, "Illegal Tax Protester Information Book", published by the IRS Criminal Investigation Office is one of the most chilling developments in the two-hundred year history of the United States.

The list goes far beyond a list of citizens "who have made threats, done acts of violence, or have a charter of violence." It also includes groups that have clearly stated policies against violence.

It also defines "spurious Christianity" as someone who believes in the Second Coming of Jesus Christ.

We of the American Coalition of Unregistered Churches do not believe that the IRS or any other governmental agency should be in the business of defining religion in the United States; or in fact, determining what is or is not "spurious Christianity."

If this hit list is allowed to stand, there is no doubt that the IRS has established a favored state church; and that is one that is considered proper by IRS standards.

We of the Coalition call upon the proper congressional committees to immediately take steps to abolish this hit list and inform the IRS that they should cease and desist in their efforts to define religion in the United States, and to establish a state religion.

FOR IF THE TRUMPET GIVE AN UNCERTAIN SOUND,
WHO SHALL PREPARE HIMSELF TO THE BATTLE?
I COR 14:8

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DAVID P RUWART

July 3, 1986

Betty Scott-Boom
Committee on Finance
Washington D.C., 20510

Re: A Written Statement for Inclusion in the Printed Hearing Record of the Senate Finance Sub-Committee on Oversight of the IRS.

It has come to our attention that the Senate Finance Sub-Committee on Oversight of the IRS has held hearings on June 19, 20 and 23, 1986 on the possible improper activities of the IRS in several tax cases. The Michigan legal firm of Plunkett, Cooney, Rutt, Watters, Stanczyk & Pedersen, P.C. represents a group of individual taxpayers who invested in a master recording leasing program which has been designated as the "Koala Record Company Master Recording Tax Shelter Project" by the Internal Revenue Service. These individuals have combined into a group known as the Master Recording Defense Fund for the purpose of consolidating their resources to properly defend and represent their interests before the Internal Revenue Service. Since 1982 the Master Recording Defense Fund has been attempting to resolve all tax issues with the Internal Revenue Service. As of this date, the Master Recording Defense Fund has settled all issues relating to the master recording leasing program investments made in 1979 and 1980. However, the Internal Revenue Service continues to act in an arbitrary and capricious manner with regards to all individuals who invested in this program in the taxable year 1981. The Master Recording Defense Fund feels that the actions of the Internal Revenue Service towards these taxpayers have resulted in a denial to these taxpayers of due process and also has been an abuse of the discretion of a governmental agency resulting in a denial to these taxpayers of equal protection under the law as guaranteed by the United States Constitution.

FACTS

From 1979 through December 31, of 1981, prepackaged joint ventures were promoted principally in the state of Michigan under the direction of the Koala Record Company. These joint ventures were promoted as a means by which an individual investor could enter into the entertainment business. The joint venture was to lease a master recording from Koala Record Company and thereby be able to exploit the use of a master recording by producing tapes and records for national distribution. From the sales of these tapes and records, the

individual was to receive a substantial profit. The recording industry by its very nature, creates an aura of glamour, community respect and nostalgia leading to incentives which overdue the traditional investment decisions. As a result, the Koala Record Company Program attracted thousands of individuals who invested millions of dollars.

The joint venture program also contained the feature of an "investment tax credit pass through". Koala Record Company placed all values and followed all of the prescribed statutory requirements of the Internal Revenue Code and the regulations thereunder with regards to these credit pass throughs. The individuals who invested in the joint ventures were then afforded the right to deduct their proportionate share of the lease payments and credits earned by these joint ventures.

Commencing in January of 1981, the Detroit district of the Internal Revenue Service decided to examine the Koala Record Company. This examination was performed chiefly by Internal Revenue Agent William R. Page. Mr. Page has been an Internal Revenue Service revenue agent for ten years. Mr. Page's investigation continued over a period of two hundred (200) weeks and consisted of five thousand (5,000) hours of investigation of tens of thousands of documents. In March or April of 1981, Mr. Page recommended that the abusive tax shelter program be implemented. At the time of this recommendation the Internal Revenue Service was aware of the continued promotion of these ventures under the guise of a tax credit program which had been approved by the Internal Revenue Service. This factor remained the same for the entire year of 1981. During their investigation, and after reaching the conclusion that the program was an abusive tax shelter, the Internal Revenue Service made no attempts to inform the potential investors of this fact.

