October 1973

Taxation

Emmerson Blue

Follow this and additional works at: https://scholarship.kentlaw.iit.edu/cklawreview

Part of the Law Commons

Recommended Citation

Available at: https://scholarship.kentlaw.iit.edu/cklawreview/vol50/iss2/9

This Article is brought to you for free and open access by Scholarly Commons @ IIT Chicago-Kent College of Law. It has been accepted for inclusion in Chicago-Kent Law Review by an authorized editor of Scholarly Commons @ IIT Chicago-Kent College of Law. For more information, please contact dginsberg@kentlaw.iit.edu.
TAXATION

EMMERSOJ BLUE*

I. INTRODUCTION

This article constitutes an analysis of selected tax cases decided by the Seventh Circuit during its most recent term. For purposes of discussion, the cases have been divided into three categories: civil income tax, estate and gift tax, and criminal.

Cases have been selected on the basis of the writer's estimate of their importance and interest to attorneys dealing with federal taxation. Since the vast majority of tax questions that arise in practice are of a civil nature, this area has been treated most extensively.

In the discussion of criminal cases, only those issues that present problems of special interest in the tax field will be considered.

II. CIVIL INCOME TAX

A. Commuting Expenses

Generally, taxpayers cannot deduct the cost of going to and from work. If, however, the taxpayer must carry his tools to and from work (musical instruments, carpenter's tools, etc.) he may be entitled to a deduction.

The government's position on commuting expenses is contained in Rev. Rul. 63-100, 1963-1 Cum. Bull. 34. If the taxpayer would use his own transportation, regardless of whether he had tools to transport, he was not entitled to a deduction. On the other hand, if he would not use his own transportation but for the tools, he was entitled to a full deduction. In Lawrence D. Sullivan, the tax court held that no deduction was allowable in any case. The Second Circuit reversed the tax court's Sullivan decision and held that the taxpayer is entitled to have a business portion deduction, by allocation, regardless of whether he would use his own transportation.

* Assistant Professor of Law at IIT/Chicago-Kent College of Law.
1. INT. REV. CODE OF 1954, § 162.
2. 45 T.C. 217 (1965).
The Seventh Circuit, in *Tyne v. Commissioner*⁴ adopts the decision of the Second Circuit. Since Tyne would have driven to work regardless of whether he had tools to transport (there was no public transportation to his job site), the court stated that he was not entitled to a full deduction. It held, however, that there was a business portion even though it was impossible to determine the amount with accuracy. Tyne was allowed one half of his “commuting expense” as a business deduction.

**B. Imputation of Interest**

Section 1235 of the Internal Revenue Code of 1954 was enacted to give long term capital gain treatment to income derived by “holders” of patents and patent rights who transfer said rights to corporations for royalties and other payments regardless of how long these rights have been held.

The government’s position is that if a transfer does not qualify under section 1235, transfers may look to other Code sections to secure long term capital gain treatment of the proceeds.⁵ If the patent or patent rights are capital assets in the hands of the transferor, such transferor may secure long term capital gain treatment under the general provisions of sections 1221, 1222, and 1223.⁶

Section 483,⁷ enacted in 1964, is designed to prevent taxpayers from converting interest income to capital gain by providing, generally, that installment sales contracts must include an interest factor. Section 483(f)(4) renders the general provisions of section 483 inapplicable to transfers under section 1235.

In *Busse v. Commissioner*,⁸ the taxpayer transferred patent rights to a corporation in which he owned fifty percent of the voting stock. He could not, therefore, secure long term capital gain treatment under section 1235(a) because section 1235(d) renders this section inapplicable if the transferor owns more than twenty-five percent of the transferee’s stock.

The patent was a capital asset in Busse’s hands, therefore, he was able to secure long term capital gain treatment under the general provi-

---

4. 468 F.2d 913 (7th Cir. 1972).
6. INT. REV. CODE OF 1954, § 1221, defines the term capital asset. § 1222 defines various terms, such as long term capital gain and short term capital gain. § 1223 discusses the method by which the holding period of the property is determined.
8. 479 F.2d 1147 (7th Cir. 1973).
TAXATION

sions of sections 1221, 1222, and 1223 of the Code. Section 1239 did not render the gain ordinary as Busse owned less than eighty percent of the stock of the transferee corporation.

