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| The Erosion of the Fifth Amendment Privilege: Why the Supreme Court Must Revisit the Required Records Doctrine |
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It would, no doubt, simplify enforcement of all criminal laws if each citizen were required to keep a diary that would show where he was at all times, with whom he was, and what he was up to.[[1]](#footnote-1) [But t]he immediate and potential evils of compulsory self-disclosure transcend any difficulties that the exercise of the [Fifth Amendment] may impose on society in the detection and prosecution of crime.[[2]](#footnote-2)

“You’d have to be living in a hole not to know that the U.S. government is really focused on offshore tax evasion,” IRS Commissioner Shulman told Bloomberg News earlier this year.[[3]](#footnote-3) The Bank Secrecy Act of 1970 (“BSA”) permits civil and criminal penalties for U.S. taxpayers who fail to report interests in foreign financial accounts. In the past, however, civil and criminal enforcement was rare; between 1996 and 2002 only twelve indictments were reported.[[4]](#footnote-4) In 2001, heightened financial reporting requirements were enacted under the Patriot Act, which is expressly designed to help prosecute international crimes. The government’s formal declaration of war on foreign tax evasion was commemorated in 2008 when a district court authorized the IRS’s John Doe Summons on Swiss bank UBS, demanding documents identifying U.S. taxpayers with unreported accounts.[[5]](#footnote-5) This order followed the indictments and guilty pleas of a high-profile UBS customer and his private UBS banker.[[6]](#footnote-6) In 2009, the DOJ charged UBS with aiding U.S. taxpayers in tax evasion. The bank avoided prosecution by paying $780 million and disclosing account data. Shulman promised severe penalties as the government pursued “criminal avenues” for these targeted individuals.[[7]](#footnote-7) Criminal charges have since been filed against numerous taxpayers, bankers, financial advisers, and lawyers linked to the data. Still, earlier this year, the IRS threatened offshore bank account holders with the increasing risks of criminal prosecution.[[8]](#footnote-8)

Along with the government’s heightened enforcement and the current prosecutorial attack on offshore bank accounts, the Department of Justice (“DOJ”) has convinced four courts to enlarge the scope of the Required Records Doctrine and effectively eviscerate Fifth Amendment protections by forcing taxpayers to produce self-incriminating foreign banking records. The Ninth Circuit’s decision in *In re: Grand Jury Investigation M.H.*[[9]](#footnote-9) is a bruising decision for taxpayers with foreign accounts, but more significantly, jeopardizes the constitutional privilege against self-incrimination and challenges fundamental protections against government investigations. The Ninth Circuit’s holding essentially permits the federal government to require individuals to keep records of criminal activities and subsequently compel those individuals to turn those records over to prosecutors. A number of district courts have recently considered the issue[[10]](#footnote-10) and only the Southern District of Texas upheld the taxpayer’s Fifth Amendment protections. The government appealed and the case is awaiting Fifth Circuit review. This erosion of the Fifth Amendment was anticipated by the Supreme Court at the formation of the Required Records Doctrine.[[11]](#footnote-11) The Court must now revisit the doctrine and revive Fifth Amendment protections before the exception swallows the rule.

Among those beset by the government’s crackdown, M.H. was the target of a grand jury investigation to determine whether he used foreign bank accounts to evade taxes. Because M.H. could undoubtedly assert the Fifth Amendment and refuse to testify regarding his interests in foreign accounts, the government demanded an indirect admission by issuing a grand jury subpoena insisting that he produce his records required to be kept under the BSA. The district court granted the government’s motion to compel, refused to grant M.H. immunity, and held M.H. in contempt when he refused to comply. M.H. appealed to the Ninth Circuit without relief.

Because M.H. is required by law to keep and maintain the foreign banking records under the BSA and also report such accounts to the IRS, M.H. was stuck between a rock and a hard place: if he disclosed the records, he risked incriminating himself if the records were inconsistent with reports previously filed (or not filed), and, if he denied the existence of the records, he risked incriminating himself for failing to keep and maintain such records. M.H. asserted his Fifth Amendment privilege and demonstrated that the very act of producing these documents would expose him to a real and appreciable hazard of self-incrimination.