In 1982, the Internal Revenue Service began auditing individual returns and disallowing all deductions and credits claimed as a result of a taxpayers investment in these master recording leasing joint ventures. Through September of 1982, the Internal Revenue Service was allowing a taxpayer to claim the amount of his original investment as a loss in the year of investment and no penalties were applied. In approximately September of 1982, the National Office of the Internal Revenue Service issued policy statement P-4-64. This statement set forth the position of the Internal Revenue Service that any individual taxpayer who filed a return after December 31, 1981 would no longer be allowed the 100 percent out-of-pocket treatment.

The Detroit District applied this policy in such a manner that any individual filing an amended income tax return claiming the one hundred (100) percent out-of-pocket deduction for an investment made in 1981, by November 1, 1982, would be afforded that treatment. As to all other 1981 individual

investors, a settlement position of a deduction for only sixty (60) percent of the original investment in the year of investment and the imposition of overvaluation penalties under §6659 of the Internal Revenue Code in the amount of fifteen (15) percent of the underpayment determined as a result of the overvaluation was applied.

Since that time the Internal Revenue Service has allowed all investors who made an investment in 1979 or 1980 to be afforded a deduction for one hundred (100) percent out-of-pocket. Furthermore, the Master Recording Defense Fund is aware of more than one hundred (100) individuals who had made an investment in 1981 and have been afforded to settle their tax issues based upon a deduction for one hundred (100) percent of the amount of their investment. Furthermore, the Master Recording Defense Fund has a member who had filed a amended return prior to the Detroit District cut-off date of November 1, 1982. This individual's amended return was accepted as filed, however, he is not being afforded the treatment of a deduction for one hundred (100) percent of the amount of his investment. This individual is being assessed deficiencies and penalties even though he followed all the published and stated procedures of the Internal Revenue Service.

COMPLAINED OF ACTION

There is a large group of taxpayers who made an investment in 1981 in the Koala Record Company program (the 1981 taxpayers). Koala Record Company is presently in bankruptcy and all sums invested are presently lost to all of the investors. The 1981 taxpayers are presently engaged in litigation both in the United States Tax Court and in the United States District Court. This group of investors are identically situated to the other 1981 Koala investors who have been extended the one hundred (100) percent out-of-pocket deduction. The 1981 taxpayers have been denied the one hundred (100%) percent out-of-pocket treatment. No factual basis exists to treat the 1981 taxpayers differently from other members of the class of 1981 Koala investors who were extended the one hundred (100) percent out-of-pocket deduction nor from that group of Koala investors making investments in 1979 and 1980.

These 1981 taxpayers have been defrauded of their invested sums. They have little hope of ever making a recovery of the original investment. The vast majority of these 1981 taxpayers are individuals with little experience in investments and earn livings in the middle income range. The 1981 taxpayers are not tax protestors nor are they a group trying to evade their fair share of tax. These 1981 taxpayers contend that they are now being defrauded by the Internal Revenue Service. They have been inadvertently caught in a fraudulent promotional scheme resulting in a loss of hard earned capital and are now being denied equal treatment under the law and are being further

deprived of their property as a result of the arbitrary and capricious application of policies of the Internal Revenue Service which should be directed against the promoters of this scheme rather than the 1981 taxpayers.

The principle of equality of treatment has repeatedly been affirmed by the Supreme Court. In referring to a statutory classification, Chief Justice Berger emphasized the importance of equal protection:

> "A classification 'must be reasonable, not arbitrary, and must rest upon some ground of difference having a fair and substantial relation to the object of the legislation, so that all persons similarly circumstanced shall be treated alike'".

Read v. Read, 404 U.S. 71, 77; 92 S Ct. 251, 254; 30 L Ed.2d 225 (1971).

