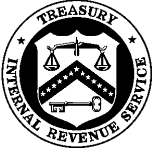


OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

July 6, 2001

Number: **200143005**
Release Date: 10/26/2001
CC:PA:APJP:B03

UILC: 9111-19-01

INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR Associate Area Counsel -St. Paul CC:SB:5:STP

FROM: Assistant Chief Counsel (Administrative Provisions & Judicial Practice) CC:PA:APJP

SUBJECT: Compliance with Rule 6(e) Order

This Chief Counsel Advice responds to your facsimile transmittal form dated April 6, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

LEGEND

X = V =

Y = W =

DATE A =
DATE B =
DATE C =

ISSUES

1. Whether the preparation of a notice of deficiency based upon materials collected and prepared by the Criminal Investigation Division during a grand jury investigation violated the restriction on the disclosure of grand jury matters in Rule 6(e)(2).
2. Whether the Internal Revenue Service (Service) should obtain an order authorizing the further release of grand jury materials before using the materials for the preparation and trial of a Tax Court case.

CONCLUSION

1. The Service properly relied upon the materials forwarded from the Criminal Investigation Division agents who had worked on the grand jury investigation of the taxpayers to prepare the notice of deficiency because the turnover of materials was not a “disclosure of matters occurring before the grand jury.” Further, if it is determined that the release of such materials did result in the disclosure of matters occurring before the grand jury, the Service should nevertheless defend the use of the materials in the civil investigation because the government had properly obtained an order pursuant to Rule 6(e)(3) of the Federal Rules of Criminal Procedure authorizing the release of such materials for use in the civil determination of the tax liabilities of the defendants in the criminal cases and relied upon that order in good faith.

2. If you determine that the release of the materials did result in the disclosure of matters occurring before the grand jury, you should ask the local United States Attorney to obtain another order authorizing the further dissemination of grand jury materials before using the information in a Tax Court trial since the order previously obtained by the Service authorizes the use of the specified grand jury materials only for the determination of the civil liability. Further disclosures may be necessary in the preparation and trial of the Tax Court case.

FACTS

During DATE A, X and Y pled guilty in a federal District Court to a violation of I.R.C. § 7201, attempting to evade or defeat tax, following the conclusion of a grand jury investigation. As part of the terms of written plea agreements, X and Y authorized the Criminal Investigation Division of the Service to disclose its tax calculations, backup documentation, and other work products to the civil tax authorities. Further, at a sentencing hearing on DATE B, the Assistant United States Attorney prosecuting the cases for the government filed a motion for entry of an order under Federal Rules of Criminal Procedure 6(e)(3). On DATE B, the presiding District Court judge entered an order providing that it would give its imprimatur to the disclosure of the personal and business records of the defendants that was obtained by way of a grand jury subpoena by authorizing the agents of the grand jury to provide the civil authorities of the Service with any tax calculations, back-up documentation and work product gathered during the criminal grand jury investigation of the defendants and their businesses.
Shortly thereafter, the Criminal Investigation Division turned over its records of the criminal investigation, including a Special Agent’s Report and the exhibits to the report, to civil investigators in the Service’s Examination Division. On DATE C, in response to an inquiry from the civil investigators in the Examination Division, the local Chief Counsel office advised the investigators that they could use the

materials provided by the Criminal Investigation Division in their investigation of X and Y's civil tax liabilities. Eventually, the Service issued notices of deficiency to X (and X's spouse V) and Y (and Y's spouse W).

Petitions were filed with the Tax Court to contest the deficiencies. You have received the materials used to prepare the notices of deficiency, but are waiting for this advice before reviewing those materials.

LAW AND ANALYSIS

1. In preparing a notice of deficiency that determined the civil tax liability of the taxpayers, the Service properly relied upon the tax calculations, back-up documentation, and work product of the Criminal Investigation Division agents who had served as agents of the grand jury in a criminal investigation.

Rule 6(e)(2) of the Federal Rules of Criminal Procedure provides a prohibition on the disclosure of "matters occurring before the grand jury," as follows:

> (2) General Rule of Secrecy. 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 (3)(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.

