

TESTIMONY BEFORE THE U. S. SENTENCING COMMISSION

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Good morning. I am Mark Matthews and I am pleased to appear before the Commission today on behalf of the Tax Division. My testimony today will focus on the need for increased severity in the tax table, especially at the lower range of the table, in order to ensure a substantial likelihood of some prison time for more defendants convicted of tax violations. I also will speak about our support for certain proposed changes and clarifications in the "sophisticated means" enhancement in criminal tax cases. The Commission came very close to making such changes last year, and it should not allow another amendment cycle to pass without taking action to promote increased deterrence in criminal tax cases.

One of the primary goals of the Tax Division is to promote the public's voluntary compliance with the federal tax laws through the investigation and prosecution of violations of the federal criminal tax laws. We believe that by prosecuting and punishing those who violate our tax laws, we deter others who might be contemplating similar conduct.

We are faced, however, with the task of deterring more Americans (over 200 million) with fewer prosecutions (approximately 1500) than any other area of law enforcement. By way of contrast, a much smaller percentage of the American public is even remotely likely to consider committing an offense against our narcotics statutes, yet we appropriately bring many more such prosecutions against such violators with much greater sanctions at our disposal. In the tax administration business, our goal is not primarily to punish clearly unlawful conduct, but to influence hundreds of millions of Americans every year to take

the affirmative steps of honestly filling out and filing often complex tax returns and making substantial payments to Uncle Sam.

Our central concern is with those otherwise law-abiding citizens who might be tempted to cheat on their taxes. Almost all Americans are required to file income tax returns. Consequently, large numbers of citizens are presented with an annual opportunity on April 15 to cheat on their taxes. These potential tax violators are our primary concern and the focus of our mission.

By any measure, ours is a difficult mission. One measure of our success is the "tax gap," or the difference between what should be reported as owing and paid to the Government each year on legal source income versus what is actually reported and paid. That figure is currently estimated to be in excess of \$100,000,000,000 (\$100 Billion) per year. The IRS estimates that the compliance rate is approximately 83%.

We cannot afford to let that compliance rate drop any further. As my boss, Assistant Attorney General Loretta C. Argrett of the Tax Division, wrote to Chairman Conaboy last April:

To maximize the deterrent value of criminal tax prosecutions and to reverse or limit the increasing tax gap, we desperately need to enhance the probability of imprisonment in more tax cases.

If taxpayers perceive that they can cheat the system without suffering any serious consequence, they will be less inclined to comply with the law and more willing to take the chance of not reporting and paying all the taxes that they owe. We believe that the prospect of a fine, home detention, or confinement in a halfway house does little to dissuade anyone tempted to cheat on their taxes. The idea, however, that one will spend time in jail if caught and convicted of a tax violation is a powerful disincentive to willfully disobeying the tax laws. As the Commission itself has stated in discussing certain economic crimes, including tax evasion, "the definite prospect of prison, even though the term may be

short, will serve as a significant deterrent, particularly when compared with pre-guidelines practice where probation, not prison, was the norm.” United States Sentencing Commission, Guidelines Manual, Ch.1, Pt. A-Introduction, 4(d), p.s. -- The Guidelines’ Resolution of Major Issues- Probation and Split Sentences.

We believe that, unfortunately, the current Tax Table does not do a good enough job of making the possibility of imprisonment upon conviction for a tax violation enough of a realistic threat for many taxpayers. For example, the Commission’s own statistics, as reflected in its 1996 Annual Report, reveal that for the total universe of federal criminal cases sentenced in Fiscal Year 1996, more than 80% of all guideline sentences included a term of imprisonment and only 11.5% of defendants sentenced received straight probation. In contrast, in tax cases, only 40% of all guideline sentences included a term of imprisonment, while 60% of the convicted defendants received a

sentence including probation and more than 30% received a term of straight probation.