The DOJ argued that the Required Records Doctrine rendered the Fifth Amendment inapplicable because M.H. voluntarily participated in a regulated activity. The Required Records Doctrine provides an exception to the Fifth Amendment when documents are voluntarily created and kept, including as a result of voluntary participation in a regulated activity.[[12]](#footnote-12) The Supreme Court has identified three elements of the doctrine: (1) the purpose of the government’s inquiry is regulatory and not criminal; (2) the information requested is contained in records the regulated party customarily kept; and (3) the records have assumed “public aspects.”[[13]](#footnote-13) When these elements are present, the individual’s choice to enter an industry subject to government regulation is deemed voluntary and documents created and kept under this scheme are distinguished from compulsorily testimony.

Thus, in *Shapiro*, the Supreme Court found business and sales records required to be maintained under the licensing prerequisites of the Emergency Price Control Act noncompulsory and sufficiently infused with “public aspects.” The Act was designed to regulate commodity prices as an emergency war measure and the Court found the disclosure a condition of participating in the highly regulated industry.

In *In re: M.H.*, the court sided with the government and found the Fifth Amendment inapplicable to M.H.’s personal banking records. Noting that not all three elements were required under the Ninth Circuit’s flexible approach, the court found each one satisfied. First, the court found that because nothing about having a foreign bank account suggests inherent illegal activity, the relevant BSA provisions were “essentially regulatory” and not criminal. Second, it found the records were the type bank customers customarily kept for practical and reporting purposes. Lastly, the court found the records assumed a “public aspect” since it found the information is compelled in furtherance of a valid regulatory scheme.

Notwithstanding the issues concerning the second element—that is, records of foreign banking were not customarily kept, whether for privacy or detection purposes—it is the Ninth Circuit’s finding with respect to the first and third elements which is most troubling. By combining the two elements, the court imbues all documents required to be kept by the government with sufficient public aspects, rendering them impervious to Fifth Amendment protections. To reach this result, the Ninth Circuit relied on *Shapiro’s* finding that if the “government’s purpose in imposing the regulatory scheme is essentially regulatory, then it necessarily has some public aspects.” But the Ninth Circuit set aside the Supreme Court’s more recent explanation in *Marchetti*,[[14]](#footnote-14) where it explained that formalizing government demands in the attire of a statute does not ascribe “public aspects” to otherwise private documents. Analogous to *In re: M.H.*, the taxpayer in *Marchetti* was required by law to file a tax report which itself would disclose involvement in illegal gambling activities. The Supreme Court found the taxpayer constitutionally protected from filing the report.

Dismissing *Marchetti*, the Ninth Circuit relied on *Byers*,[[15]](#footnote-15) a Supreme Court case which involved an “inherently public” act and did not implicate the Required Records Doctrine. In *Byers*, the Supreme Court upheld a state statute requiring drivers involved in accidents to provide their names and addresses to police because the “[d]isclosure of name and address is an essentially neutral act. Whatever the collateral consequences of disclosing name and address, the statutory purpose is to implement the state police power to regulate use of motor vehicles.” The Supreme Court found the Fifth Amendment inapplicable because the disclosure itself would not confront the individual with substantial hazards of self-incrimination.

Drawing from *Byers*, the Ninth Circuit found “disclosure of basic account information is an ‘essentially neutral’ act necessary for effective regulation of offshore banking.” This reasoning is flawed for several reasons. First, the disclosure of banking records is not “essentially neutral” because the records alone were sufficient, or at least provided a “link in the chain” of evidence, to convict M.H.[[16]](#footnote-16) Second, *Byers* involved verbal utterances and did not implicate the Required Records Doctrine or analyze the “public aspect” of the disclosure. Lastly, it is hard to imagine a less factually comparable case and two more divergent activities. *Byers* involved the use of a vehicle on public streets, requiring public licensing and policing, implicating numerous public traffic laws, and involving constant interaction with strangers—risking the safety and lives of the general public. The Court found the statutory purpose to regulate the use of vehicles an “inherently public” act. *In re: M.H.* involved the private bank transactions of an individual involving monies in his personal and sole possession. The information requested in *Byers* is public information, along with marriage licenses, property records, and 10-Ks. This information serves the public purpose of providing notice and is filed in court and available for public review.[[17]](#footnote-17) Banking records, on the other hand, are private, often locked in safes or password protected, accessible only by the owner, and subject to privacy laws.[[18]](#footnote-18)

Documents courts have previously found to have “public aspects” include sales records required to be kept under an emergency war act, patient records related to the purchase and sale of prescription drugs, escrow records, and odometer statements. These documents are facially distinct from personal banking records.