Rule 6(e)(3) provides the limited exceptions under which "matters occurring before the grand jury" may be disclosed. In addition to authorizing disclosures to the government attorneys working on the criminal case that is the subject of the grand jury investigation and to other government personnel assisting in the criminal investigation, Rule 6(e)(3)(C) provides that "disclosures otherwise prohibited . . . may also be made: (i) when so directed by a court preliminarily to or in connection with a judicial proceeding."

The Supreme Court decisions in United States v. Baggot, 436 U.S. 476 (1983) and United States v. Sells Engineering, Inc., 436 U.S. 418 (1983), narrowly interpreted the conditions under which district courts may authorize the disclosure of grand jury material to the Service for use in determining the civil tax liabilities of taxpayers. In Sells, the Supreme Court held that Rule 6(e) orders are available to the Service only preliminarily to or in connection with a judicial proceeding and only upon a showing of "particularized need." In Baggot, the Court held that a civil tax audit is not preliminary to or in connection with litigation, but is intended for the assessment

of tax liability through administrative channels. As a result of these rulings, it is generally necessary to wait until after a taxpayer has initiated litigation to request disclosure of matters occurring before a grand jury, unless the material is sought preliminarily to the government's initiation of court action. The government may, however, rely upon documentation that does not result in the disclosure of "matters occurring before the grand jury" in its civil investigation.

A. The tax calculations, back-up documentation, and work product disclosed to the Service's civil investigators did not result in the disclosure of matters occurring before the grand jury.

The restriction on disclosure in Rule 6(e)(2) applies only to "matters occurring before the grand jury." In applying Rule 6(e)(2), courts have generally limited such "matters occurring before the grand jury" to those materials that could disclose what happened before the grand jury. "The touchstone of Rule 6(e)'s applicability is whether the disclosed materials would 'elucidate the inner workings of the grand jury.'" United States v. Benjamin, 852 F.2d 413, 417 (9th Cir. 1988), vacated and remanded, 490 U.S. 1043 (1989) (remanded on grounds that circuit court lacked jurisdiction to consider interlocutory appeal of motion to dismiss case based upon an alleged Rule 6(e)(2) violation). Under the "inner workings" approach, the rule encompasses evidence which would tend to reveal "the identities of witnesses or jurors, the substance of testimony, the strategy or direction of the investigation, the deliberations or questions of the jurors, and the like." Fund for Constitutional Gov't v. National Archives, 656 F.2d 856, 869 (D.C. Cir. 1981); see also Church of Scientology International v.United States Department of Justice, 30 F.3d 224 (1st Cir. 1994); United States v. Dynavac, 6 F.3d 1407 (9th Cir. 1993); United States ex rel. Woodward v. Tynan, 757 F.2d 1085 (10th Cir. 1985) citing United States v. Interstate Dress Carriers, Inc., 280 F.2d 52, 54 (2d Cir. 1960). "The rule does not provide a shield of secrecy for books and records created for purposes independent of the grand jury that are provided to the grand jury in the course of its investigation." Securities and Exchange Commission v. Dresser Industries, 628 F.2d 1368 (D.C. Cir. 1980).

Thus, in considering whether materials collected or prepared for use in connection with a grand jury investigation may be disclosed without disclosing a "matter occurring before the grand jury," it is necessary to separately study each item or collection of items. Some items, such as recorded transcripts of the grand jury proceedings, are obviously protected under Rule 6(e)(2). See Douglas Oil v. Petro Stops Northwest, 441 U.S. 211 (1979) (disclosure of grand jury transcript is subject to Rule 6(e)(2)(C)(i)); In re Grand Jury Matter (Catania), 682 F.2d 61, 63 (3d Cir. 1982) ("Rule 6(e) applies not only to information drawn from a transcript of grand jury proceedings, but also to anything which may reveal what occurred before the grand jury") ; Fund for Constitutional Gov't v. National Archives, 656 F.2d 856, 869 (D.C. Cir. 1981) (Rule 6(e) encompasses direct

revelations of grand jury transcripts); United States v. Miramontez, 995 F.2d 56 (5th Cir. 1993) (to obtain grand jury transcripts, party seeking disclosure must demonstrate that material is needed to avoid possible injustice in another proceeding, that need for disclosure is greater than need for continued secrecy, and that the request is structured to cover only material so needed); Church of Scientology International v. United States Department of Justice, 30 F.3d 224 (1st Cir. 1994) (Rule 6(e) encompasses the direct revelation of grand jury transcripts and documents identified as grand jury exhibits, whose contents are testimonial in nature or otherwise directly associated with the grand jury process).

