

# Criminal, Civil, or Both: Navigating Parallel Investigations with the IRS

By Sandra R. Brown and Hunter Keaster

**A**s recent announcements<sup>1</sup> by the Internal Revenue Service (IRS) serve to remind taxpayers and tax practitioners of its ever-expanding focus on compliance work to ensure fairness in the tax system through education, civil examinations, and criminal investigations (CIs), a reminder of the IRS' use of parallel investigations could not be timelier.

## Parallel Investigations Pursued By the IRS

One of the most powerful tools in its enforcement arsenal is the use of parallel civil investigations and CIs. Civil investigations are concerned with determining and, eventually, collecting the correct amount of taxes owed by a taxpayer in addition to assessing penalties and/or interest. Revenue officers and agents are often able to resolve civil matters without moving cases to the IRS Appeals Division or to the Department of Justice (DOJ) for litigation. As such, tax professionals and their clients are incentivized to cooperate with requests for information, interviews, and examinations to avoid costly litigation, negotiations, and/or penalties. In contrast, the goal of a criminal tax investigation is to procure information about suspected tax offenses that may be eventually referred for criminal prosecution. With CIs, information obtained by special agents can be the foundation for criminal charges and an eventual conviction through referral to the DOJ. Thus, tax professionals have different incentives—notably, preserving their client's Fifth Amendment right against self-incrimination. With the development of parallel investigations as an indispensable tactic in the agency's enforcement efforts, cooperation between a civil investigation and CI has increased, blurring previously established boundaries and incentives that were essential for taxpayers, tax professionals, and the IRS navigating an increasingly complex tax landscape.

## Background

While the term “parallel investigation” would seem to suggest, and should simply mean, simultaneous investigations that do not intersect (*i.e.*, that do not cooperate, coordinate, share information, or otherwise aid in the other's goals),

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in practice, the IRS utilizes parallel investigations specifically *because* the civil and criminal personnel leading each investigation can be of mutual benefit to one another through communication, coordinating internal logistics, and information sharing. The IRS states that “civil and criminal parallel investigations are conducted as separate investigations” and that “they are not joint investigations,” yet acknowledge that they “do require coordination between the operating divisions” and the Internal Revenue Manual (IRM) requires frequent meetings between civil and criminal investigators participating in a parallel investigation.<sup>2</sup> Case status meetings are required to take place at least quarterly, and their purpose is to “communicate the case developments and facilitate information sharing between Collection and CI (Criminal Investigation).”<sup>3</sup> In many cases, information sharing between civil and criminal divisions is appropriate and taxpayers with criminal exposure, and those who represent such taxpayers, should be aware of possible parallel investigations.

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In 1970, the Supreme Court permitted the use of parallel investigations in *Kordel*, upholding the convictions of two corporate officers who were interviewed for a civil action by the Food and Drug Administration (FDA) before having criminal charges brought against them for the same transactions that were the subject of the civil action.<sup>4</sup> The Court, in unanimity, held that proscribing parallel investigations of this type “would be tantamount to the adoption of a rule that the Government’s use of interrogatories directed against a corporate defendant in the ordinary course of a civil proceeding would always immunize the corporation’s officers from subsequent criminal prosecution.”<sup>5</sup> Applied to tax enforcement,

proscribing the use of parallel investigations outright would mean taxpayers could never be held criminally liable for offenses discovered during a civil investigation—an untenable outcome for the Government and the multitude of law-abiding taxpayers. Consequently, determining the limits of *Kordel* and parallel investigations would become the primary task for judges examining the strategy in subsequent years.

## ***Tweel*: Limiting Parallel Investigation Abuses**

Then, in 1977, the Fifth Circuit began to limit abuses of parallel investigations that were harmful to taxpayers’ rights in *Tweel*.<sup>6</sup> Nicholas J. Tweel was the subject of a civil audit conducted by a revenue agent at the request of the Organized Crime and Racketeering Section of the DOJ. During the audit, Tweel’s accountant asked the revenue agent whether a “special agent” was involved in the investigation. Accurately, the revenue agent responded that he was not working with any special agent on the case; however, he failed to disclose that the audit was being conducted at the request of the DOJ in connection with a federal CI. Relying on the revenue agent’s statement that no special agent was assigned to the case, Tweel and his accountant shared various documents with the hope of resolving the civil audit. Later, faced with criminal charges that involved the produced documents, Tweel’s attorneys filed a motion to suppress, arguing the revenue agent violated the Fourth Amendment by obtaining consent to a search through deception. The Fifth Circuit agreed, holding the search was the result of “sneaky deliberate deception” and that the “misrepresentation was both intentionally misleading and material,” proscribing the IRS from conducting CIs deceitfully through the use of civil examinations.<sup>7</sup>

However, the record in *Tweel* presents somewhat of an egregious case. Tweel’s accountant was clearly inquiring about the involvement of a special agent to learn more about the nature of the investigation. While maintaining accuracy, the revenue agent on the case managed to pedantically answer the accountant’s inquiry while intentionally and deceitfully moving attention away from the true nature of the investigation. What if a revenue agent accurately states that no special agent was involved in an investigation, only for one to be assigned days afterwards? What if a taxpayer never inquired about the nature of the investigation? Because of *Tweel* and similar decisions, the IRS implemented rules for agents aimed at avoiding materially misleading taxpayers who may be subject to a

CI. Revenue agents were then directed to cease civil audits and refer cases to CI after discovering “firm indications of fraud” or “badges of fraud.”<sup>8</sup> But the seemingly direct language of *Tweel* that inspired these administrative changes would soon be obscured.

