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APPLICATION OF THE EXCLUSIONARY RULE TO CRIMINAL TAX FRAUD INVESTIGATIONS

*Crofford J. Macklin, Jr.**

I. INTRODUCTION

In investigating criminal tax fraud matters, the Internal Revenue Service (I.R.S.) has operated under certain informal customs and practices to obtain taxpayers' records from financial institutions and other third-party recordkeepers.¹ These informal customs and practices often violate information gathering procedures required by the Internal Revenue Code of 1954 (I.R.C.) and the Treasury Regulations.² Therefore, taxpayers whose records have been obtained in violation of the I.R.C. and regulations may seek to suppress such evidence under the exclusionary rule³ by claiming violations of due process⁴ and the fundamental right of privacy.⁵

The focus of this article will be on the following three areas: (1) the formal procedures in acquiring such records as set forth in the I.R.C. and Treasury Regulations; (2) the informal customs and practices of the I.R.S. in obtaining a taxpayer's records from third party record-

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1. The Internal Revenue Code of 1954 defines a "third-party recordkeeper" as follows:

THIRD-PARTY RECORDKEEPER DEFINED.—For purposes of this subsection, the term 'third-party recordkeeper' means—

(A) any mutual savings bank, cooperative bank, domestic building and loan association, or other savings institution chartered and supervised as a savings and loan or similar association under Federal or State law, any bank (as defined in section 581), or any credit union (within the meaning of section 501(c)(14)(A));

(B) any consumer reporting agency (as defined under section 603(d) of the Fair Credit Reporting Act (15 U.S.C. § 1681a(f));

(C) any person extending credit through the use of credit cards or similar devices;

(D) any broker (as defined in section 3(a)(4) of the Securities Exchange Act of 1934 (15 U.S.C. § 78c(a)(4));

(E) any attorney; and

(F) any accountant.

I.R.C. § 7609(a)(3).

2. *Id.* Treas. Reg. § 301.7602-1 (1973).

3. The exclusionary rule generally precludes the admission of evidence gathered in violation of the fourth amendment at a criminal trial. *Weeks v. United States*, 232 U.S. 383 (1914). *See also* *Mapp v. Ohio*, 367 U.S. 643 (1961).

4. *See* notes 27-43 and accompanying text *infra*.

5. *See* notes 44-48 and accompanying text *infra*.

keepers; and (3) the appropriate application of the exclusionary rule and availability of civil remedies when the information gathering procedures have violated the I.R.C. or Treasury Regulations.

II. FORMAL PROCEDURES FOR OBTAINING RECORDS

To obtain records from a third party recordkeeper, the I.R.S. must follow the procedures for notification and stay of compliance in I.R.C. section 7609.⁶ First, the I.R.S. must issue a summons to the recordkeeper.⁷ Second, within three days after the summons is served on the recordkeeper, and, in any event, no later than fourteen days prior to the time that the third-party recordkeeper is to comply with the summons, notice must be given to the taxpayer.⁸ The notice must include both a copy of the summons and directions for staying compliance.⁹

If a taxpayer decides it is not in his best interests to have a third-party recordkeeper furnish his records to the I.R.S., he may stay compliance by notifying, in writing, the recordkeeper and instructing him

6. I.R.C. § 7609(a)(1)-(2), (b).

7. *Id.* § 7609(a)(1).

8. *Id.*

9. *Id.* § 7609(a)(1)(B). Certain exceptions will cause the special procedures for a third party summons to not apply:

EXCEPTIONS

Paragraph (1) shall not apply to any summons—

(A) served on the person with respect to whose liability the summons is issued, or any officer or employee of such person,

(B) to determine whether or not records of the business transactions or affairs of an identified person have been made or kept, or

(C) described in subsection (f).

Id. § 7609(a)(4).

EXCEPTIONS

A summons shall not be treated as described in this subsection if—

(A) It is solely to determine the identity of any person having a numbered account (or similar arrangement) with a bank or other institution described in subsection (a)(3)(A), or

(B) it is in aid of the collection of—

(i) the liability of any person against whom an assessment has been made or judgment rendered, or

(ii) the liability at law or in equity of any transferee or fiduciary of any person referred to in clause (i).