The royalty agreement between Busse and the corporation did not include an interest factor, but merely provided for a payment of five percent of the selling price of the units manufactured and sold under the patent. The government imputed interest on the payments as per section 483, even though section 483(f)(4) exempted transfers described under 1235 from the general provisions of section 483. The Commissioner's position, of course, that Busse had not made a transfer under section 1235. The tax court found for Busse and the appellate court affirmed.

The Commissioner conceded that the transfer appeared to fall within the literal language of section 1235(a), but asked that the statute not be strictly construed because it was plain that Congress had not intended this result. The appellate court, however, refused to challenge the clear and unambiguous language of the section.

C. Presumption of Correctness of Signatures on Waivers

In United States v. Borchardt, a federal income tax lien was imposed under section 6321 of the Internal Revenue Code of 1954 against property owned by Mary Mensik, wife of Charles Owen Mensik, the elusive Chicago savings and loan executive, for joint and several federal income taxes for the year 1956. The lien was effective to defeat the wife's interest in the property as long as the government had the right to collect the tax.

Although the normal six year collection statute established by section 6502(a)(1) had expired, the government maintained that the period had been extended by mutual agreement between the government and the taxpayers under section 6502(a)(2) of the Code.

9. INT. REV. CODE OF 1954, § 1239(a)(2), provides that if an individual transfers depreciable or amortizable property to a corporation in which he, his spouse, and his minor children and minor grandchildren own more than 80 percent in value of the outstanding stock, any gain shall be treated as ordinary income.

10. 470 F.2d 257 (7th Cir. 1972).

11. INT. REV. CODE OF 1954, § 6321, creates a lien in favor of the United States against the property of any person who neglects or refuses to pay any tax after demand for payment is made.

12. INT. REV. CODE OF 1954, § 6502(a)(1), establishes that taxes must be collected within six years of assessment unless a waiver is signed.

13. INT. REV. CODE OF 1954, § 6502(a)(2), provides for an extension of the six year period by mutual agreement between the taxpayer and the government.
The property against which the lien applied had been sold; so the parties to the government’s action to foreclose the lien included, inter alios, the subsequent purchasers and the Mensiks. The Mensiks were given notice by publication, but failed to appear, and a default was entered as to them.

Since the wife’s name appeared on the collection waiver executed under section 6502(a)(2), the district court granted summary judgment holding that under section 6064, there was a presumption that the signature was authentic. The appellate court vacated the judgment and remanded the case.

There are two lines on the waiver that are to be used by spouses with joint liability. A third line follows which is preceded with “By”, to be used when someone signs in a representative capacity such as a corporate officer. The waiver in question showed what was purported to be the wife’s and husband’s signatures on the proper lines and the husband’s signature on the “By” line.

The court held that the presumption under section 6604 was overridden by the above irregularity on the face of the instrument and that a material question of fact was raised thereby. The court also held that the default against the Mensiks was no bar to a question of the validity of the waivers by the present property owners, and vacated the summary judgment.

D. Debt as Second Class of Stock Under Subchapter S

In Portage Plastics Company v. United States, two non-shareholder advanced money to a corporation under basically the following conditions:

Amount: $12,500 each.
Interest Rate: Five percent of the net profit before income taxes.
Debt Instruments: Standard Notes.
Collateral: None.
Default Provisions: None.
Subordination Agreements: The notes were subordinated to other creditors on two occasions.

The corporation subsequently elected the provisions of Subchapter S,
sections 1371-1379 of the Internal Revenue Code, and acted accordingly for its fiscal years ending May 31, 1961, 1962, and 1963. The Commissioner of Internal Revenue held that the "loans" described above constituted a second class of stock and therefore the corporation could not utilize the provisions of Subchapter S.

The district court, by applying the "thin capitalization" doctrine, determined that the "loans" were contributions to capital but that they did not constitute a second class of stock. The district court relying on W.C. Gamman, held that the "thin capitalization" doctrine did not apply to Subchapters S corporations since all undistributed taxable income is taxed to the shareholders at ordinary income rates.

The appellate court agreed with the concept that a debt does not constitute a second class of stock where the only question is the debt to equity ratio. The court held, however, that the "thin capitalization" doctrine is much broader. It includes such considerations as interest out of profits, lack of fixed maturity dates, provisions for repayment, subordination of priorities, and others.

