

Are Personal Tax Returns Discoverable in California?

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How do you defend against a lost income claim made by a self-employed plaintiff, when the plaintiff keeps little to no business records? This type of plaintiff is usually able to provide testimony about their revenue, but draws a blank when asked to describe related business expenses.

Traditional Approach

The traditional approach to test plaintiff's claim would be to request their business records through written discovery. Unfortunately, some plaintiffs will claim they simply do not keep records. Others will produce records showing revenue, but be unable to find records showing expenses.

The Tax Return Privilege

Under California law, plaintiffs enjoy what is referred to as a "tax return privilege." The various statutes making it a misdemeanor for taxing authorities to disclose confidential tax return information (see e.g. Rev. & Tax.C. §§ 19542, 7056) impliedly creates this privilege. (*Save-On*

Drugs v. Super. Ct. (1975) 15 Cal.3d 1, 6.) Under the "tax return privilege," a California citizen is generally protected from turning over tax returns in the course of litigation. (*Id.*)

Alternative Discovery Methods

Small business owners will often use a CPA, accounting firm, or bookkeeper to keep their books, put together general ledgers, prepare tax returns, or audit their financial statements. The CPA will often keep better records than their clients. The defense can subpoena records from the CPA or bookkeeper (excluding the actual tax returns, of course).

The CPA's client (i.e. plaintiff) is entitled to, and likely will, object to production of his tax returns. Often, however, the plaintiff will not object to production of the underlying documentation for the tax returns. If the plaintiff will not agree to production of underlying financial records via subpoena, your attorney will have to file a motion to compel production.

An informed CPA will often require a "consent to disclosure" statement from the plaintiff before turning over any documents in response to a subpoena. This is because a number of statutes criminalize production of tax-related information absent a court order or consent of the taxpayer. (See e.g. 26 U.S.C.A. §§ 6103, 6713,

7216; Treas. Reg. § 301.7216-1; Cal. Bus. & Prof. Code §§ 5063.3; and see CBA Reg. § 54.1.) Again, if plaintiff will not consent, your attorney will need to file a motion to compel the production via court order.

Exceptions to the Tax Return Privilege

What happens if your plaintiff has no financial documents, does not have a CPA or bookkeeper, and decides to exercise the "taxpayer privilege" to withhold tax returns? Will the court order production under this scenario?

Arguably, by seeking damages for loss of income, personal injury plaintiffs impliedly waive the tax return privilege (at least where they refuse to produce any other substantial evidence of lost income). To date, however, there is no California authority so holding. The only citable personal injury case approaching the point was rooted primarily in the privilege against self-incrimination. In this case, when the client refused to answer a question on whether he had failed to file tax returns, his tendering the issue of lost income was held to have waived the privilege to be free from self-incrimination (but was silent regarding his "tax return privilege"). (*Newson v. City of Oakland* (1974) 37 Cal.App.3d 1050, 1055.) Notably, however, the court in *Newson* only required plaintiff to disclose the fact that

he failed to file tax returns. The court did not require plaintiff to turn over his tax returns.

In *King v. Mobile Home Rent Review* (1989) 216 Cal.App.3d 1532, the Rent Review Board sought a mobile home park owner's tax returns to verify the owner's rent increase application. The Board argued that the public policy in expediting administrative proceedings outweighed the renter's tax return privilege. The court disagreed because the Board failed to provide evidence that the mobile home owner's tax returns were necessary to verify its rent increase application. The court reasoned that because the Board could ascertain financial information via alternative methods, the owner's tax returns were unnecessary. By analogy, one might argue a personal injury defendant is entitled to a plaintiff's tax returns if the plaintiff fails to provide alternative methods to verify his lost income.

Steiny & Co v. California Electric Supply (2000) 79 Cal.App.4th 285 may also potentially provide a basis to obtain tax returns. *Steiny* stems from a general contractor settling an action brought against it by an aircraft company for damages suffered when an electric switchboard exploded in the company's facility. *Steiny* does not involve personal injury, lost income claim, discovery of tax returns, or the tax return privilege. It does, however, involve disputed discovery of financial information potentially

in violation of the trade secret privilege. The trial court excluded evidence of one party's damages because it violated the trade secret privilege. On appeal, the trial court ruled it was proper for a party to stand on their privilege to withhold evidence, but that same party could not then pursue a claim against its adversary while withholding evidence of the claim. (*Id.* at 292-293.) Although *Steiny* does not directly address the tax privilege, one might argue it calls for discovery of tax returns by analogy.

Conclusion

While there is no black letter law confirming waiver of the "taxpayer privilege" in the absence of other documentation of lost income, there is legal authority arguably supporting production of tax returns when a plaintiff fails to produce evidence of his or her income. This is an evolving area of law worth watching for new developments.

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