Personal tax and banking records have long been recognized as private and not public.[[19]](#footnote-19) For example, in *Smith*, the Seventh Circuit found personal tax records beyond the scope of the Required Records Doctrine. Similarly, in *Porter*, the court found the doctrine inapplicable to personal banking records required to be maintained under I.R.C. § 6001. Noting that the nature of the relationship between the taxpayer and the IRS alone was insufficient to imbue taxpayers’ private banking records with public aspects, the court upheld the taxpayer’s Fifth Amendment privilege.

*In re: M.H.* distinguished *Smith*, finding the decision to become a taxpayer involuntary and foreign banking voluntary. But taxpayers frequently do not enter into foreign banking voluntarily and instead, often inherit foreign bank accounts or are made beneficiaries without their knowledge. Foreign bank accounts are commonly opened by foreign family members and without the involvement of the U.S. taxpayer. Moreover, “[t]he national government regulates nearly every aspect of life. It may not eviscerate the limits on its authority under the Constitution by turning every regulated choice into a constitutional waiver.”[[20]](#footnote-20) Under the Ninth Circuit’s holding, the government can enact statutes which require *voluntary* drivers to consent to having their cars searched at any time, *voluntary* homeowners to waive their privilege against unlawful searches and seizures, and *voluntary* bank depositors to waive whatever privilege they have in account information.[[21]](#footnote-21)

Acknowledging this potential abuse, the Ninth Circuit reasoned that the first element of the doctrine serves as a deterrent because a determination of whether the statute is criminal protects individuals from unconstitutional exploitation. The court stated this determination requires an analysis that goes beyond the label Congress or the agency provides. But the court’s analysis lacked such scrutiny. The BSA itself states that its purpose is criminal and the legislative history indicates that lawmakers were concerned about tax evasion and the illegal use of foreign accounts.[[22]](#footnote-22) Further, “[the presumption in Congress is] that secret foreign bank accounts and secret foreign financial institutions are inevitably linked to criminal activity in the United States.”[[23]](#footnote-23) Even assuming the statute’s purpose was “essentially regulatory” at its origin, the current prosecutorial environment suggests that the statute’s utility has changed. The Ninth Circuit disregarded the DOJ’s focus on heightened enforcement over the last decade.

When the IRS summoned the same information from UBS under the John Doe Summons, it argued that “money transfers between the U.S. and Switzerland . . . are inherently reasonably suggestive of tax avoidance.”[[24]](#footnote-24) To support a legitimate purpose of the summons, the IRS alleged the documents were essential to the investigation and prosecution of tax crimes.[[25]](#footnote-25) The IRS further insisted that the summons was narrowly tailored and related to an ascertainable class of U.S. taxpayers with foreign accounts for which there existed a reasonable basis for believing those individuals failed to comply with the law.[[26]](#footnote-26)

The government now hides behind a regulatory purpose, asserting that the reporting requirements apply to a broad class of individuals, not necessarily involved in illegal activity. But the government’s regulatory justifications are empty. The government does not manage the money supply or currency flows of the U.S. economy through these reports and records. The statute neither restricts overseas investment nor licenses foreign investors. Instead, it simply aids in the prosecution of crime.

It will be interesting to see how the Fifth Circuit weighs in and whether on appeal, M.H. can convince the Supreme Court to revisit the Required Records Doctrine and revive the Fifth Amendment.[[27]](#footnote-27)

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Dentons counsel drafted this paper for a specific event which occurred in the past. As such, it reflects the state of the law at the time it was drafted, and is not necessarily a reflection of current developments. For an update on this topic, please contact the editors of USTaxDisputes.com.