The court held that if the proper standards were used in the "thin capitalization" test—it found that the district court had used the proper ones—the test is applicable to Subchapter S corporations. If further held that once a determination was made that the advances were equity, they constituted stock as there was no such thing as a non-stock equity. Since the "interest" on the notes was based on a percentage of profits, the court had no trouble treating this as a preference, thus making the notes a second class of stock.

The real factual difference between this case and previous cases dealing with this problem is that the "debt" holders were not shareholders. The regulation, as amended, does not treat as a second class of stock, debt held proportionately by the shareholders. The appellate court sustained the validity of this regulation.

Portage Plastics apparently has no applicability to shareholders who make proportionate advances to their Subchapter S corporations. It has applicability where financing is obtained from outsiders who risk

16. INT. REV. CODE OF 1954, §§ 1371-79. These sections provide generally that the stockholders of a corporation may elect to have the undistributed taxable income of the corporation taxed to them individually, with no tax to the corporation.
their funds in a business without taking stock certificates of the same class as the one outstanding.

**E. Business Losses**

*J.R. Thompson Co. v. United States*\(^{20}\) raises some interesting, although somewhat academic, questions regarding business losses. It involves the once famous Henrici's restaurant. The restaurant was acquired in 1929 by J.R. Thompson Co., a corporate restaurant operator. Part of this acquisition consisted of forty-two oil paintings, engravings and prints, costing $185,000, which were displayed on the walls of the restaurant as part of its Victorian decor.

The City of Chicago condemned the restaurant's leasehold in 1962, preparatory to erecting the Chicago Civic Center on the site, and thereby forced a closing of the restaurant. After the condemnation, J.R. Thompson Co. considered re-opening the restaurant at another location using the paintings to maintain the atmosphere of the original restaurant. This was never done and the paintings were sold in 1964.

After the restaurant was closed in 1962, the company had the paintings appraised ($44,000) and sought to deduct, as a business loss under section 165 and/or 167 of the Internal Revenue Code,\(^{21}\) the difference between the cost in 1929 and the appraised value in 1962.

With regard to section 165, the court said that most of the company's loss was not incurred in a trade or business. The court indicated that if the purchase price in 1929 were more than the art market value, such excess could be the basis for a business loss. In holding that the loss in art market value was not deductible, the court differentiated between a business loss and one incurred in a place of business.

The court stated that the mere fact that an art owner chooses to display his collection in his place of business, for whatever reason, does not transform a loss incurred in the art market into a loss incurred in the business.

This holding does not appear to be supported by the facts. The paintings were purchased as part and parcel of the restaurant; the pur-

\(^{20}\) 477 F.2d 164 (7th Cir. 1973).

\(^{21}\) INT. REV. CODE OF 1954, § 165, allows a deduction for losses in a trade or business. § 167 provides for depreciation of tangible property used in a trade or business.
chaser was a corporation and therefore probably not an art collector. The court was apparently concerned with the possibility of individuals changing personal assets to business assets by placing them on display at business locations. This would certainly be a different factual situation.

The court allowed no loss under section 165 because the company failed to show that the condemnation was a "closed transaction." The court also reaffirmed the generally accepted principle that works of art, since they have no determinable useful life, are not subject to depreciation under section 167.

The final disposition of this case awaits the taxpayer's action for the year 1964 when the loss was unquestionably realized. The court indicated that the only loss allowable would be the amount paid in excess of the art market value in 1929. It would appear, however, that the paintings had always been business assets and that any loss should be a business loss.

F. Capital Expenditures

In Clark Oil and Refining Corporation v. United States,22 property owned by a third party and used as a paint factory, was surrounded on three sides by property housing Clark Oil and Refining Corporation (hereinafter referred to as taxpayer). The operation of taxpayer's refinery caused gas emissions, smoke and acid fumes to fall on the third party's property creating a potential threat of explosion.

In order to eliminate this dangerous situation, taxpayer, commencing in 1953, made several attempts to purchase third party's property. The parties, however, could not agree upon a purchase price and no sales was consumated.

