

What's the IRS Criminal Investigation Division Telling Us About Its Priorities and Update on the Erosion of the Attorney-Client Privilege in Tax Cases

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As we close the books on 2021 and head into a new year, the Internal Revenue Service Criminal Investigation Division (“IRS-CI”) touted the year’s prominent and high-profile cases in Information Release 2022-04 (January 7, 2022). The top ten list provides insights into the types of cases that have caught IRS-CI’s attention and where IRS-CI has devoted its resources. The IRS’s 2021 list provides insights into what can be expected in the coming year. As agency coordinated programs and staffing takes time to ramp up, practitioners are likely to see a significant repeat of the types of investigations that IRS-CI considers noteworthy from 2021. Another important development that occurred in 2021 involved two Federal Appellate Court rulings on attorney-client privilege in the tax advise context. The rulings portend a troubling trend.

IRS Criminal Investigation Division’s 2021 Priorities

It’s no surprise that the top ten IRS-CI list contains the traditional Ponzi schemes, tax return preparation businesses, and investment scams. These types of cases fall within IRS-CI’s docket year after year. A growth area, that should not come as a surprise, is the division’s focus on offshore and cryptocurrency cases. However, what makes an impression is the tax agency’s ability to deliver in the offshore and crypto investigations and obtain significant convictions and plea deals despite the once-believed-view that the assets were anonymous and the money trail undiscoverable.

In terms of size of tax loss, the case against Russian banker Oleg Tinkov stands out. The case involved Tinkov’s expatriation and concealment of assets and income as part of that process. Tinkov was ordered to pay \$248 million in taxes and sentenced to time-served and one year of supervised release. In recent years, IRS-CI has become more coordinated with off-shore asset information gathering. Through its information sharing agreements with other countries, the treasure trove of information that surfaced in the Panama and Pandora Papers, as well information provided through the Foreign Account Tax Compliance Act (FATCA) channels, IRS-CI is well-equipped to track down and verify information provided in the expatriation process. Furthermore, there is anecdotal evidence that the Joint International Tax Shelter Information Centre is sharing information in real-time, rather than waiting for mutual releases of information at designated times.²

IRS-CI’s tracking of cryptocurrency is featured prominently on the 2021 top ten list. In one case, an Ontario man ran a bitcoin exchange business that exchanged over \$13 million in bitcoin and cash for drug traffickers and others. Mr. Mejia was sentenced to three years in prison

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² See <https://www.oecd.org/tax/forum-on-tax-administration/jitsic/>

and forfeited all assets derived from the operations. In another crypto-currency case, a Bulgarian national was sentenced to 121 months in prison for running a Craigslist and eBay scam that advertised high-priced items, converted the payments to cryptocurrency, and then transferred the cryptocurrency overseas. These two cases demonstrate IRS-CI's ability to trace what was once considered "anonymous" cryptocurrency transactions. IRS-CI has developed expertise and tools to take on crypto-related crimes and follow the "virtual" money.

The IRS Office of Fraud Enforcement has formed a coordinated team to focus on cryptocurrency-based cases. Its "Operation Hidden Treasure" applies an artificial intelligence engine to its traditional data gathering sources to produce fraud referrals. In 2021, the IRS fraud cases in the crypto tax world has moved from primarily narcotics, child exploitation, and Ponzi cases to include pure criminal tax cases and civil fraud cases.³ Recently, during a panel presentation, Los Angeles Special Agent in Charge Ryan Korner reported that "[w]e're just seeing mountains and mountains of fraud in this area." He reported that IRS investigators seized \$3.5 billion worth of cryptocurrencies tied to financial crimes during fiscal year 2021 and ended the year with 80 crypto cases in the agency's inventory.⁴

Finally, the number one item on the 2021 list arises from a flagrant COVID relief application scheme. The Ayvazyan family used stolen and fictitious identities to submit 150 fraudulent applications for COVID-relief funds and then used the funds to purchase luxury homes, gold coins, and jewelry. Hopefully, the COVID virus will dissipate in 2022 but defense counsel are likely to see additional IRS-CI investigations in this area as additional filings are reviewed.

2021: Not a Good Year for Privilege in Tax Cases

Two Appellate Court rulings stand out in the privilege context in 2021: *In re Grand Jury* and *Taylor Lohmeyer Law Firm P.L.L.C. v. United States*. Both cases reflect a worrisome trend for tax lawyers and the defense bar.

The parameters of the attorney-client privilege was explored in *In re Grand Jury*, a Ninth Circuit case that dealt with dual-purpose tax law communications between a law firm and its client.⁵ *In re Grand Jury* involved an unnamed target company and its law firm. Both were served with grand jury subpoenas relating to a criminal investigation. The law firm refused to produce certain documents, citing the attorney-client privilege. The government moved to compel production of these documents, and after the district court granted the government's motion, in part, the company and law firm maintained its refusal to produce. After motions to hold the company and law firm in contempt were granted, the company and law firm appealed to the Ninth Circuit.