Id. § 7609(c)(2).

SPECIAL EXCEPTION FOR CERTAIN SUMMONSES.—In the case of any summons described in subsection (c), the provisions of subsections (a)(1) and (b) shall not apply if, upon petition by the Secretary, the court determines, on the basis of the facts and circumstances alleged, that there is reasonable cause to believe the giving of notice may lead to attempts to conceal, destroy, or alter records relevant to the examination, to prevent the communication of information from other persons through intimidation, bribery, or collusion, or to flee to avoid prosecution, testifying, or production of records.

Id. § 7609(g).

not to comply.¹⁰ Additionally, the taxpayer must mail to the I.R.S. either by registered or certified mail, a copy of the notice not to comply.¹¹

However, if the I.R.S. determines that the records subject to the summons are necessary to its case, the I.R.S. can bring an action to enforce the summons pursuant to I.R.C. sections 7210, 7402, and 7604.¹²

III. INFORMAL CUSTOMS AND PRACTICES

During the period immediately subsequent to the effective date of I.R.C. section 7609,¹³ officials of at least one banking institution located in the southwestern area of Ohio met with officials of the Criminal Investigation Division of the I.R.S. The purpose of the meetings was to establish procedures under which the banking institutions, as third-party recordkeepers, could comply with summons issued pursuant to I.R.C. section 7609. The third-party recordkeepers were anxious to establish procedures for compliance with the statute that would require minimum time and effort. As a result of the meetings, informal customs and practices were adopted to comply with the requirements of I.R.C. section 7609.

In order to reduce the time and effort required in complying with I.R.C. section 7609(a), a special agent might issue a "preliminary" summons to a third-party recordkeeper. This summons could read as follows: The name and account number of any of the following in which *A* has an individual interest or an interest with *B* (*A*'s spouse), *C* (*A*'s son), or *D* (*A*'s daughter): checking account, savings account, trust account, loan account, letter of credit, security transaction account, foreign transaction account, certificate of deposit, safety deposit as lessee, safety-deposit-box right of entry, credit card account. Although such a summons would be issued to the third-party recordkeeper, notice of such summons would not be delivered to the taxpayer under investigation.

After the information requested in the "preliminary" summons is produced, the I.R.S. would issue a summons to the bank under I.R.C. section 7609 requesting more detailed information. But by the time the I.R.C. section 7609 summons is issued to the bank, the I.R.S. already knows and, therefore, states in the summons, the names and numbers of the accounts subject to the summons. At this point, the taxpayer

10. *Id.* § 7609(b)(2)(A).

11. *Id.* § 7609(b)(2)(B).

12. *Id.* §§ 7210, 7402, 7604. These sections provide federal district courts with the power to compel production of data pursuant to a summons and to issue contempt citations.

13. The provisions of I.R.C. § 7609 are applicable to a summons issued after February 28, 1977.

under investigation would receive a copy of the summons and notice of his right to stay compliance under I.R.C. section 7609. The taxpayer's recognized representative, however, would not in all cases receive a copy of the summons and notice received by the taxpayer.

If the taxpayer and his advisor determine that it is not in the taxpayer's best interest to stay compliance under I.R.C. section 7609, the third-party recordkeeper is required to deliver the documents or records to the I.R.S. as requested under the summons.¹⁴ Due to a desire on the part of the I.R.S. in the southwestern area of Ohio to "help" third-party recordkeepers, the I.R.S. frequently waives the time requirement stated in the summons; the I.R.S. permits the third-party recordkeeper to comply with the summons at a date or dates subsequent to the one stated in the summons. The taxpayer and his advisor receive no notice of the change of date.

IV. PROCEDURAL VIOLATIONS OF THE I.R.C. AND TREASURY REGULATIONS BY THE I.R.S. AND THIRD-PARTY RECORDKEEPERS IN INFORMAL INFORMATION GATHERING PRACTICES

An examination of the informal customs and procedures reveals several possible defects upon which arguments for the exclusion of evidence obtained from third-party recordkeepers can be based. The defects can be summarized as follows: (1) The "preliminary" summons should be issued pursuant to I.R.C. section 7609 with the attendant notice to the taxpayer under investigation; (2) When notice of the summons subsequently issued under I.R.C. section 7609 is sent to the taxpayer under investigation, a copy of such notice should be sent to the taxpayer's recognized representative listed on Form 2848, Power of Attorney; (3) Compliance with a summons issued pursuant to I.R.C. section 7609 should be accomplished at the time stated in the summons.