In 1958, third party filed suit to abate the nuisance created by taxpayer. The parties agreed to settle the suit by having taxpayer purchase the property at a price set by arbitration. The arbitrators recommended a payment of $287,500 and the judge added $35,000 as reasonable attorney's fees.

On its income tax return for the year in question, taxpayer deducted all but $25,000 of its payment to third party as a liquidated damage payment under section 162 of the Internal Revenue Code.23

22. 473 F.2d 1217 (7th Cir. 1973).
23. INT. REV. CODE OF 1954, § 162, allows deduction of ordinary and necessary business expenses.
The Commissioner disallowed the deduction since he termed it a capital expenditure. The district court sustained the Commissioner and the appellate court affirmed.

The appellate court started with the basic premise that capital expenditures are not deductible by virtue of section 263. The court also cited cases supporting the position that capital expenditures do not change character simply because they are made in connection with the settlement of a law suit.

At this point, the court decided to put basics aside and advanced a theory dealing with the origin and character of the claim with respect to which the settlement was made. In short, the court held that since the litigation was commenced only after the parties could not agree on the selling price, the acquisition of the property was at the heart of the dispute. Taxpayer, therefore, was not allowed a deduction.

By implication, the court would have allowed a deduction if the court litigation represented, in origin, a meritorious lawsuit in tort for damages and injunctive relief. These remedies were prayed in the third party's suit, but since taxpayer had tried to purchase the property, this was ignored.

The holding appears unnecessarily aleatory. If the parties had not discussed acquisition, taxpayer would be entitled to a deduction. If taxpayer could show that it changed its mind about the purchase and only wanted to settle the tort claim, it should be entitled to a deduction.

It seems that the proper settlement of the case would have been to hold that the fair market value of the property constituted a capital expenditure and any excess represented liquidated damages. This is consistent with the court's statement that a capital expenditure is not changed because it was made in settlement of a lawsuit. It certainly seems improper to burden the property with a basis substantially in excess of its value at date of acquisition.

III. Estate and Gift Taxes

A. Gross Estate

In United States v. Harris Trust & Savings Bank, decedent, Gertrude W. Hanlin (hereinafter, taxpayer), was one of three beneficiaries

25. 470 F.2d 6 (7th Cir. 1972), cert. denied, 93 S. Ct. 554 (1972).
TAXATION

under a testamentary trust set up by her grandfather. In effect, each beneficiary received a life estate in the income from one-third of the corpus with the remainder to go to the beneficiary's issue or descend-ents of issue. If a beneficiary died without issue or descendents of issue, his life interest passed to the survivor or survivors of the three life tenants; if all three beneficiaries died without issue or descendents of issue, the remainder passed to the son of the testator and his heirs at law.

Two of the beneficiaries died without issue and without descendants of issue prior to taxpayer's demise survived by five children. She possessed at least a life estate in the full corpus of the trust and pos-sibly some other interest in the two-thirds received by survivorship.

Upon the demise of the taxpayer, taxpayer's executors failed to include any part of this property in her estate as they viewed taxpayer's interest as purely a life estate. The government agreed that the original one-third interest constituted a mere life estate, but concluded that the two-thirds acquired through survivorship was a determinable fee and included this amount in the taxpayer's gross estate.

The executors did not contest the validity of the original assessment; they eventually filed an Offer In Compromise in an attempt to settle the liability of $92,459.63 for one thousand dollars. The gov-ernment rejected the offer and filed suit in district court to collect the tax in 1967. The district court sustained taxpayer's position that the six year collection statute under section 6502 of the 1954 Internal Revenue Code had expired. The appellate court reversed. Since taxpayer had filed an Offer In Compromise, the government had one year from the rejection of the offer to commence its collection action.

In 1896, upon the demise of the first beneficiary, an action was filed in state court (Illinois) to determine the property rights of the survivors. The trial court determined that the deceased beneficiary's share descended to the survivors as tenants in common in fee determinable. The Supreme Court of Illinois held that the corpus remained in trust but refused to decide whether it was a determinable fee or a life estate. On remand, however, the trial court treated the interest as a life estate. No appeal was taken from this holding.