## Stringer and Changes to the IRM

Incrementally, *Tweel* and agency policies limiting the use of parallel investigations were undermined with courts becoming more tolerant of the tactic. In *Stringer*, the Securities and Exchange Commission (SEC) was investigating alongside the DOJ.<sup>9</sup> The defendants were unaware of the DOJ’s involvement and, while engaging with the SEC investigation, inquired about the nature of the investigation, the involvement of other agencies, and whether they were being considered for criminal charges. Instead of responding plainly, the SEC agent referenced Form 1662, which was attached to the defendants’ subpoenas. The form states that “the Commission often makes its files available to other governmental agencies, particularly the United States Attorneys and state prosecutors.”<sup>10</sup>

The District Court, using language reminiscent of *Tweel*, found that the “government engaged in deceit and trickery to keep the criminal investigation concealed.”<sup>11</sup> The Ninth Circuit reversed the District Court’s ruling, holding that the Government is “free to make” the decision “not to conduct [a] criminal investigation openly” so long as they do not engage in “deceit or affirmative misrepresentation.”<sup>12</sup> Following *Stringer*, the IRS made changes to the IRM that instruct revenue officers not to inform taxpayers of an ongoing CI:

“(3) If a taxpayer under investigation inquires about criminal implications or whether the taxpayer is the subject of a criminal investigation before CI has contacted the taxpayer, the revenue officer must be careful to provide accurate information and not mislead the taxpayer. The revenue officer should inform the taxpayer that they are conducting a civil investigation, and that the information obtained can be shared with CI. Under no circumstances should the revenue officer inform the taxpayer that the case has been referred to CI. This is CI’s responsibility.”<sup>13</sup>

These changes in the IRM signal the agency’s commitment to utilizing parallel investigations, and the willingness to adapt enforcement tactics to an evolving judicial framework. The IRS is permitted to deploy CIs in a “silent” way, so long as they are not “affirmatively” and “materially misleading” taxpayers while doing so.

Handling interactions with the IRS requires careful attention, and it is often precarious whether a taxpayer is under investigation for a civil or criminal issue (or both). For taxpayers, making immediate contact with an experienced tax attorney is essential to protect one’s rights, interests, and assets. For tax professionals, understanding parallel investigations is necessary to represent one’s client both carefully and zealously.

## Identifying a Parallel Investigation

While the IRS may conduct CIs covertly at first, there are many proactive measures taxpayers and tax professionals can take to identify (a) if a parallel investigation is present and (b) the appropriate steps to take given the determination of (a). Despite IRM instructions for civil personnel not to disclose the status or existence of a parallel CI, *Stringer* demonstrates that asking civil personnel directly may be, in the right situation, a good place to start. An inquiry posed to the Government about other potential investigative activity could bear an answer that is instructive or establish grounds to later challenge improper conduct. Per *Stringer*, the Government may not materially mislead taxpayers under CI.<sup>14</sup> Simply failing to inform a taxpayer of the existence of a CI may not be considered “deceit” or “misleading,” but giving an inaccurate answer to an inquiry about the nature of an investigation would.

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On the other hand, caution in suggesting to the examining agent, by such an overt inquiry, that the taxpayer has reason to be concerned about a criminal referral may be the better course. As such, an experienced tax counsel may advise that paying close attention to the personnel communicating status updates, interview requests, and other investigative actions can help determine the nature

of an investigation. If multiple agencies or divisions are requesting similar or related information, there is a chance they are coordinating through a parallel investigation. Other indicators can be found in the types of questions civil personnel ask taxpayers. If a revenue agent makes repeated inquiries about a taxpayer's intentions, awareness of the law, or other topics pertaining to fraud or criminality, it is possible there is coordination with criminal personnel or another agency. Despite undertaking proactive steps to identify a parallel investigation, CIs are often conducted "silently" before taxpayers are made aware of them. Accordingly, prudent taxpayers and tax professionals, while hoping for the best, may need to proceed under the assumption that there will be a parallel investigation until there is evidence to prove otherwise.