A. The "Preliminary" Summons Should Have Been Issued Under Code Section 7609.

In issuing a section 7609 summons without giving the taxpayer notice under I.R.C. section 7609, the I.R.S. is apparently relying upon the exception to I.R.C. section 7609(a)(1)¹⁵ contained in I.R.C. section

14. I.R.C. § 7609(a). I.R.C. § 7609 provides for the enforcement of a summons issued pursuant to I.R.C. § 7602(2) for a person having custody, possession, or care of books of account relating to a person allegedly liable for tax. I.R.C. § 7609(c)(1) incorporates the requirements of I.R.C. 7602(2).

15. *Id.* § 7609(a)(1):

If—

(A) any summons described in subsection (c) is served on any person who

7609(a)(4)(B),¹⁶ which concerns ascertainment of the existence of taxpayer records.

The language of section 7609(a)(4)(B) implies that the information allowed under the exception is limited to a "yes" or "no" answer.¹⁷ As can be seen from the language of the "preliminary" summons, far more is requested. Such summons requires: (1) The names of any of the taxpayer's individual accounts; (2) The account numbers of the accounts; and (3) The name and account number of any account in which the taxpayer has an interest with other specified persons.

The Senate Committee Report on this section provides support for a limited interpretation of the above exception.

However, this procedure will not apply in the case of a summons issued solely for purposes of collection. Also, this procedure would not apply in cases where the only information requested by the Service was whether or not the third-party record keeper had records with respect to a particular person (*without any information contained in those records*).

. . . .

However, this exception does not apply where the Service is attempting to obtain information concerning the taxpayer's account for purposes other than collection as, for example, where the Service is attempting to compute the taxpayer's taxable income by use of the 'net worth' method.¹⁸

As can be seen from the language of I.R.C. section 7609 and the language of the Senate Committee Report, the exception to the summons provisions of Code section 7609 provided by I.R.C. section 7609(a)(4)(B) is limited. The exception relates only to a "yes" or "no" answer to the question whether the third-party recordkeeper has records relating to the taxpayer under investigation. Because the language of the "preliminary" summons requests far more than a "yes" or

is a third-party recordkeeper, and

(B) the summons requires the production of any portion of records made or kept of the business transactions or affairs of any person (other than the person summoned) who is identified in the description of the records contained in the summons, then notice of the summons shall be given to any person so identified within 3 days of the day on which such service is made, but not later than the 14th day before the day fixed in the summons as the day upon which such records are to be examined. Such notice shall be accompanied by a copy of the summons which has been served and shall contain directions for staying compliance with the summons under subsection (b)(2).

16. *Id.* § 7609(a)(4)(B). See note 9 *supra*.

17. I.R.C. § 7609(a)(4)(B). See note 9 *supra*.

18. S. REP. NO. 94-938, 94th Cong., 2d Sess. 371-72 (1976) (emphasis added).

“no” answer, the summons containing such language violates I.R.C. section 7609. The statutory exception is inapplicable and the notice provisions of I.R.C. section 7609 are not followed.

B. A Copy of the Notice Under Code Section 7609 That is Mailed to a Taxpayer Should Be Mailed to the Taxpayer's Recognized Representative

Treasury Regulations,¹⁹ the Internal Revenue Manual,²⁰ and the instructions to Form 2848²¹ each require that the I.R.S. send copies of all notices sent to a taxpayer to the taxpayer's recognized representative. The Regulations state: “Notices to be given to recognized representatives; delivery of refund checks to recognized representatives.--(a) *Notices.* Any notice or other written communication (or a copy thereof) required or permitted to be given to a taxpayer in any matter before the Revenue Service shall be given to the taxpayer's recognized representative.”²² The Internal Revenue Manual incorporate the relevant regulation, noting that “26 CFR 601.506(a) provides that any notice or other written communication given to a taxpayer in a matter before the Service shall also be given to the taxpayer's recognized representative.”²³ Additionally, the instructions to Form 2848, concerning the power of attorney, provide that “[c]opies of notices and other written communications will be sent to not more than two representatives provided that they are located at different addresses. In all other cases, copies will be sent to one representative.”²⁴

Based upon the above regulation and instructions, when notice pursuant to I.R.C. section 7609 is mailed to a taxpayer under investigation, a copy of the notice must be mailed to the taxpayer's recognized representative. If a copy is not sent to the taxpayer's recognized representative, the I.R.S. violates not only Treasury Regulations, but also its own manual and form instructions.