The second beneficiary died in 1909 without issue or descendants of issue, but his former wife brought an action to recover dower. The trial court denied dower on the basis of the trial court's holding that the interest acquired through survivorship was a life estate. On appeal, the supreme court allowed dower in the one-sixth interest acquired by survivorship calling that portion a determinable fee.\(^{30}\)

We now return to the estate tax case. The district court refused to follow the state supreme court's holding that taxpayer owned a determinable fee.\(^{31}\) It followed the holding of the trial court that had determined the interest to be a life estate as this ruling had not been reversed. It did not deal with the question of the dower interest allowed by the state supreme court except to say that it was judicially created.

The Seventh Circuit court of appeals adhered to the principle that state law determines the devolution of property and that the state's highest court best knows its state law.\(^{32}\) As the state supreme court had indicated that the survivorship shares were fees determinable, the court sustained the government.

The district court apparently felt that the state supreme court's holding was inconsistent with its description of interest acquired by survivorship.\(^{33}\) The court stated that the acquired shares were held under the same restrictions and conditions as the original shares which were life estates. If the acquired interests were to remain in trust and pass to the issue of the last survivor or, barring issue, to the testator's son, they would certainly appear to be life estates. The court indicated that the corpus of the acquired interests was alienable, however, it gave no indication of what property rights taxpayer could alienate. There was some merit, therefore, to the district court's contention that the testator made a complete disposition of the property by his will.

**B. Marital Deduction**

In *Greene v. United States*\(^ {34} \) a Wisconsin decedent left all of his property to his widow. The widow filed a Declaration of Renunciation

\(^{30}\) Aloe v. Lowe, 278 Ill. 233, 115 N.E. 862 (1917).


\(^{32}\) 470 F.2d at 10.


\(^{34}\) Greene v. United States, 476 F.2d 116 (7th Cir. 1973).
in which she disclaimed certain assets. These assets went to her three sons who agreed to pay the estate taxes and expenses therefrom.

On the estate tax return, the widow computed a marital deduction based on the remainder of decedent's property passing to her without diminution for estate taxes. On March 27, 1969, the Commissioner of Internal Revenue charged the estate taxes to the widow's share and made the corresponding assessment. The county court, on December 13, 1969, held that the taxes should be paid from the sons' share of the estate. The assessment was paid, and thereafter, a claim for refund was filed in district court. The district court sustained the commissioner and the court of appeals affirmed.

The appellate court held that state law was to be used to determine upon whom the burden of the federal estate tax should fall. It also decided that the Wisconsin law allowed a decedent to make the determination in his will or allow the liability to be determined by statutory and common law rules.

The decedent's will provided in part:

First: It is my will and I hereby direct all my just debts and expenses of last illness and funeral be paid by my executor hereinafter named as soon after my decease as conveniently may be. The court interpreted "debts" to include the federal estate tax. It also included that since all of decedent's property was to go to his widow under the will, the decedent realized that his widow would have to pay the estate taxes out of her share.

The court dispelled the widow's argument that it should presume that her deceased husband wanted her to get the maximum marital deduction; and, of course, the court did not consider itself bound by the state court's determination that the sons were to pay the tax as that decision was not from the state's highest court. The court cited Commissioner v. Estate of Bosch in support of the latter.

C. Release of Powers

In Commissioner v. Estate of Robert R. Ware, Deceased, decedent set up several family trusts and granted the trustee complete discretionary power to either accumulate or distribute income from the

36. 476 F.2d at 117.
38. 480 F.2d 444 (7th Cir. 1973).
trusts. Decedent was the original trustee for all the trusts and was to serve as such, under the terms of the instruments as long as he was competent.

By several notarized documents, decedent tried to divorce himself from the trust prior to his demise. New trustees had been appointed and were acting as such prior to decedent's death. The government contended that decedent's efforts to divorce himself from these trusts were not effective and included the corpora in decedent's gross estate under sections 2036 (a)(b) and/or section 2038 of the Code.\(^39\)

The tax court held that decedent's extra judicial releases were not effective.\(^40\) The appellate court reversed.

The appellate court held that the Illinois Termination of Powers Act,\(^41\) applied to a power to alter or amend a trust and that no court approval was needed.

IV. CRIMINAL CASES

A. Exclusion of Evidence

In *United States v. Dickerson* the court held that Miranda warnings must be given to the taxpayer by either the revenue agent or the special agent at the inception of the first contact with the taxpayer after the case has been transferred to the Intelligence Division.\(^42\)

A task faced by the court in its most recent term was a further definition of the scope of this holding.