The rationale for keeping grand jury matters secret disappears if the information is, or subsequently becomes, a matter of public knowledge. Typically, the source of such evidence will be the transcript of the criminal trial proceedings. Such proceedings may be the actual criminal trial, or a sentencing hearing. See In re Special February 1975 Grand Jury (Baggot), 662 F.2d 1232, 1236-37 n.10 (7th Cir. 1981), aff'd sub. nom., United States v. Baggot, 463 U.S. 476 (1983) (if the tax evidence had been publicly disclosed in open court to provide the basis for the acceptance of a guilty plea, or otherwise received at trial, no disclosure problem would have arisen); Sisk v. Commissioner, 791 F.2d 58 (6th Cir. 1986) (neither Sells nor Baggot prohibits the use of evidence which is presented at a criminal trial in determining civil tax liability as such evidence is a matter of public record); United States v. Manglitz, 773 F.2d 1463 (4th Cir. 1985) (prosecutor did not have to obtain a Rule 6(e) order prior to disclosing grand jury material during a guilty plea hearing). But the government cannot vitiate grand jury secrecy by dumping grand jury records into evidence at a sentencing hearing. United States v. Alexander, 860 F.2d 508 (2d Cir. 1988).

The consensus of the courts, however, is that Rule 6(e) has no application to "matters" obtained prior to the referral of a case for grand jury proceedings. For example, books, records, documents, witness statements, special agent's reports, Counsel reports, Service fact sheets, and similar items which were obtained or prepared prior to a referral do not constitute "matters occurring before the grand jury." See Lombardo v. Commissioner, 99 T.C. 342 (1992). It is also fairly clear that the presentation of evidence to a grand jury does not change the nature of that evidence so as to become Rule 6(e) "matters." See United States v. Navarro-Ordas, 770 F.2d 959, 968 (11th Cir. 1985) (government's disclosure of evidence obtained from a source independent of a grand jury does not violate Rule 6(e)); United States ex rel.Woodard v. Tynan, 757 F.2d at 1087 (Rule 6(e) only protects against disclosure of what occurs in the grand jury room); In re Grand Jury Matter (Catania), 682 F.2d 61, 63-64 (3d Cir. 1982) (evidence acquired during an FBI investigation, including tape recordings, transcripts of consensually monitored conversations, documents, and a summary memorandum, were the product of an independent investigation and the disclosure of those items does not violate Rule 6(e)); In re Special February 1975 Grand Jury (Baggot), 662 F.2d 1232, 1238 (7th

Cir. 1981) aff'd sub. nom., United States v. Baggot, 463 U.S. 476 (1983) (portions of a Special Agent's report which could be clearly divorced from the grand jury proceedings were not subject to Rule 6(e)); In re Grand Jury Investigation (Lance), 610 F.2d 202, 217 (5th Cir. 1980) (disclosure of a recommendation that an indictment be sought and of the potential criminal liability of an individual did not violate Rule 6(e) as disclosure was the result of a prior investigation); In re Grand Jury Subpoena, 920 F.2d 235 (4th Cir. 1990) (Service's supervisory intelligence agent did not violate grand jury secrecy rule by making available to Service civil agents material obtained from criminal investigation targets through search warrants that were obtained during a grand jury investigation).

