

Internal Revenue Service

memorandum

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MAR - 5 1998

date:

to: Assistant Commissioner (Criminal Investigation) CP:CI

from: Assistant Chief Counsel (Criminal Tax) CC:EL:CT

subject: Proposed 1998 Sentencing Guideline Amendments

The purpose of this memorandum is to apprise you of our views on the 1998 proposed amendments to the sentencing guidelines to the extent they relate to offenses involving taxation. As an overview, we wish to point out our perspective when examining sentencing issues relating to federal criminal tax statutes.

Background

On January 6, 1998, the United States Sentencing Commission set forth six proposed amendments which it may submit to Congress no later than May 1, 1998. The proposed amendments appeared in the Federal Register, (Vol. 63, No.3, Part II) and the United States Sentencing Commission's Proposed Guideline Amendments for Public Comment (January 14, 1998). Written public comment should be received no later than March 12, 1998, by Mr. Michael Courlander, Public Information Specialist, at the United States Sentencing Commission, One Columbus Circle, N.E., Suite 2-500 Washington, D.C. 20002-8002. The Commission has scheduled a public hearing on the proposed amendments for March 12, 1998, at the Thurgood Marshall Federal Judiciary Building, One Columbus Circle, N.E., Washington, D.C. An additional hearing focusing primarily on proposed amendments to the theft, fraud and tax guidelines is scheduled for March 5, 1998, at the Parc Fifty-Five Hotel in San Francisco, California, in conjunction with the American Bar Association's 1998 National Institute on White Collar Crime.

Notwithstanding that the Internal Revenue Service's current philosophy of tax administration focuses on taxpayer education and relies on the compliance of the educated taxpayer, it is, nevertheless, important that there is an adequate sentencing mechanism which effectively addresses noncompliance. Although the Service is continually increasing its efforts to foster taxpayer compliance rather than relying solely on after the fact enforcement, some segments of the population will continue to refuse to comply voluntarily. Accordingly, the focused use of enforcement tools and sanctions

against intentional noncompliance remains essential. To this end, substantial but fair sentencing guidelines permit courts to send the message that tax offenses are serious and intentional violators will be punished seriously. With this concept as our matrix, we offer our comments on the following proposed amendments.

Discussion

Proposed Amendment 1 - Fraud, Theft, and Tax Loss Tables (§§2B1.1, 2F1.1, 2T4.1)

Proposed Amendment 1, inter alia, "presents two options for revising the tax loss table to raise penalties for . . . [offenses involving taxation] . . . that have medium to high dollar losses in order to achieve better proportionality with guideline penalties for other offenses of comparable seriousness." Pursuant to Option 1, for tax losses of \$40,000 or less, the offense levels of the proposed tax table would remain the same as the current tax loss table. For losses of more than \$40,000, the proposed increases in offense levels are the same as the increases in offense levels (two level increments) in the proposed theft and fraud loss tables. Option 2, on the other hand, increases the offense levels in increments of two throughout the proposed tax table.

Considering the two tax table options, Option 2 is our preference. Our preference is based on the fact that, in Option 2, lower tax losses result in higher offense levels than in either Option 1 or the existing tax table, which is consistent with the Commission's intention to treat tax violations as serious crimes. For instance, Zone D (mandatory prison)² is reached under Option 2 with a tax loss that exceeds \$30,000 while to reach Zone D under Option 1 and the current tax table requires a tax loss in excess of \$40,000. Option 2 enables courts to more effectively address a significant area

² A sentence falling within Zone D of the Sentencing Table mandates that the minimum term shall be satisfied by a sentence of imprisonment. This would amount to 12 months in jail for an offense level of 13, the first offense level in Zone D.

of noncompliance within the segment of the income spectrum which files the majority of tax returns or fails to file tax returns for any given taxable period.²

As we noted above, the tax table in Option 2 incorporates two level increases as opposed to the one level increments in the first part of Option 1 and the present tax loss table, but we do not find this objectionable. In fact, Option 2's tax table seems to provide a somewhat smoother progression through the loss amounts than Option 1's progression from single to double level increments and the current table's single level increments.