In *United States v. Habig*,\(^43\) the defendants were the chief stockholders of a corporation. Following a civil audit of the corporate records, the case was transferred to the Intelligence Division of the Internal Revenue Service for a full scale investigation. The district court found that the investigation was directed against the defendants personally from its inception. A special agent examined the corporate books in 1964 and 1965 without giving *Miranda* warnings. Criminal proceedings were then commenced. The defendants moved to sup-

39. INT. REV. CODE OF 1954, § 2036(a)(2), provides for the inclusion in the gross estate of property over which decedent possessed the right to determine who should possess or enjoy the property or the income therefrom. § 2038 includes in the gross estate property held in trust, where the decedent had power to alter or revoke the trust.
40. Estate of Ware, 55 T.C. 69 (1970).
41. ILL. REV. STAT. ch. 30, §§ 177-82 (1943).
42. 413 F.2d 1111, 1116-17 (7th Cir. 1969).
43. 474 F.2d 57 (7th Cir. 1973), cert. denied, 93 S. Ct. 2145 (1973).
press the evidence obtained, and the district court sustained this motion.

In a prior decision concerning this case, the court of appeals had held that its holding in *Dickerson* would apply to the facts in *Habig*.

Upon remand, the district court again determined that the corporate records and the leads obtained from them were inadmissible. On appeal the Seventh Circuit reversed.

The court stated that "the law of the case" doctrine did not apply in this instance. As the Supreme Court had previously held that the right against self-incrimination was a purely personal one, the court reasoned that *Miranda* warnings were not required to be given when a request to submit corporate records is made by an Internal Revenue Agent, even after the matter has been transferred to the Intelligence Division.

This result is comparable to those reached by other courts that have considered the problem. In *Hensley v. United States*, the Tenth Circuit, although refusing to extend *Miranda* to interviews that were not custodial even after transfer to the Intelligence Division, stated that a more certain reason was that the evidence was obtained from the corporate records. In *United States v. Maciel*, a district court held that the failure of agents to comply with an Internal Revenue News Release, while resulting in the inadmissibility of oral statements, did not result in the exclusion of incriminating evidence obtained from the records of a corporation.

In *United States v. Waitkus*, the court again reviewed the question of the retroactivity of *Dickerson*. In accordance with its position in *United States v. Gallagher*, *United States v. Ming*, and *Dickerson* itself, *Miranda* warnings were held to be required for only non-custodial interviews that took place after the date of the *Dickerson* decision.

---

44. United States v. Habig, 413 F.2d 1108 (7th Cir. 1969).
47. 406 F.2d 481 (10th Cir. 1968).
50. 470 F.2d (7th Cir. 1972), *cert denied*, 93 S. Ct. 1368 (1973).
51. 430 F.2d 1222 (7th Cir. 1970).
52. 466 F.2d 1000 (7th Cir. 1972), *cert. denied*, 409 U.S. 937 (1972).
53. 413 F.2d at 1117.
In *United States v. Lehman*, 54 the effect of the failure of Internal Revenue Agents to comply with the requirements of an Internal Revenue Service Manual 55 was considered.

On June 8, 1964, Dr. Lehman was interviewed for eight hours by special agents of the Intelligence Division and his records were audited. Prior to the interview no *Miranda* warnings were given. During the course of the interview the agents examined records after the defendant had asked them to stop. This continued examination in the face of the taxpayer's request was in contravention of the instructions contained in a Service Manual.

The court held that as this was a pre-*Miranda* case, the failure to give *Miranda* warnings did not result in the exclusion of any voluntary statements made by the defendant. After a lengthy discussion the court concluded that the statements were voluntary.

In regards to the defendant's assertion that the agents acts were in contravention of the Internal Revenue Service Manual, the court stated:

> It would be anomalous for us then to hold that the breach of an internal regulation of the IRS . . . leads to the exclusion of evidence that the Constitution does not exclude. 66

This statement may be compared with the decision of the First Circuit court of appeals in *United States v. Leahey*, 57 where the court held that non-compliance with an Internal Revenue News Bulletin resulted in the exclusion of the evidence obtained. One of the factors operative in *Leahey* was that the news release was public and that the persons or lawyers may have relied on it. The Internal Revenue Manual in *Lehman* was viewed by the court as being an internal regulation.

