Kluger v. Commissioner, 91 T. C. 969 (1988)

A deficiency notice based on grand jury materials remains valid if the court supervising the grand jury implicitly approves its use, even if the materials were obtained under a pre-Baggot and Sells rule 6(e) order.

Summary

In Kluger v. Commissioner, the IRS used grand jury materials to issue a deficiency notice to Debra Kluger, related to her deceased husband's alleged drug trafficking income. The key issue was whether this notice was valid post-Supreme Court decisions in Baggot and Sells, which tightened the rules on grand jury material disclosure. The Tax Court held that the notice was valid because the court supervising the grand jury had implicitly approved its use. Furthermore, the IRS could use these materials to identify witnesses and documents for trial preparation without disclosing their grand jury origin, provided they could show particularized need for any further disclosure.

Facts

A federal grand jury investigated Henry Kluger's alleged drug trafficking, subpoenaing related documents and testimony. After his death, the IRS obtained these materials under a rule 6(e) order for civil tax assessment. Post-Baggot and Sells decisions, which limited such use, the IRS issued deficiency notices to Debra Kluger for tax years 1977-1980, based solely on the grand jury materials. The Eastern District of New York later modified the rule 6(e) order, requiring particularized need for further disclosure.

Procedural History

The IRS issued a deficiency notice for 1979 before Baggot and Sells, upheld by the Tax Court in Kluger I. Notices for 1977, 1978, and 1980 were issued post-Baggot and Sells. The Eastern District of New York modified the rule 6(e) order in 1986, requiring particularized need for further disclosure. The Second Circuit affirmed this modification. Kluger challenged the validity of the notices for 1977, 1978, and 1980 in the Tax Court.

Issue(s)

1. Whether the deficiency notice issued for tax years 1977, 1978, and 1980 is valid despite being based on grand jury materials obtained under a pre-Baggot and Sells rule 6(e) order.
2. What actions the IRS may take to establish particularized need for grand jury materials in trial preparation.

Holding

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1. Yes, because the Eastern District of New York implicitly approved the use of grand jury materials for the deficiency notice, making it valid.
2. The IRS may review grand jury materials to identify and subpoena witnesses and request documents without disclosing their grand jury origin, but must show particularized need for further disclosure.

Court's Reasoning

The court reasoned that the Eastern District of New York, by not invalidating the deficiency notice upon modifying the rule 6(e) order, had implicitly sanctioned its use. This was crucial as the notice did not reveal the nature of the grand jury's inquiry. For trial preparation, the court, citing United States v. John Doe, Inc. I, allowed the IRS to use grand jury materials internally without new disclosure, emphasizing that no new information should be disclosed to third parties. The court emphasized the need for the IRS to pursue alternative sources and document their efforts to establish particularized need for any disclosure.

Practical Implications

This decision clarifies that deficiency notices based on grand jury materials can remain valid if implicitly approved by the supervising court, even if the materials were obtained under outdated legal standards. Practitioners should note that while the IRS can use grand jury materials for internal review and to identify witnesses, they must diligently pursue alternative sources to justify any further disclosure. The case sets a precedent for balancing the secrecy of grand jury proceedings with the needs of civil tax litigation, affecting how similar cases are approached in the future.

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