Proposed Amendment 5 - Theft, Fraud and Tax Related Issues

Proposed Amendment 5(C), inter alia, provides for the modification of the existing sophisticated means enhancement in the tax guidelines and the addition of a "floor" offense level of 12. Once again, two options are presented for comment. Option 1 includes minor non-substantive modifications to the existing sophisticated means specific offense characteristic plus the addition of the "floor" offense level of 12. Option 2, on the other hand, changes the specific offense characteristic from sophisticated means to sophisticated concealment, thus conforming to the proposed language for the fraud and theft guidelines, and also includes the "floor" offense level of 12.

It is our opinion that the important aspect of this proposed amendment is twofold. First, there is the "floor" offense level of 12 which is contained in both options. An offense level of 12 places the offender in Zone C of the Sentencing Table with range of 10 - 16 months imprisonment.³

² According to the SOI Bulletin (Fall 1997), for 1995, the average tax on returns in the adjusted gross income range of \$75,000 to \$100,000 was \$12,625. Returns with adjusted gross income of less than \$100,000 accounted for approximately 96 percent of all returns filed for 1995. As an unfortunate consequence, under either option the vast majority of taxpayers, even if they are completely noncompliant, would not face mandatory prison.

³ Zone C of the Sentencing Table provides for a sentence of imprisonment or a sentence of imprisonment that includes a term of supervised release with a condition that substitutes community confinement or home detention provided that at least one-half of the minimum term is satisfied by imprisonment. For offense level 12, one-half of the minimum term would be five months.

It is also noted that it currently takes a tax loss or more than \$23,500 to reach level 12. Pursuant to Option 2, level 12 would be reached with a tax loss of more than \$12,500. Second, the difference between retaining the specific offense characteristic of "sophisticated means" (Option 1) as opposed to replacing it with "sophisticated concealment" (Option 2) is that the language in the latter specifically pertains to overall offense conduct as opposed to offender conduct,⁴ thus, favorably resolving a conflict between the circuits. See, United States v. Lewis, 93 F.3d 1075 (2d Cir. 1996); United States v. Richman, 93 F.3d 1085 (2d Cir. 1996); and, United States v. Kraig, 99 F.3d 1361 (6th Cir. 1996).

Based on the foregoing, we endorse the "floor" offense level of 12 contained in both Options and the concept set forth in Option 2 which makes clear that the enhancement is offense specific rather than offender specific. However, we believe that it is unnecessary to change the enhancement from "sophisticated means" to "sophisticated concealment." "Sophisticated means" has been a specific offense characteristic in Part T of Chapter 2 of the Guidelines since their inception. Judges, defense attorneys, probation officers and prosecutors have become familiar with the term "sophisticated means" and the body of law concerning its interpretation. Changing "sophisticated means" to "sophisticated concealment" seems unnecessary and destined to cause confusion and needless litigation over whether there is a definitional difference between the two terms. We believe it is in the best interests of all concerned to retain the "sophisticated means" specific offense characteristic and supplement the commentary thereto with language that clearly establishes that "sophisticated means" is offense specific rather than offender specific.

Proposed Amendment 4 - Definition of Loss (§§2B1.1 and 2F1.1)

Proposed Amendment 4, inter alia, addresses competing proposals for redefining "loss" in regard to fraud and theft offenses. There is no mention of this proposed amendment relating to offenses involving taxation but, not withstanding that disclaimer, we mention it because of the concept which is present in the taxation guidelines. Both of the options in Proposed Amendment 4 define loss as the greater of the actual or intended loss. Specifically, actual loss is defined to include reasonably foreseeable harm resulting from a defendant's relevant conduct. Intended loss is defined as harm

⁴ Sophisticated concealment means complex or intricate offense conduct that is designed to prevent the discovery of the offense or its extent.

intended to be caused by the defendant and other persons for whose conduct the defendant is accountable under the relevant conduct provision.