**B. Discovery by Defendant**

In its last term, the Seventh Circuit re-evaluated its position as to whether a report made by an Internal Revenue Agent constituted a statement discoverable under the Jencks Act. 58

---

54. 468 F.2d 93 (7th Cir. 1972), *cert. denied*, 93 S. Ct. 273 (1972).
55. Int. Rev. Man., Man. Transmittal 9300-20 § 9284.2, requires that the agent not deny the taxpayer the right to refuse to give any evidence that would be incriminating.
56. 468 F.2d at 104.
57. 434 F.2d 7 (1st Cir. 1970);
58. 18 U.S.C. § 3500(b) (1970), states:

After a witness called by the United States has testified on direct examination, the court shall, on motion of the defendant, order the United States to
States v. Kieg\textsuperscript{59} and United States v. Krilich,\textsuperscript{60} the court implied that an agent's report was not a statement. The court in United States v. Cleveland\textsuperscript{61} expressly disapproved of the language in these cases and held that the trial judge should examine such reports in camera to determine if the report relates to the subject matter about which the agent testifies.

C. Attorney-Client Privilege and The Work Product Doctrine

In United States v. Brown,\textsuperscript{62} an attorney had prepared a memorandum of a meeting attended by an accountant and an aide to the taxpayer. The memorandum was placed in the files of the accounting firm employed by the taxpayer. A summons was served on the firm by the Internal Revenue Service pursuant to section 7602 of the Internal Revenue Code.\textsuperscript{63} The district court, following an evidentiary hearing, held that the document was producible.\textsuperscript{64}

On appeal, the appellate court held initially that as the memorandum was a work product, and under the rule of Hickman v. Taylor\textsuperscript{65} was not protected by the attorney-client privilege. The court then stated that the work product doctrine was applicable to an Internal Revenue Summons but that the government had shown good cause that the document was essential.

In its analysis the court noted that the strong interest expressed by Congress in enforcing the Internal Revenue Laws was relevant in determining what degree of necessity was required to avoid the work

\textsuperscript{59} 334 F.2d 823, 825 (7th Cir. 1964).
\textsuperscript{60} 470 F.2d 341 (7th Cir. 1972).
\textsuperscript{61} 477 F.2d 310 (7th Cir. 1973).
\textsuperscript{62} 478 F.2d 1038 (7th Cir. 1973).
\textsuperscript{63} \textsc{Int. Rev. Code of 1954, § 7602 provides:}
\begin{quote}
For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax . . . the Secretary . . . is authorized—
(1) To examine any books, papers, records or other data which may be relevant or material to such inquiry;
(2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary or his delegate may deem proper . . . to produce such books, papers, records, or other data . . .
\end{quote}
\textsuperscript{65} 329 U.S. 495 (1947).
product doctrine. The extent therefore of the applicability of the doctrine to an Internal Revenue Summons remains to be determined.

D. Self-incrimination and Internal Revenue Summons

In *United States v. Turner*, the Internal Revenue Service served a summons upon Turner, a tax preparer, seeking a list of those persons for whom he had prepared tax returns. One of Turner's allegations was that the summons violated his right against self-incrimination, as it would aid the government to discover the returns he had prepared and in gathering evidence against him.

The government maintained that Turner's fifth amendment privilege was not violated in that he was not a member of "a highly selective group inherently suspect of criminal activities." The court defined the issue as the conflict between a legitimate regulatory scheme and the individuals right to privacy. On the grounds that there was no substantial risk of self-incrimination and there was no expectation of privacy, the court allowed the summons.

V. Conclusion

Due to its long history, countless court battles, and numerous statutory revisions, the federal tax area does not readily lend itself to landmark court decisions. Many cases presently being decided contain somewhat novel issues that, while being material to the taxpayers involved, have no wide application to the tax laws generally.

Although most of the cases discussed above fall in this category, the significance of any case must await the test of time. In the tax area where changing economic conditions quite often dictate the form and content of a transaction, this is especially true. It seems, therefore, that judgment at this time is premature.

66. 480 F.2d 272 (7th Cir. 1973).