Disclosure of evidence that was obtained after a case had been referred to a grand jury or was obtained by means of the grand jury process is not automatically a disclosure of matters occurring before the grand jury. Although the Sixth Circuit, in In re Grand Jury Proceedings, 861 F.2d 860 (6th Cir. 1988), concluded that such matters presumptively involved matters occurring before the grand jury, it allowed the government to rebut the presumption by showing that the materials would otherwise be available in civil discovery and would not reveal the nature scope or direction of the grand jury. See also United States v. Alpha Medical Management, Inc., 1997 U.S. App. LEXIS 16209, 97-2 U.S.T.C. (CCH) ¶ 50,551 (6th Cir. June 26, 1997) (unpublished opinion, any link between the documents produced in response to a grand jury subpoena seeking all of a taxpayer's business records to determining the nature or direction of the grand jury inquiry was tenuous at best).

Other appellate courts have reached similar conclusions. See, e.g., In re Grand Jury Proceedings (Perl), 838 F.2d 304, 306 (8th Cir. 1988) (unless a document reveals something about the intricate workings of the grand jury itself, documents are not intrinsically secret just because they were examined by the grand jury); In re Grand Jury Investigation, 610 F.2d 202, 217 (5th Cir. 1980) (information developed by the Government investigatory agency with an eye toward ultimate use in a grand jury proceeding does not become protected by Rule 6(e) if it exists separately and independently of the grand jury process). In contrast, information concerning whether evidence, regardless of how and when it was obtained by the investigators, was presented to the grand jury is protected from disclosure by Rule 6(e). Anaya v. United States, 815 F.2d 1373, 1379 (10th Cir. 1987). The resolution consistently turns on "whether revelation in the particular context would in fact reveal what was before the grand jury." United States v. Dynavac, Inc., 6 F.3d 1407 (9th Cir. 1993); Fund for Constitutional Gov't v. National Archives, 656 F.2d 856 (1981).

The Service and the Justice Department both take the position that: (1) evidence which existed without regard to the inner workings of a grand jury, and (2) the existence of which is known without resort to grand jury "leads," may be used for civil purposes. See I.R.C. § 7602 (Service summons authority); I.R.M.9.5.2.4.3 (which requires that Service employees acting as agents of a grand jury segregate

and mark as “non grand jury” any information obtained prior to the agents’ involvement in the grand jury investigation and any independently obtained information).

Since you have not yet reviewed the records used to prepare the notice of deficiency, we do not know what documents provided by the grand jury agents have been included in the civil investigation file or whether any of these documents would tend to disclose what happened before the grand jury. In view of the Service’s policy of segregating and documenting the independent source of materials that are not subject to the secrecy requirement of Rule 6(e) and the caution used by the grand jury agents before disclosing any investigative materials to the civil authorities in this case, we would presume that only materials that are not subject to Rule 6(e) have been included.

B. If any matters occurring before the grand jury have been disclosed to the Service civil investigators and were used in the preparation of the notice of deficiency, such disclosures were made in good faith and should not form the basis for any punitive action by the Tax Court in the pending cases.

Even if the Service inadvertently and in good faith uses grand jury information in making deficiency determinations, courts do not routinely suppress that information and declare the notices invalid. See Kluger v. Commissioner, 83 T.C. 309 (1984) (good-faith exception to exclusionary rule set forth in United States v. Leon, 468 U.S. 897 (1984), makes suppression inappropriate); Graham v. Commissioner, 770 F.2d 381 (3d Cir. 1985) (good-faith reliance on facially valid disclosure order makes suppression inappropriate); Caprio v. Commissioner, 787 F.2d 109 (3d Cir. 1986) (same). The Supreme Court made it clear in United States v. Leon that suppression of evidence in any judicial proceeding is permissible only to vindicate a constitutional right or to deter governmental violation of a statute designed to secure a constitutional right or to implement a fundamental right arising from the criminal process. Leon, 468 U.S. at 909, citing Mallory v. United States, 354 U.S. 449 (1957). Suppression is inappropriate in a situation where the Service inadvertently and in good faith improperly uses grand jury information in making deficiency determinations or in good faith relies on a facially valid disclosure.