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1. *Shapiro v. United States*, 335 U.S. 1, 17 (1948) (Jackson, J., dissenting). [↑](#footnote-ref-1)
2. *United States v. White*, 322 U.S. 694, 698 (1944). [↑](#footnote-ref-2)
3. David Voreacos, *Eight Offshore Banks Under Grand Jury Investigations Over Taxes, U.S. Says*, Bloomberg News, Sept. 20, 2011, *www.bloomberg.com*. [↑](#footnote-ref-3)
4. U.S. Treasury Department, Report to Congress in Accordance with §361(b) of the 2001 Patriot Act (Apr. 26, 2002). [↑](#footnote-ref-4)
5. Order, *In re: John Does*, No. 1:08-mc-21864-JAL (S.D. Fl. July 1, 2008). [↑](#footnote-ref-5)
6. See Declaration of Daniel Reeves in Support of Petition to Enforce John Doe Summons, *United States v. UBS AG*, Civ. No. 1:09-cv-20423-ASG, \*22 (S.D. Fl. Feb. 19, 2009). [↑](#footnote-ref-6)
7. *See* Statement of Commissioner Shulman on Offshore Income (Mar. 26, 2009), *available at http://www.irs.gov/newsroom/ article/0,,id=206014,00.html*. [↑](#footnote-ref-7)
8. IR-2011-14 (Feb. 8, 2011), *http://www.irs.gov/newsroom/article/0,,id=235695,00.html*. [↑](#footnote-ref-8)
9. 648 F.3d 1067 (9th Cir. Aug. 19, 2011) (“*In re: M.H.*”). [↑](#footnote-ref-9)
10. *In re Grand Jury Investigation*, 3:11-mc-00297 (S.D. Ca. Mar. 22, 2011); *In re: Grand Jury Subpoenas Dated January 3, 2011*, No. 10-403-073 (D.C. Fl. Mar. 4, 2011); *In re: Grand Jury Subpoena*, No. 4:11-mc-00174, (S.D. Tex. Feb. 11, 2011) (under seal). [↑](#footnote-ref-10)
11. *Shapiro*, 335 U.S. at 17. [↑](#footnote-ref-11)
12. *Id*. [↑](#footnote-ref-12)
13. *Grosso v. United States*, 390 U.S. 62, 67-68 (1968). [↑](#footnote-ref-13)
14. *Marchetti*, 390 U.S. 39, 57 (1968). [↑](#footnote-ref-14)
15. *California v. Byers*, 402 U.S. 424, 431-32 (1971). [↑](#footnote-ref-15)
16. *See Hoffman v. United States*, 341 U.S. 479, 486-87 (1951). [↑](#footnote-ref-16)
17. *See In re: Grand Jury Subpoena*, No. H-11-174, \*3 (S.D. Tex. Feb. 11, 2011) (under seal). [↑](#footnote-ref-17)
18. *See, e.g., The Right to Financial Privacy Act*, 12 U.S.C. § 3401 *et. seq*. [↑](#footnote-ref-18)
19. See, *e.g., Smith v. Richert*, 35 F.3d 300, 303 (7th Cir. 1994); *United States v. Porter*, 711 F.2d 1397, 1405 (7th Cir. 1983). [↑](#footnote-ref-19)
20. *In re: Grand Jury Subpoena*, No. H-11-174, \*7 (S.D. Tex. Feb. 11, 2011) (under seal). [↑](#footnote-ref-20)
21. *Id*. at \*6. [↑](#footnote-ref-21)
22. *Id*. at \*5 (citing Sen. Rep. No. 91-1139 (1970)). [↑](#footnote-ref-22)
23. *Id*. (citing *United States v. Hajecate*, 683 F.2d 894, 901 (5th Cir. 1982)). [↑](#footnote-ref-23)
24. Memorandum in Support of Ex Parte Petition for Leave to serve “John Doe” Summons, *In re: John Does*, No. 1:08-mc-21864-JAL, \*9 (June 30, 2008). [↑](#footnote-ref-24)
25. Declaration, *supra* note 6, at \* 3-5, 21-23 (“The IRS seeks documents from UBS that would identify and help the IRS to investigate these US taxpayers.”). [↑](#footnote-ref-25)
26. Memorandum, *supra* note 24 at \* 8-9. [↑](#footnote-ref-26)
27. The Supreme Court denied stay on October 25, 2011. *M.H. v. United States*, 2011 WL 5041539 (U.S. Oct. 25, 2011) (NO. 11A412). [↑](#footnote-ref-27)