C. A Third-party Recordkeeper Cannot Deliver the Information Requested in a Summons at a Time Other Than the Time Stated in the Summons.

I.R.C. section 7609(a)(1)(A), by reference to subsection (c) of I.R.C. section 7609, defines the type of summons to which the notice

19. Treas. Reg. § 601.506(a) (1979).
20. INTERNAL REV. MANUAL ¶ 4055.4.
21. FORM 2848, Power of Attorney.
22. See note 19 *supra*.
23. See note 20 *supra*.
24. See note 21 *supra*.

provisions of I.R.C. section 7609 apply. Subsection (c) reads: "Except as provided in paragraph (2), a summons is described in this subsection if it is issued under paragraph (2) of section 7602 or under section 6420(e)(2), 6421(f)(2), 6424(d)(2), or 6427(e)(2) and requires the production of records."²⁵

Additionally, I.R.C. section 7602 provides that for the purpose of ascertaining the correctness of any return on the liability of any person for internal revenue tax, the Secretary is authorized

[t]o 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 may deem proper, to appear before the Secretary *at a time and place named in the summons* and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry. . . .²⁶

If pursuant to sections 7609(a)(1)(A) and (c)(1) and 7602, the I.R.S. compels production of records at a later time, then the I.R.S. is operating under the questionable authority of a stale subpoena.

V. SUPPRESSION OF EVIDENCE DUE TO VIOLATION OF DUE PROCESS AND RIGHT TO PRIVACY.

The defendant in a criminal tax fraud case may argue for the exclusion of probative evidence gathered by the I.R.S. from third-party recordkeepers who violate the notice and time requirements of I.R.C. section 7609 and the Treasury Regulations. The motion to suppress would be based on a violation of the due process clause and the individual's expectation of privacy in personal records.

A. *Violation of Due Process.*

In 1970, the Court of Appeals for the First Circuit decided *United States v. Leahey*²⁷ in which the I.R.S. failed to follow its own procedure and neglected to warn Alice Leahey that she was being investigated for criminal tax fraud.²⁸ The I.R.S. agents obtained bank statements and books from Leahey. She filed a motion to suppress

25. I.R.C. § 7609(c)(1) (emphasis added). I.R.C. sections 6420, 6421, 6424, and 6427 deal with gasoline used on farms and transit systems, lubricating oil not used in vehicles, and fuel used for nontaxable purposes.

26. I.R.C. § 7602(2) (emphasis added).

27. 434 F.2d 7 (1st Cir. 1970). See also *United States v. Heffner*, 420 F.2d 809 (4th Cir. 1970).

28. 434 F.2d at 8.

relying on the principle that "due process requires government agencies to follow their specified procedures."²⁹

The *Leahey* court recognized that the agency's requirements went beyond the express requirements of the Constitution but, nevertheless, excluded the evidence.³⁰ The exclusion was based on two factors: (1) the general guidelines affect the post-offense conduct of citizens and (2) a public announcement was involved on which many taxpayers and their advisors could reasonably be expected to rely.³¹ Much of the court's decision was based on a policy of protecting the individual citizen. The court quoted Mr. Justice Frankfurter who stated in *McNabb v. United States*³² that, "A democratic society, in which respect for the dignity of all men is central, naturally guards against the misuse of the law enforcement process."³³

In 1979, the Supreme Court addressed the issue whether evidence obtained in violation of I.R.S. regulations could be admitted in the criminal trial of the taxpayer. *United States v. Caceres*³⁴ involved the electronic taping of the defendant's attempted bribery of an I.R.S. agent. The I.R.S. agents who made the tapes did not obtain prior authorization for the taping as required by I.R.S. regulations.³⁵ The defendant Caceres sought to exclude the evidence based on a violation of due process and the fundamental right of privacy.