The Constitution of the United States guarantees its citizens due process under the Fifth Amendment. The Supreme Court has concluded that the due process clause of the Fifth Amendment applies to the federal government and encompasses the theory of "equal protection". As is clearly indicated by the above facts, the Internal Revenue Service is guilty of denying the taxpayers of the United States their rights under the Fifth Amendment to equal protection.

> "While the Fifth Amendment contains no equal protection clause, it does forbid discrimination that is 'so unjustifiable as to be violative of due process.' Schneider v. Rusk, 377 U.S. 163, 168; 84 S Ct. 1187, 1190; 12 L Ed.2d 218, 222 (1964); See also Bolling v. Sharpe, 347 U.S. 497, 499, 74 Supreme Court 693, 694, 98 L Ed. 884 (1954). This Court's approach to Fifth Amendment equal protection claims has always been precisely the same as to equal protection claims under the Fourteenth Amendment. See, e.g., Schlesinger v. Ballard, 419 U.S. 498, 95 S Ct. 572, 42 L Ed.2d 610 (1975); Jimenez v. Weinberger, 417 U.S. 628, 637, 94 Supreme Court 2496, 2502, 41 L.Ed.2d 363, (1974); Frontiaro v. Richardson, 411 U.S. 677, 93 S Ct. 1764, 36 L Ed.2d 583 (1973)."

Weinberger v. Wiesenfeld, 420 U.S. 637, 638; 95 S Ct. 1225, 1228; 43 Lawyer's Edition 2d 514 (1975) (Emphasis supplied).

The 1981 taxpayers are being denied equal treatment under the law. The Internal Revenue Service, in its administration of the tax laws, has not treated them evenly with other members of the class of Koala investors. Unequal administration of the laws valid on their face, treating similarly situated persons differently violates the very underpinnings of the concept of equal protection.

The 1981 taxpayers being denied the equal treatment under the law are identical to those investors who have been afforded the one hundred (100) percent out-of-pocket settlement treatment. The Internal Revenue Code was the same for all taxpayers who made investments in the Koala program in 1981 used the same transactional document. The facts and circumstances surrounding the 1981 investors were the same for all 1981 investors. The group of taxpayers being denied this treatment had no greater input to the program nor did they participate to any less extent then any taxpayers being afforded the one hundred (100) percent out-of-pocket treatment.

Insofar as this group of taxpayers being denied the equal treatment are concerned, the actions of the Internal Revenue Service could not be more arbitrary. The facts are undeniable that the Internal Revenue Service was not consistent in its extension of the one hundred (100) percent out-of-pocket deduction. The requirement that uniformity and equality required by law is to be preferred as the just and ultimate purpose of law mandates that all 1981 Koala investors, including the 1981 taxpayers being denied this treatment, be extended the one hundred (100) percent out-of-pocket deduction.

Given the opportunity we will submit sworn affidavits of individuals in support of the facts of the arbitrary and unequal treatment of the Internal Service. As an example, an individual taxpayer submitted a 1040x in September of 1982 claiming the one hundred (100) percent out-of-pocket loss treatment for his 1981 investment. This individual was allowed this treatment for his 1981 investment. Another taxpayer submitted a 1040x in September of 1982 claiming the one hundred (100) percent out-of-pocket loss treatment for his 1981 investment. This individual was not allowed this treatment for his 1981 investment. Furthermore, the Master Recording Defense Fund is aware of over one hundred individuals to whom the one hundred (100) percent out-of-pocket deduction was extended for investments made in 1981.

As further examples we submit the recently accepted settlement offer of the Internal Revenue Service as to all 1979 and 1980 investors presently with pending petitions before the United States Tax Court. Presently, there are approximately two hundred (200) individuals with petitions before the United

States Tax Court. The Internal Revenue Service has allowed the taxpayer who invested in 1979 or 1980 the one hundred (100) percent out-of-pocket deduction treatment. These taxpayers will be allowed to enter into closing agreements with the Internal Revenue Service claiming the one hundred (100) percent out-of-pocket treatment in entering a decision document to that effect with the United States Tax Court. The taxpayers remaining before the Tax Court who have at issue an investment in the taxable year 1981 submit to this Committee that an investment made in 1979, 1980 or 1981 was identical and should be afforded the same treatment under the law. Regardless of this fact, which is well known to the Internal Revenue Service, taxpayers making an investment in the Koala Record Program in 1979 and 1980 and having petitions before the Tax Court are allowed the one hundred (100) percent out-of-pocket deduction. Taxpayers making an investment in the Koala Record Program in 1981 and having petitions before the tax court are not allowed similar treatment.