Further, district courts have broad discretion to determine whether disclosure is warranted. In granting Rule 6(e) orders, district courts consider whether the public interest in efficient, effective, and fair enforcement of federal statutes, which is often best served by permitting disclosure, outweighs the threat to the grand jury system caused by disclosure. Douglas Oil Co. v. Petrol Stops Northwest, 441 U.S. 211, 222 (1978). The concerns underlying grand jury secrecy are implicated to a much lesser extent when the disclosure is limited to government agents who have

incentives, such as other disclosure laws, in preventing further dissemination. United States v. John Doe Inc., 481 U.S. 102 (1987).

The Tax Court will respect an order issued by a district court. In Arc Electrical Construction Co. v. Commissioner, 91 T.C. 947 (1988), for example, the taxpayer asserted that the Service failed to demonstrate "particularized need" when it obtained the Rule 6(e) order from the district court and that the testimony of witnesses before the Tax Court who also testified before the grand jury should be suppressed. The Tax Court held that comity and judicial economy dictate that it not review the order of another court. Likewise, in Kluger v. Commissioner, 91 T.C. 969 (1988), the Tax Court decided that a deficiency notice issued after Baggot and Sells and based on a pre-Baggot and Sells Rule 6(e) order was valid. It found that the district court, in issuing the Rule 6(e) order, implicitly sanctioned the use of grand jury materials in preparing the notice of deficiency.

Thus, even if the Service inadvertently relied upon materials that could disclose the workings of the grand jury, the Tax Court is unlikely to find that the notice of deficiency is invalid or suppress the evidentiary materials from the civil examination at the trial in this case.

2. Seek a Rule 6(e) order if you determine that the materials used by the Service's agents to prepare the notice of deficiency include materials that would tend to disclose matters occurring before the grand jury and that you may need to make further disclosures of those materials to prepare the civil cases for trial.

Although the Tax Court will not generally undo actions previously taken by the Service in good faith in preparing the notice of deficiency, the Court will follow district court orders governing the use of grand jury materials or, if no order has been issued, will itself disallow the use of protected grand jury materials in the cases before it. In Kluger v. Commissioner, 91 T.C. 969 (1988), the Tax Court followed the instructions in a district court by requiring the Service to establish a particularized need for the further disclosure of protected grand jury materials in trial preparation and at the trial. Since the district counsel attorney was privy to the grand jury materials and proceedings, the Court permitted him to review the materials to gather proof of particularized need, so long as he did not disclose either what occurred before the grand jury or any specific documents in his investigation. Likewise, in In the Matter of Grand Jury Proceedings "Operation Gateway", 877 F.2d 632 (7th Cir. 1989), after a series of battles over the use of grand jury materials under a pre-Baggot and Sells Rule 6(e) order, the Seventh held that an order it had issued was adequate to permit the Service's further disclosure of grand jury materials in the Tax Court case. See also In the Matter of the December 3, 1979 Houston Division Federal Grand Jury, 889 F.2d 1466 (5th