The Court held that unless a regulation was mandated by the Constitution or federal law, the exclusionary rule would not apply to evidence obtained by violation of such regulation.³⁶ In *Caceres*, the Court stated the relevant I.R.S. regulations were not required by the Constitution.³⁷ The negative implication of the Court's logic is that where a federal statute or the Constitution is violated, the exclusionary rule is applicable. Further, where an I.R.S. regulation is violated and the regulation or compliance with it is mandated by the Constitution or federal statute, violation of the regulation would cause the exclusionary rule to be applicable.

Two of the above described customs and practices, that is, the "preliminary" summons and instructions for compliance with the

29. *Id.*

30. *Id.* at 11. See also U.S. CONST. amend. IV:

The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place to be searched and the persons or things to be seized.

31. 434 F.2d at 11.

32. 318 U.S. 332 (1943).

33. *Id.* at 343, quoted in *United States v. Leahey*, 434 F.2d at 9.

34. 440 U.S. 741 (1979).

35. *Id.* at 743.

36. *Id.* at 752-53.

37. *Id.* at 751-52.

summons subsequent to the date stated in the summons, appear on their face to violate I.R.C. subsections 7609(a)(1)(A) and 7609(a)(4)(B)³⁸ which are federal statutes. Under the logic of *Caceres*, evidence obtained through the use of such methods should be subject to the exclusionary rule.

As to the third informal practice, the failure to comply with the I.R.S. regulation which requires that copies of all notices be sent to the taxpayer's recognized representative, such procedure may constitute a violation of the taxpayer's constitutional due process rights. The *Caceres* court found no due process violation because the individual did not rely on the agency regulation nor had he suffered by violation of them.³⁹ But a taxpayer would be expected to rely on a public regulation that states his authorized representative will be notified. Obviously, the taxpayer does suffer because without notice, the representative cannot undertake action for the benefit of the taxpayer. The *Leahey* court stated that the obligations of the I.R.S. increase when it publicly announces procedures it will follow. "This must be so since inquiry of personal, subjective knowledge of a person affected by a procedural dereliction is no more practicable than in the securities field."⁴⁰

Subsequent to the holding of the court in *Caceres*, the Court of Appeals for the Sixth Circuit, in *United States v. Nuth*,⁴¹ examined the question whether the failure of a revenue agent to give the warnings discussed in *Leahey* resulted in the application of the exclusionary rule. Relying on *Caceres*, the court in *Nuth* held that the exclusionary rule was not applicable. In particular, the court in *Nuth* noted that the defendant did not contend that he was aware of the news release describing the warning procedure and that the defendant failed to contend that he relied upon the failure of the revenue agent to give the warning.⁴² This position forces the taxpayer to have knowledge of I.R.S. procedures prior to any formal legal action, or forfeit the benefits and protections of the procedures. It is an onerous burden for a lesser educated individual or one not represented by legal counsel.

Regardless of whether *Nuth* puts the holding of *Leahey* in ques-

38. I.R.C. §§ 7609(a)(1)(A), (a)(4)(B). See notes 6-18 and accompanying text *supra*.

39. *United States v. Caceres*, 440 U.S. 741, 752-53 (1979).

40. *United States v. Leahey*, 434 F.2d 7, 10-11 (1st Cir. 1970). Thus, although the regulation in question may not be mandated by federal law, compliance with it is mandated by principles of fairness embodied in the due process clause, once the regulation is publicly announced.

41. 605 F.2d 299 (6th Cir. 1979).