We would like to call to the attention of this Committee, that the Internal Revenue Service has admitted that the cases presently before the United States Tax Court are substantially similar no matter what the year of investment. In the motion to consolidate for trial made by the Internal Revenue Service, the Internal Revenue Service states the issue of fact and law in the entitled cases are substantially identical in each of the cases. The Internal Revenue Service made this motion under Rule 61 of the Rules of Practice and Procedure of the United States Tax Court. Rule 61(a) states in pertinent part, "joinder is permitted only where all or part of each participating parties' tax liability arises out of the same transaction, occurrence, or series of transactions and occurrences and, in addition, there is a common question of law or fact relating to these parties." The Tax Court has allowed the motion of the Internal Revenue Service to consolidate the test cases which cases relate to investments made in 1979, 1980 and 1981.

Despite the Internal Revenue Service maintaining that all the cases consolidated pursuant to their motion are identical in each of those cases, the Internal Revenue Service will not afford the same settlement offer to each of these consolidated cases. The Internal Revenue Service is taking an arbitrary and unequal position with regard to taxpayers making investment in 1981. Of the thirteen cases consolidated, pursuant to the Internal Revenue Services motion to consolidate, the Internal Revenue Service has extended a one hundred (100) percent out-of-pocket settlement offer to seven (7) of the cases and denied the same treatment to six (6) of the cases consolidated under their motion.

The Internal Revenue Service has not set forth any position to differentiate the remaining taxpayers before the United States Tax Court and the United States District Court. They have afforded an unequal treatment to those individual taxpayers making an investment in the identical program in 1979 or 1980. Furthermore, they have clearly offered a differing treatment to individual taxpayers who are in the identical situation as the taxpayers still remaining with unsettled issues before the Courts of the United States. The fact that an investment was made in 1979, 1980 or 1981 has no bearing on the treatment given by the Internal Revenue Service. There is no rational explanation for their discrimination other than that they are treating the taxpayers of the United States in an arbitrary and capacious manner.

The policy statements of the Internal Revenue Service mandate that the federal tax laws be administered fairly, equally and uniformly on a national basis. As stated, the purpose of the service is:

> ". . . to collect the proper amount of tax revenues at the least cost to the public, and in a manner that warrants the highest degree of public confidence in our integrity, efficiency, and fairness."

Internal Revenue Service Manual, policy statement P-1-1 (approved April 10th, 1981).

All taxpayers are to receive equal treatment:

> "National office officials believe discretion to regions, districts, and service centers will issue detailed procedures only when necessary to achieve maximum economy, efficiency, or equal treatment of all taxpayers."

Internal Revenue Service Manual, policy statement P-1-17 (approved November 27, 1959).

The duty not to discriminate between taxpayers is so important that the duty has been imposed upon the Appellate Division of the Internal Revenue Service:

> "An exaction by the U.S. Government, which is not based upon law, statutory or otherwise, is a taking of property without due process of law, in violation of the Fifth Amendment to the U.S. Constitution. Accordingly an Appellate Division representative in his conclusions of fact or application of the law, shall hew the law in the recognized standards of legal

> construction. It shall be his duty to determine the correct amount of the tax, with strict impartiality as between the tax payer and government and without favoritism or discrimination between taxpayers."

I.R.S. Reg. §601.106(f)(1) [Rule 1 of practice before the Appellate Division].

The Doctrine of Equality of Treatment, aside from being required by the Internal Revenue Service by its own policy statements and regulations, has been judicially recognized:

> "Equality of treatment (by the Internal Revenue Service) is so dominant in our understanding of justice that discretion, where it is allowed a role, must pay the strictest heed."

