T.C. Memo. 1990-179

Deficiency notices based on grand jury materials are not automatically invalid, and government attorneys with prior access to grand jury materials may review them to establish particularized need for disclosure, provided they do not make new disclosures.

Summary

The Tax Court addressed whether a deficiency notice based on grand jury materials was invalid after Supreme Court rulings in *United States v. Baggot* and *United States v. Sells Engineering, Inc.*, and the extent to which government attorneys could use grand jury materials to demonstrate particularized need for disclosure in a civil tax case. The court held the deficiency notice was valid because the District Court implicitly approved its use. It further ruled that government attorneys who had prior access could review grand jury materials to identify witnesses and evidence, as long as they did not make new disclosures of grand jury matters and attempted to obtain information from independent sources first.

Facts

A federal grand jury in the Eastern District of New York investigated Henry Kluger for alleged drug trafficking. In 1983, before the Supreme Court decisions in *Baggot* and *Sells*, the IRS obtained a Rule 6(e) order from the Eastern District of New York authorizing disclosure of grand jury materials for determining Kluger's civil tax liabilities. Based solely on grand jury information obtained under this order, the IRS issued deficiency notices to Debra Kluger, Henry Kluger's widow, for tax years 1977-1980. After *Baggot* and *Sells* limited the permissible disclosure of grand jury materials for civil matters, Kluger's estate challenged the validity of the deficiency notices and the continued use of grand jury materials.

Procedural History

In 1983, the Eastern District of New York issued a Rule 6(e) order permitting disclosure of grand jury materials to the IRS.

Based on these materials, the IRS issued deficiency notices for tax years 1977, 1978, 1979, and 1980.

The Supreme Court decided *United States v. Baggot*, 463 U.S. 476 (1983), and *United States v. Sells Engineering, Inc.*, 463 U.S. 418 (1983), limiting grand jury disclosure for civil tax audits.

In 1986, the Eastern District of New York modified its Rule 6(e) order to prohibit further disclosure of grand jury material without a showing of particularized need, applying *Baggot* and *Sells* prospectively.

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The Second Circuit affirmed the modified order in 1987, *In re Grand Jury Proceedings (Henry Kluger, Deceased)*, 827 F.2d 868 (2d Cir. 1987).

The Tax Court consolidated cases related to the deficiency notices.

Petitioner Debra Kluger moved to dismiss the deficiency notice for tax years 1977, 1978, and 1980, arguing it was invalid because it was based on grand jury information obtained under the original Rule 6(e) order, which did not meet the standards of *Baggot* and *Sells*.

Issue(s)

1. Whether the deficiency notice for taxable years 1977, 1978, and 1980, based on grand jury materials obtained pursuant to a pre-*Baggot* and *Sells* Rule 6(e) order but issued after those decisions, is invalid.

2. What use of grand jury materials, copies, and fruits of such materials may the respondent make in demonstrating particularized need to obtain the right to disclose in trial preparation and at trial.

Holding

1. No. The deficiency notice is valid because the Eastern District of New York implicitly approved the use of grand jury materials for preparing the notice when it modified the Rule 6(e) order without invalidating prior disclosures.

2. Respondent's counsel, who had prior access to grand jury materials, may review them to identify witnesses and evidence to establish particularized need. However, they must not make new disclosures of grand jury matters and should first attempt to obtain information from independent sources before seeking disclosure of grand jury materials.

Court's Reasoning

Validity of Deficiency Notice: The Tax Court reasoned that the Eastern District of New York and the Second Circuit were aware of the deficiency notices when they addressed the Rule 6(e) order. Neither court invalidated the notices or suggested that their issuance was improper, implying tacit approval of the use of grand jury materials for this purpose. The court noted that the primary remedy for improper disclosure of grand jury materials is contempt of court, not invalidation of a deficiency notice. The court concluded that the Eastern District of New York implicitly sanctioned the use of grand jury materials to prepare the deficiency notice.

Particularized Need and Use of Grand Jury Materials: The court relied on *United States v. John Doe, Inc. I*, 481 U.S. 102 (1987), holding that internal review of grand jury materials by government attorneys who already had authorized access

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does not constitute a “disclosure” under Rule 6(e). The modified Rule 6(e) order from the Eastern District of New York prohibited “further disclosure,” but not internal “use.” The court rejected the petitioner’s argument that the “fruits” of grand jury materials were inadmissible under the “fruit of the poisonous tree” doctrine, as the initial Rule 6(e) order was lawful when issued, and thus there was no unlawful governmental conduct to taint the evidence. The court outlined a process for the IRS to establish particularized need, requiring them to first attempt to obtain information from independent sources, such as interviewing witnesses and seeking documents through regular discovery channels, before seeking disclosure of grand jury materials. The court allowed respondent 180 days to conduct discovery following these guidelines to demonstrate particularized need.

Practical Implications

Kluger v. Commissioner clarifies that deficiency notices based on grand jury information are not automatically invalid, even if the initial disclosure of grand jury materials might later be deemed improper under stricter interpretations of Rule 6(e) established in *Baggot* and *Sells*. It emphasizes that the focus of Rule 6(e) is on preventing further disclosure of grand jury matters, not retroactively invalidating actions taken based on previously authorized disclosures.

The case also provides practical guidance on how government attorneys can use grand jury materials internally to build civil tax cases while respecting grand jury secrecy. It confirms that attorneys with prior authorized access can review grand jury materials to identify leads and evidence, but must still demonstrate a particularized need to disclose those materials to others or use them at trial. This requires exhausting other avenues of discovery first and ensuring that any use of grand jury-derived information does not result in new, unauthorized disclosures. The decision balances the need to maintain grand jury secrecy with the government’s ability to enforce tax laws effectively, particularly in cases originating from criminal investigations.

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