The need for higher offense levels at lower loss amounts is brought into even sharper focus when one considers the number of individual taxpayers who actually face a real risk of imprisonment under the guidelines. Under the current guidelines, because almost 88% of convicted tax defendants receive a reduction for acceptance of responsibility, the certainty of prison time is generally faced only when the loss amount exceeds \$40,000. Below that amount, most tax defendants can fall into Zone B or lower, and, thus, receive a sentence that does not require imprisonment. But the number of taxpayers who could cheat on their taxes to the tune of \$40,000 is minuscule. For tax years 1992 through 1995, somewhere between 95% and 97% of the individual income tax returns filed reported an adjusted gross income of \$100,000 and less. The average tax liability reported for those years in the adjusted gross income range of \$75,000 to \$99,999 was between

\$12,625 and \$12,936. In other words, if those approximately 95% of all individual taxpayers cheated on every dollar of tax liability for three consecutive years, they still would not reach the \$40,000 tax loss level that would guarantee them some prison time under the guidelines. Only by increasing the offense levels at lower dollar amounts can the risk that most taxpayers face the likelihood of prison time become something more than a theoretical possibility.

Among the various tax loss table options, our clear preference is Option 2 of the published version, although the April 1997 staff proposal, to which we agreed last year, is also acceptable. Except between a tax loss of \$1,701 and \$2,000, Option 2 and the April 1997 staff proposal tables would be higher than the existing tax table, thereby increasing the likelihood of prison exposure. Both tables also move tax violators beyond offense level 12 (to offense level 14) more quickly than does the current table (at the \$30,000 tax loss level rather than at the \$40,000 level), thus making it impossible to reach, through an

acceptance of responsibility reduction, Zone B and a sentence that does not require the service of any prison time. Moreover, large losses are punished much more severely under both of these proposals. We prefer Option 2 to the April 1997 staff proposal because of the slightly lower loss amount breakpoints in Option 2 at mid to upper level income ranges.

The Commission also seeks comments on several proposals regarding "sophisticated means," an enhancement that has been a part of the tax guidelines since the inception of the Sentencing Guidelines. We support the Commission's proposal to add a floor of "12" to the enhancement. We also endorse the Commission's proposal to resolve a circuit conflict by clarifying that the sophisticated means enhancement is offense, rather than offender, specific. That the enhancement is offense specific is consistent with the "relevant conduct" provisions of the Guidelines, and enhancements and reductions related to offender characteristics are already covered in the role-in-the offense provisions.

Moreover, one does not have to be the creator of the sophisticated means used to impede discovery of the existence or extent of the offense to benefit from them. The fact that the defendant did not create the sophisticated means but merely utilized them does not make his or her scheme any easier to detect or punish.

We would urge the Commission to include in Appendix C, as reasons for the amendment, language similar to that employed in the synopsis to the proposed amendment to the “sophisticated means” enhancement in tax cases published in the Federal Register. This will make clear that the enhancement applies based on the overall offense conduct for which the defendant is accountable and not the personal conduct of the defendant. In this way, the Commission’s purpose and intent regarding its resolution of the circuit conflict in this area will be plain. In our view, the mere language of the proposed guideline modification is cryptic and needs additional amplification by way of background.

We believe that of the two proposals in this area, Option 1 is far superior. "Sophisticated means" has been a specific offense characteristic in the Chapter 2, Part T guidelines since their inception. A body of law has developed concerning its interpretation, and interested parties (i.e., judges, defense attorneys, defendants, probation officers and prosecutors) have become accustomed to dealing with this definition. Changing the definition of this sophisticated offense characteristic potentially would confuse and complicate sentencing proceedings without any demonstrated benefit flowing from the proposed change.

The proposed change in Option 2 narrows the scope of the sophisticated means enhancement to sophisticated concealment. No claim is made, nor can it be made, that the dramatic changes proposed by Option 2, the "sophisticated concealment" option, are necessary. Moreover, Option 2 dilutes the language of the existing guideline that the enhancement applies where the offense involved the use of foreign bank accounts or foreign transactions, or transactions through corporate

shells or fictitious entities for language that such actions “ordinarily indicate” sophisticated concealment. In our view, absolutely no case has been made for the need to adopt Option 2, much less propose its adoption.

In closing, I would again like to thank the Commission for the opportunity to appear before it and present the case for meaningful deterrence in criminal tax enforcement through enhanced offense levels at virtually all income levels.