³ American Bar Association Criminal Tax Fraud/Tax Controversy 2021 meeting, "Cryptocurrency: Where Are We Today" presentation (Dec. 20, 2021).

⁴ Liedtka, Dave, "IRS Seeing 'Mountains and Mountains' of Fraud with Crypto, NFTs," *Bloomberg Tax* (January 26, 2022).

⁵ *In re Grand Jury*, 13 F.4th 710 (9th Cir. 2021), *order and amended opinion* (Jan. 27, 2022).

The question before the Ninth Circuit was whether communications from a law firm to its client providing advice falls within the attorney-client privilege. Because of grand jury secrecy, the circumstances involved in the case are not clear. Since the law firm did not rely on work product doctrine, it appears that the lawyer’s advice was provided in a non-anticipation of litigation context. However, it also seems that the lawyer’s advice was provided in a tax reporting or tax advisory role. The court’s ruling on this issue caused concern among the tax defense bar.

Specifically, footnote 5 of the opinion states: “We are aware, for example, that normal tax advice—even coming from lawyers—is generally not privileged, and courts should be careful to not accidentally create an accountant’s privilege where none is supposed to exist.”⁶ The Ninth Circuit’s passing statement, relegated to a footnote, sent shockwaves through the tax and criminal defense bars because a tax lawyer’s role, whether in a transaction or controversy context, is primarily about tax-related legal advice – that is advising clients about the tax implications of certain transaction or the proper reporting on a tax return. The Ninth Circuit’s broad statement would seemingly gut the attorney-client privilege for tax lawyers.

Interestingly, on January 27, 2022, the Ninth Circuit issued an Order and Amended Opinion.⁷ The Order and Amended Opinion removed the phrase “tax advice” and replaced it with the phrase “tax return preparation assistance.” The revised footnote is in-line with the principle that a lawyer’s tax return preparation services are not privileged. However, what constitutes pure tax return preparation as opposed to providing legal advice about a tax return reporting remains a case-by-case issue. The Ninth Circuit’s initial language reflects the tax bar’s concern that the attorney-client privilege is under attack.

The attorney-client privilege was also at issue in the Fifth Circuit ruling *Taylor Lohmeyer Law Firm P.L.L.C. v. United States*.⁸ In *Taylor Lohmeyer*, a Texas-based law firm filed an action to quash an IRS John Doe summons which sought production of documentation that would reveal the identities of unnamed clients who may have hired the firm to establish offshore accounts or foreign entities, thereby potentially avoiding U.S. income tax. The summons arose out of an IRS investigation of an unnamed taxpayer who allegedly used the firm’s services to establish foreign accounts and entities, avoiding over \$2 million in U.S. income tax. The IRS now sought the identities of other clients of the firm who may have similarly used its services.

The IRS summons sought a broad range of information. For example, the summons sought documents for unnamed clients “who at any time ... used the services of [the law firm] ... to acquire ... or control (1) any foreign financial account or other asset; (2) any foreign

⁶ *In re Grand Jury*, 13 F.4th at ___, fn. 5 (underline added).

⁷ *In re Grand Jury*, No. 21-55085, 21-55145, 2021 WL 6750904 (9th Cir. Jan. 27, 2022).

⁸ *Taylor Lohmeyer Law Firm P.L.L.C. v. United States*, 957 F.3d 505 (5th Cir. 2021), *rehearing denied*, 982 F.3d 409 (2021), *cert. denied* ___ U.S. ___ (2021).

corporation ... or other legal entity; or (3) any foreign or domestic financial account or other asset in the name of such foreign entity.”⁹

The law firm sought blanket protection from disclosure. It contended that the identities were privileged because, although the identity of clients is generally not privileged, revealing the identities here would lead to the disclosure of confidential information. The court held that the clients’ identities were not privileged because the identities were not “connected inextricably with a privileged communication” and because the IRS agent’s declaration supporting the summons did not state that the IRS knew the substance of the legal advice given to the clients. The IRS agent’s declaration simply outlined evidence establishing a reasonable basis that the clients were of interest to the IRS. The Fifth Circuit concluded that disclosing the clients’ identities would not inevitably lead to a disclosure of specific confidential communications.

Given the broad scope of the document request, the resulting privilege review and privilege log exercise are sure to be daunting tasks. The Fifth Circuit’s ruling is troubling because of the IRS’s extremely broad requests for documentation, the slim evidentiary basis on which the summons was based, and the burdensome privilege review that is required as a result. Law firms once thought that its client files were protected. However, this ruling demonstrates that this assumption is no longer clear cut (at least in the Fifth Circuit).

Conclusion

IRS-CI will move into 2022 with emphasis on traditional as well as new categories of criminal tax investigations. The agency is evolving and updating its investigatory tools to keep up with technology, specifically cryptocurrency. While this is going on, the agency is continuing its attack on the attorney-client privilege to obtain evidence of fraud. Recent rulings out of the Fifth and Ninth Circuits will embolden these efforts.

⁹ *Taylor Lohmeyer Law Firm P.L.L.C.*, 957 F.3d 505, at 507.