## Fifth Amendment Considerations

A taxpayer's Fifth Amendment right against self-incrimination is implicated in the administration of a parallel investigation. While some information or testimony may be helpful, or even instrumental, in resolving a civil matter quickly and cooperatively, the same information or testimony could carry significant criminal exposure. The Fifth Amendment privilege can be asserted when there is a "real danger" of self-incrimination concerning individuals, testimony, or documents.<sup>15</sup> Individuals may also elect to "waive" their Fifth Amendment privilege and produce requested testimony or documents. While admissions that result from a taxpayer's decision to waive can be used in other proceedings, usually, the taxpayer can invoke their Fifth Amendment privilege at a separate proceeding. Generally, electing to invoke one's Fifth Amendment privilege can be used as a legitimate basis for adverse inferences in a civil proceeding.<sup>16</sup> Thus, advising a client to assert their Fifth Amendment privilege could lead to an unfavorable outcome in a possible civil trial.

Many defendants faced with a parallel investigation that evolves into a parallel judicial proceeding seek a stay

of the civil proceeding until the criminal matter has concluded. In doing so, taxpayers simplify Fifth Amendment calculus as no negative inferences can be drawn from Fifth Amendment assertions in criminal proceedings. However, there is no Constitutional requirement for a court to stay a civil proceeding to allow a criminal proceeding to resolve itself. Overall, discretion lies with the court and its analysis of the parties' competing claims when considering a stay. A court may elect to grant relief that does not come in the form of a stay, like a protective order sealing discovery items/transcripts or staying civil proceedings with certain defendants/witnesses but not others. While stays are not always granted, focusing on a single criminal proceeding can drastically reduce the complexity of a decision to invoke the Fifth Amendment privilege. Not every case or circumstance will necessitate a stay—keeping all relief options open can help position a taxpayer advantageously.

## Conclusion

The IRS, like many other agencies, has demonstrated its commitment to the use of collaborative parallel investigations and the advantages that come with them. From *Kordel* in the 1970s affirming the legitimate use of parallel investigations to *Stringer* in the late 2000s granting leniency to agencies leveraging the tactic, courts have repeatedly permitted the use of parallel investigations and later grappled with their consequences. Despite the IRS leveraging "silent" CIs, taxpayers and tax practitioners can and should take steps to identify when a parallel investigation is taking place. Doing so will empower taxpayers with the necessary knowledge to make informed decisions about their tax, legal, and Fifth Amendment strategies. After decades of use, parallel investigations seem to be here to stay. For taxpayers and tax professionals who need assistance with navigating a parallel investigation or parallel proceeding, contacting a qualified and experienced tax professional as soon as possible is recommended.

## ENDNOTES

<sup>1</sup> See [www.irs.gov/newsroom/irs-employee-retention-credit-compliance-effort-tops-1-billion-threshold-since-fall-voluntary-disclosure-program-suspended-after-march-22-special-withdrawal-program-remains-open-as-audits](http://www.irs.gov/newsroom/irs-employee-retention-credit-compliance-effort-tops-1-billion-threshold-since-fall-voluntary-disclosure-program-suspended-after-march-22-special-withdrawal-program-remains-open-as-audits) and [www.irs.gov/newsroom/dirty-dozen-irs-warns-tax-pros-businesses-to-be-cautious-of-ongoing-spearphishing-attacks-to-gain-sensitive-information-warns-of-surge-in-new-client-scams](http://www.irs.gov/newsroom/dirty-dozen-irs-warns-tax-pros-businesses-to-be-cautious-of-ongoing-spearphishing-attacks-to-gain-sensitive-information-warns-of-surge-in-new-client-scams).

<sup>2</sup> IRM 5.1.5.4 (Aug. 03, 2009) and 5.1.5.6 (Aug. 03, 2009).

<sup>3</sup> IRM 5.1.5.6 (Aug. 03, 2009).

<sup>4</sup> *L. Kordel*, SCT, 397 US 1, 90 SCT 763 (1970).

<sup>5</sup> *Id.*

<sup>6</sup> *N.J. Tweel*, CA-5, 77-1 USTC ¶9330, 550 F2d at 299-300.

<sup>7</sup> *Id.*

<sup>8</sup> IRM 25.11.3 (Jan. 23, 2014).

<sup>9</sup> *J.K. Stringer*, CA-9, 521 F3d 1189, 1191 (2008), amended by CA-9, 535 F3d 929 (2008).

<sup>10</sup> *Id.*

<sup>11</sup> *J.K. Stringer*, DC-OR, 408 FSupp2d 1083 (2006).

<sup>12</sup> *J.K. Stringer*, CA-9, 521 F3d 1189, 1191 (2008), amended by CA-9, 535 F3d 929 (2008).

<sup>13</sup> IRM 5.1.5.7 (Aug. 03, 2009).

<sup>14</sup> *J.K. Stringer*, CA-9, 521 F3d 1189, 1191 (2008), amended by CA-9, 535 F3d 929 (2008).

<sup>15</sup> *Kastigar*, SCT, 406 US 441, 92 SCT 1653 (1971).

<sup>16</sup> *Baxter v. Palmigiano*, SCT, 425 US 308, 96 SCT 1551 (1976).