International Business Machines Corp. v. United States, 343 F2d 914, 920 (Court of Claims 1965).

Cost to the public and in a manner that warrants the highest degree of public confidence in integrity efficiency and fairness. These are the principles upon which our tax laws are based. The 1981 taxpayers have offered on numerous occasions to settle all issues with the Internal Revenue Service based upon the treatment afforded to identically situated taxpayers. The Internal Revenue Service has consistently refused to offer this treatment to this group of taxpayers. This refusal of equality of treatment is unwarranted and unconstitutional. A governmental agency should not be allowed to treat United States citizens who are controlled by the same laws and under the same jurisdictions, in a different manner. There is no rational or factual differentiation which can explain the different treatment being imposed upon these individuals.

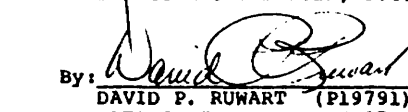
The position of the Internal Revenue Service towards the 1981 taxpayers is resulting in thousands of dollars being unduly and unreasonably assessed against them. These assessments have not been made against taxpayers who are in the identical situation. Representations have been made by counsel for the Internal Revenue Service setting forth the position that this arbitrary treatment of the 1981 taxpayers is being mandated by the "national office" of the Internal Revenue Service. Where under the laws of these United states, is it provided that the Internal Revenue Service can, through its arbitrary and capricious actions, deprive the citizens of the United States of Constitutionally guaranteed rights?

The 1981 taxpayers have set forth a fair settlement position that would end the costly litigations being pursued by the Internal Revenue Service in the United States Tax Court and by the Justice Department and the United States District Courts. Although these actions have been affirmatively brougnt

by the taxpayers, the taxpayers have only done this to protect their rights guaranteed under the Constitution of the United States. Congress has not enacted a tax code which in any way was intended to afford the citizens of the United States unequal treatment nor deprivation of property both rights guaranteed by the United States Constitution. The abuse of the discretion of the Internal Revenue Service is far without merit. We request that this Committee report back to Congress on these abuses by the Internal Revenue Service. We request that an investigation be done as to the unfair treatment of the taxpayers in this particular program.

Congress has designed laws for the collections of revenues for the maintenance of our government that are fair and equally applied to all individual citizens. The Internal Revenue Service has fashioned and applied policies and procedures which have completely circumvented the intent of Congress. The Master Recording Defense Fund on the behalf of the 1981 taxpayers submit that these practices and procedures and policies should be held to be without basis under the statutes and a denial of the protections guaranteed by the Constitution of the United States.

Respectfully submitted,
PLUNKETT, COONEY, RUTT, WATTERS,
STANCZYK & PEDERSEN, P.C.

By: 

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DATED: July 3, 1986

0851M

CERTIFICATE OF MAILING

This is to certify that a copy of the foregoing paper was served upon William Hammack and Jacqueline Hotz by mailing the same on July 3, , 1986 in a postage paid wrapper addressed to them at Internal Revenue Service, District Counsel, P.O. Box 32516, Detroit, MI 48232.

This is to further certify that the original of the aforementioned paper was mailed to the Court on July 3, 1986.

David P. Ruwart
Attorney

Dated: July 3, 1986

CERTIFICATE OF MAILING

This is to certify that a copy of the foregoing paper was served upon Beth Williams by mailing the same on July 3, 1986 in a postage paid wrapper addressed to her at the Internal Revenue Service, District Counsel, North-Atlantic Region, 100 Summer St., Boston, Massachusetts 02110.

This is to further certify that the original of the aforementioned paper was mailed to the Court on July 3, 1986.

David P. Ruwart
Attorney

Dated: July 3, 1986

CERTIFICATE OF MAILING

This is to certify that a copy of the foregoing paper was served upon Donald Wolfson by mailing the same on July 3, 1986 in a postage paid wrapper addressed to him at 30100 Chagrin Blvd., Suite 203, Pepper Pike, OH 44124.

This is to further certify that the original of the aforementioned paper was mailed to the Court on July 3, 1986.

David P. Ruwart
Attorney

Dated: July 3, 1986