Graham v. Commissioner, 82 T. C. 299 (1984)

Improper use of grand jury materials by the IRS in determining tax deficiencies does not invalidate statutory notices of deficiency.

Summary

The U. S. Tax Court held that the use of grand jury materials by the IRS to issue notices of deficiency to Thomas A. Graham, Elizabeth Graham, and Meridian Engineering, Inc. did not invalidate these notices, even if the use was improper under the rules established in later Supreme Court cases. The case involved grand jury materials obtained under court orders issued in 1971 and 1973, before the Supreme Court clarified restrictions on such use. The court reasoned that the notices remained valid, and petitioners' stipulation to the deficiencies if the notices were upheld led to decisions for the respondent. The practical implication is that the Tax Court will not look behind a deficiency notice to examine the legality of evidence used in its preparation.

Facts

In 1971, a federal grand jury began investigating possible criminal violations in Philadelphia, leading to court orders allowing IRS agents access to grand jury materials for both criminal and civil purposes. In 1973, another grand jury issued a subpoena to Meridian Engineering, Inc. , which was complied with. The IRS used these materials to issue notices of deficiency to Thomas A. Graham, Elizabeth Graham, and Meridian Engineering, Inc. for the years 1969-1972, alleging unreported dividend income and disallowed business expenses. The taxpayers argued that the IRS's use of the grand jury materials was improper and sought to invalidate the notices.

Procedural History

The IRS issued deficiency notices in 1980 based on grand jury materials obtained under court orders from 1971 and 1973. The taxpayers petitioned the U. S. Tax Court, arguing that the use of these materials was improper and invalidated the notices. The case was submitted fully stipulated, with the taxpayers agreeing to the deficiencies if the notices were found valid. The Tax Court decided in favor of the Commissioner, holding that improper use of grand jury materials does not invalidate statutory notices of deficiency.

Issue(s)

1. Whether the use of grand jury materials by the IRS to determine tax deficiencies, if improper under subsequent Supreme Court rulings, invalidates the statutory notices of deficiency.

Holding

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1. No, because even if the use of grand jury materials was improper, such use does not render the statutory notices null and void. The Tax Court will not look behind a deficiency notice to examine the evidence used or the propriety of the IRS's conduct in determining the deficiency.

Court's Reasoning

The court assumed, without deciding, that the IRS's use of grand jury materials was improper and that the Supreme Court's rulings in *United States v. Sells Engineering, Inc.* and *United States v. Baggot* applied retroactively. However, the court held that this did not invalidate the notices of deficiency. The Tax Court traditionally does not look behind a deficiency notice to examine the evidence used or the propriety of the IRS's conduct in determining the deficiency, except in cases of unconstitutional conduct or "naked assessments. " The court found that the taxpayers' stipulation to the deficiencies if the notices were upheld meant that the IRS was not required to introduce evidence at trial. The court left the determination of the appropriate remedy for improper use of grand jury materials to another day, but held that invalidation of the statutory notice was not that remedy.

Practical Implications

This decision clarifies that the Tax Court will not invalidate a statutory notice of deficiency based on the IRS's use of grand jury materials, even if such use was improper. Practitioners should be aware that challenging the validity of a deficiency notice on these grounds will not succeed. However, other remedies, such as motions to suppress evidence or shift the burden of proof, may be available in cases where the IRS has used improperly obtained grand jury materials. The decision also highlights the importance of the distinction between the existence of a legal wrong and the appropriate remedy for that wrong. Taxpayers and their counsel should carefully consider the appropriate remedy to pursue in cases involving potentially improper use of grand jury materials.

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