By contrast, for the purpose of defining tax loss, §2T1.1(c)(1) provides that the tax loss in regard to tax evasion or filing a false return, statement or other document "is the total amount of loss that was the object of the offense (i.e., the loss that would have resulted had the offense been successfully completed)." Section 2T1.1(c)(2) provides that the tax loss in regard to a failure to file violation is "the amount of tax that the taxpayer owed and did not pay." Section 2T1.1(c)(3) provides, in regard to wilful failure to pay violations, "the tax loss is the amount of tax that the taxpayer owed and did not pay" and in regard to false claims for refund violations §2T1.1(c)(3) provides that "the tax loss is the amount of the claimed refund to which the claimant was not entitled." And, §2T1.1(c)(5) provides that "the tax loss is not reduced by any payment of the tax subsequent to the commission of the offense." Although these provisions, in conjunction with existing case law, results in the greater of the intended or actual tax loss being used for determining the offense level in the tax tables, §§2T1.1, 2T1.4, 2T1.6, 2T1.7 and 2T1.9 would benefit from the inclusion of similar language as used in Proposed Amendment 4, Option 1, §2F1.1 Application Note 7.⁵ In addition, this would avoid confusion as to whether the concept of loss being the greater of the actual or intended loss was applicable to the tax guidelines.

Related to Proposed Amendment 4 is also Issue for Comment (G) which is, in essence, how to deal with an intended loss pursuant to §2F1.1. The concept of this issue seems to provide the framework for Option 2 of Proposed Amendment 4. More broadly stated, the issue becomes whether the current rule should be changed to provide that a loss should be based primarily on the actual loss, with the intended loss available only as a possible ground for departure or whether, if the substance of the current rule is retained, the magnitude of the intended loss should be limited by the amount that a defendant realistically could succeed in obtaining. In other words, whether the intended loss should be limited by concepts of "economic reality" or "impossibility." We believe that the current rule should be retained with no modification for the amount that the defendant realistically could have succeeded in obtaining.

⁵ Loss is the greater of the actual or the intended loss.

Basing loss on actual loss has the potential to reward defendants for factors beyond their control. For instance, a defendant who intended a large loss but who was discovered before he/she could consummate the offense would be treated less seriously than a defendant who was not discovered until after the offense was completed. Sentencing a defendant based on the intended loss still permits courts to take into account the value of pledged collateral in cases involving fraudulently obtained loans and actual performance in cases involving falsification to obtain contracts.

In addition, basing a determination of loss on the economic reality of a defendant's scheme would require courts to make speculative judgments and quite probably would lead to similarly situated defendants being treated differently. Regardless, change is unnecessary considering the fact that the concept of current Application Note 10 to §2F1.1 which provides that, "[i]n a few instances, the loss determined . . . may overstate the seriousness of the offense . . . [and] in such case, a downward departure may be warranted" would be incorporated in Proposed Amendment 4, Application Note 7. Specifically, Proposed Amendment 4, Application Note 7 provides that "[t]here may be cases in which the loss substantially understates or overstates the seriousness of the offense or the culpability of the defendant. In such cases, a departure may be warranted." We believe that this is adequate to address the issue without encumbering the courts with restrictive definitions and special rules.

Conclusion

We recommend that the Assistant Commissioner (Criminal Investigation) submit written comments to the United States Sentencing Commission which support Option 2 of Proposed Amendment 1 and the "floor" offense level of 12 and offense specific aspects of Proposed Amendment 5. In addition, opposition should be voiced in regard to basing the determination of any loss primarily on the actual loss and limiting intended loss by concepts of economic reality or impossibility.



BARRY J. FINKELSTEIN