42. *Id.* at 233.

tion, the rule of *Nuth* and *Caceres* should cause evidence obtained in situations where a copy of a summons is not given to a taxpayer's representative to be subject to the exclusionary rule. A taxpayer's representative in a criminal tax fraud case is (or should be) aware of the notification requirement. Further, a taxpayer's representative can contend that he relied upon the failure to provide a copy of a summons.⁴³

B. Right to Privacy.

If the taxpayer is not able to have evidence suppressed based on a due process violation, he may allege that the informal customs and practices violate regulations which safeguard the privacy of a citizen. Congressional committee reports indicate that while the administrative summons is a necessary administrative tool for legitimate investigations, "the use of this important investigative tool should not unreasonably infringe on the civil rights of taxpayers, including the right to privacy."⁴⁴

The majority in *Caceres* would not extend the privacy expectation to include matters protected by regulations not constitutionally mandated.⁴⁵ The Court took the view that "rigid application of an exclusionary rule to every regulatory regulation could have a serious deterrent impact on the formulation of additional standards to govern prosecutorial and police procedures."⁴⁶ But Mr. Justice Marshall's dissent noted that the history of the I.R.S. regulation suggested that its purpose was to protect privacy interests.⁴⁷ Therefore, the violation of the regulation would affect substantial individual interests.

The majority in *Caceres* requires that the regulation be mandated by the Constitution or federal law, or that violation of the regulation violate the due process clause, before the exclusionary rule will be applied. This does not create any incentive on the part of the I.R.S. to follow its own rules. As Justice Marshall stated:

Denying an agency the fruits of noncompliance gives credibility to the due process and privacy interests implicated by its conduct.

43. See *United States v. Desert Palace, Inc.*, 79-1 U.S. Tax Cas. 86,670 (D. Nev. 1979), wherein the Internal Revenue Service did not consider *Caesars Palace* to be a third-party recordkeeper within the meaning of I.R.C. section 7609; accordingly, notice under I.R.C. section 7609 was not given to the taxpayer under investigation. Even though the taxpayer received informal, actual notice, the summons was quashed because actual notice was not considered equivalent to a statutory notice.

44. [1980] 9 STAND. FED. TAX REP. (CCH) ¶ 5930C.

45. 440 U.S. at 755.

46. *Id.* at 755-56.

47. *Id.* at 760-62.

Also, and perhaps more significantly, exclusion reaffirms the Judiciary's commitment to those values. Preservation of judicial integrity demands that unlawful intrusions on privacy should 'find no sanction in the judgments of the courts.'⁴⁸

C. *Financial Privacy Act.*

Violations of the I.R.C. may also give rise to a remedy under the Right to Financial Privacy Act of 1978.⁴⁹ In general, the Act creates notice provisions which are similar to the provisions of I.R.C. section 7609 and are applicable to government agencies which seek financial information regarding a person from a financial institution.⁵⁰ If an agency of the United States obtains information from a financial institution in violation of the Act, the agency or the financial institution will be liable to the person for at least \$100, any actual damages sustained, punitive damages if the violation is willful or intentional, and reasonable attorney's fees, as determined by the court.⁵¹ As one might expect, information obtained by the I.R.S. is exempt from the provisions of the Act if a disclosure of financial records is made "in accordance with procedures authorized by the Internal Revenue Code."⁵²

If the above-outlined informal customs and procedures are violations of the I.R.C., then disclosure of financial records by a financial institution which relies on the I.R.C. exception would not be "in accordance with procedures authorized by the Internal Revenue Code."⁵³ Accordingly, it would appear that in the absence of compliance with the Act, or I.R.C. section 7609, the government or the financial institution would be liable for the civil penalties outlined in the Act.⁵⁴

VI. CONCLUSION

There may be certain informal customs and practices that have been adopted by third-party recordkeepers and the I.R.S. which are peculiar to each practitioner's local area. The tax practitioner should not limit the scope of his review of compliance by the I.R.S. with procedural safeguards for a taxpayer under investigation. Instead, informal discussions should be conducted with third-party recordkeepers

48. *Id.* at 769-70 (quoting *Weeks v. United States*, 232 U.S. 383, 392 (1914)). See also *Elkins v. United States*, 364 U.S. 206, 222-23 (1960).

49. 12 U.S.C.A. §§ 3401-3422 (West Supp. 1979).

50. *Id.* §§ 3401-3403.

51. *Id.* § 3417.

52. *Id.* § 3413(c).

53. *Id.*

54. *Id.* § 3417.

throughout the investigative stage of a criminal tax fraud prosecution. Such discussions may disclose informal customs and practices which, depending upon subsequent court decisions, may result in the application of the exclusionary rule. At a minimum, knowledge of informal customs and procedures can enable the practitioner to demand that his client's procedural rights be protected.