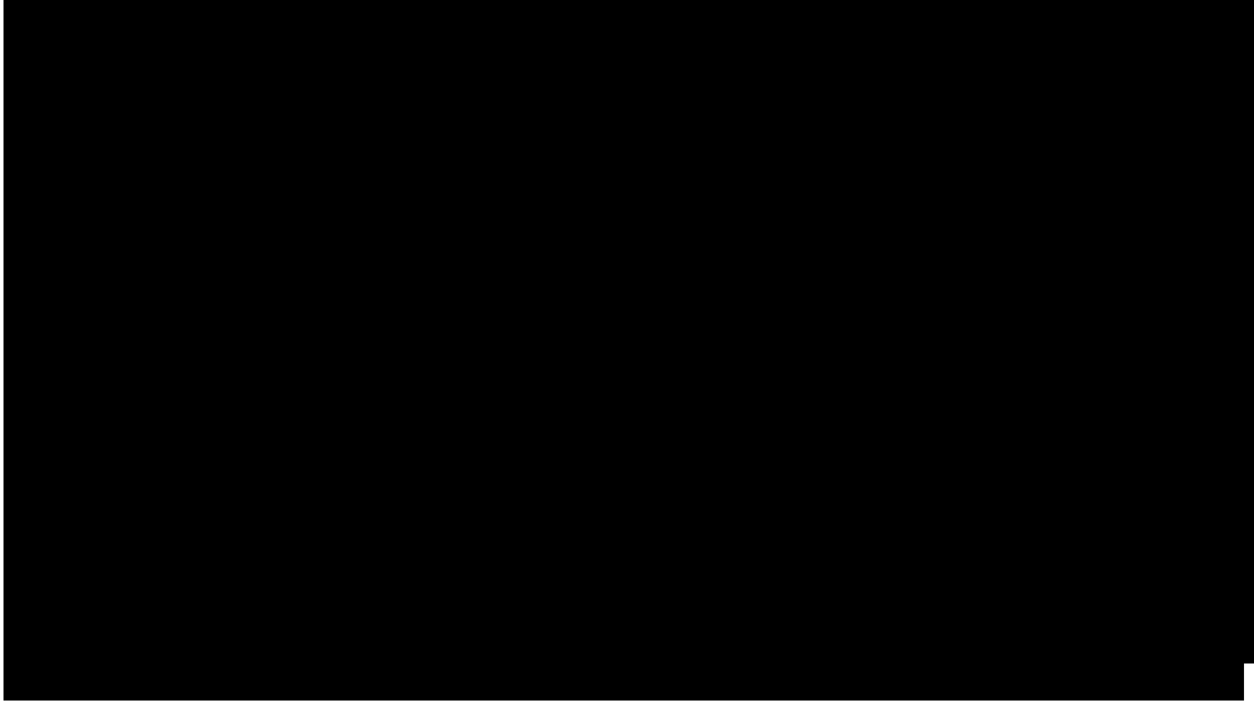
Cir. 1989) (government filed a second Rule 6(e) motion showing a particularized need for using the documents in tax litigation).

If you determine, upon review of the materials relied upon by the Service in issuing the notice of deficiency, that the materials tend to disclose the nature of the grand jury proceedings or if you decide that you need additional grand jury materials that are protected by Rule 6(e)(2), consider whether to request a new order under Rule 6(e)(3)(i) for the disclosure of grand jury materials in connection with the judicial proceeding in the Tax Court. We would not rely upon the existing order inasmuch as it covers only some documents and permits their disclosure to civil authorities for use in the determination of the defendant's tax liability. Although we might argue that the Tax Court case furthers the determination of tax liability, preparation and trial of the case could necessitate disclosures beyond "the civil authorities."

Make the request, in writing, to the prosecuting Assistant United States Attorney to obtain a disclosure order and be prepared to provide an affidavit that sets forth particularized need. In any motion for a Rule 6(e) order, the government will need to address the requirement of particularized need, which is derived from the Supreme Court's decision in United States v. Procter and Gamble, 356 U.S. 677 (1958). To establish particularized need, the moving party must show that (1) the material sought is needed to avoid a possible injustice in another judicial proceeding; (2) the need for disclosure is greater than the need for continued secrecy; and (3) the request is structured to cover only the material so needed. Douglas Oil Co. v. Petrol Stops Northwest, 441 U.S. 211 (1978). Although the particularized need standard applies to the government's disclosure requests as well as to those of private litigants, the special interests of the public that are served by disclosure to the government must be considered by a district court. Illinois v. Abbott & Associates, Inc., 460 U.S. 557 (1983).

Structure any request to cover only material that is needed. In departing from the general requirement of secrecy, a court should require that the showing of need be made with particularity so that the secrecy of the proceedings may be lifted discretely and limitedly. United States v. Alexander, 860 F.2d 508 (2d Cir. 1988). The request should also specify for what purposes they will be used and who else besides the Service attorney will be using or receiving this information. If it is contemplated that the evidence will be used in the Tax Court, that should be specified. As set forth in the rule, a motion for a disclosure order may be requested and granted ex parte when the moving party is the government. Whether to proceed ex parte should be determined on a case by case basis. The motion for the order should specifically seek permission to use the materials in all phases of the litigation, including further discovery and any later collection litigation.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS



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Please call if you have any further questions.