



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER

March 12, 2001

The Honorable Diana E. Murphy
Chair, U.S. Sentencing Commission
One Columbus Circle, N.E.
Suite 2-500
South Lobby
Washington, D.C. 20002-8002

Dear Madam Chairman:

I am writing to express my deep concern about proposed amendments to the United States Sentencing Guidelines. In my view and that of the officials in the IRS responsible for enforcing the criminal tax laws, adoption of amendments that lessen the likelihood that convicted tax offenders will be incarcerated will undermine our efforts to promote and achieve voluntary compliance with the tax laws. The criminal tax laws play a crucial role in deterring unlawful tax evaders and assuring the honest taxpayers that those who willfully and deliberately evade paying their fair share face very serious criminal sanctions. Unless the punishment meted out to those found guilty of violating those laws adequately reflects the gravity of criminal tax offenses, this vital message will be lost.

The proposed amendments, particularly both options proposed in amendment 14, communicate to the American public that no matter how much you cheat on your taxes, you will not go to jail. These amendments clearly indicate that tax crimes are "less serious economic crimes." If adopted, these amendments will undermine our efforts to enforce the tax laws.

There could not be a more dangerous time for the United States Sentencing Commission to devalue tax law enforcement. The most recent estimate of the tax gap is \$195 billion dollars; this gap represents a hidden surcharge of \$1,625 with respect to each return filed. The Sentencing Commission has, from its inception, recognized the special deterrence issues associated with tax crimes: the need to encourage over 200 million taxpayers to comply voluntarily with their affirmative tax obligations by seeking meaningful punishment for willful evasion. The Commission further recognized that priority by enhancing the tax loss table in 1993 (see, U.S.S.G. Appendix C, amendment 491 (2000)).

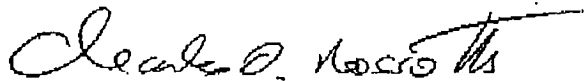
The current proposal to expand Zones B and C of the sentencing table or to characterize certain tax crimes as "less serious economic crimes" is wholly at odds with those prior messages. According to your most recent data, almost 70 percent of convicted tax

offenders are sentenced within the currently configured Zones A, B, and C of the sentencing table. (See, *Sourcebook of Federal Sentencing Statistics*, Table 12, 1999.)

By reducing Zone D by 4 levels, the number of convicted tax offenders who may be sentenced to serve less than at least the minimum term in prison will increase dramatically. The tax loss required for such a sentence of imprisonment will rise more than eight-fold (from \$40,000 to \$325,000), requiring evasion of taxes on approximately \$1.1 million in income. This result is unconscionable given our current compliance predicament.

I have enclosed "Internal Revenue Service Comments On: 2001 Proposed Amendments to Federal Sentencing Guidelines," that sets forth our views on pending proposed amendments that will affect tax administration. I sincerely hope that you will consider the potentially devastating effect adoption of some of the proposed amendments will have on our tax compliance effort. I also ask that you consider the testimony of my Chief, Criminal Investigation, Mark E. Matthews, during your hearings on March 19 and 20, 2001.

Sincerely,



Charles O. Rossotti

Enclosure

**Internal Revenue Service Comments On:
2001 Proposed Amendments to Federal Sentencing Guidelines**

As the Sentencing Commission itself has recognized:

The criminal tax laws are designed to protect the public interest in preserving the integrity of the nation's tax system. Criminal tax prosecutions serve to punish the violator and promote respect for the tax laws. Because of the limited number of criminal tax prosecutions relative to the estimated incidence of such violations, deterring others from violating the tax laws is a primary consideration underlying these guidelines.¹

**Proposed Amendment Twelve: Economic Crime Package
Part B: Loss Tables for Consolidated Guideline and § 2T4.1 (Tax Table)**

The amendment proposes three options for a consolidated loss table² and two options for a new Tax Table. Our discussion is limited to the proposed Tax Table options.

There are two options proposed to replace the current Tax Table, § 2T4.1. See Attachment One. Each option attempts to compress the current Tax Table by moving from one level to two level increments, thus increasing the range of losses that correspond to an individual increment. We support the Option One Tax Table. Option One provides a base offense level of six for tax loss amounts equal to or less than \$2,000. The offense levels increase by two levels thereafter, depending on the tax loss amount. For example, a tax loss amount greater than \$2,000 but less than \$5,000 would receive an offense level of eight. The highest offense level for the Option One Tax Table is thirty-two, corresponding to tax loss amounts of more than \$100,000,000. Option One is an appropriate reflection of the seriousness of tax offenses³, provides a lower base offense level loss amount (\$2,000 or less) and achieves the current

¹ U.S.S.G. § 2T1.1, intro. commentary.

² The consolidated loss table is consistent with Amendment Twelve Part A, which consolidates the offenses of theft, property destruction and fraud offenses under one guideline.

³ The Guidelines state that "[t]ax offenses, in and of themselves, are serious offenses." U.S.S.G. § 2T1.1, commentary.

mandatory imprisonment offense level of thirteen at a lower loss amount (more than \$30,000) than Option Two.⁴

In addition, we note that while the proposed amendment is silent on this issue, there is language in the synopsis of Amendment Twelve, Part B, which discusses using one loss table for theft, property destruction, fraud and tax crimes.⁵ We strongly object to this proposal because it is wholly at odds with long-standing policies that treat tax crimes as serious crimes, warranting higher penalties than theft, property destruction, and fraud crimes.

Part F: Computing Tax Loss

A. Computation

This amendment resolves the circuit conflict regarding the method of calculating aggregate tax loss in accord with the decisions of the Second and Seventh Circuits⁶ and rejecting the contrary conclusion reached by the Sixth Circuit. Adoption of this amendment would confer an unfair sentencing advantage to the convicted tax criminal because the totality of the criminal conduct is not adequately counted. The amendment proposes to calculate tax loss as though an offender who failed to report diverted corporate funds on both the corporate return and his or her own individual return had obeyed the law and filed appropriate returns upon which he reported the income properly, even though he did not. The Seventh Circuit reasoned that the corporate tax should be deducted from the diverted monies before the individual tax was calculated,

⁴ Option Two Tax Table starts with a loss amount of \$5,000 or less and achieves the current mandatory imprisonment offense level of thirteen at a loss amount of more than \$70,000. Option Two also provides a base offense level of six, but establishes the base level at a tax loss amount of \$5,000. The offense levels increase by two levels thereafter, with tax loss amounts greater than \$5,000 but less than \$10,000 establishing an offense level of eight. The highest offense level for Option Two is also thirty-two, corresponding to tax loss amounts of more than \$100,000,000. 66 Fed. Reg. 7992 (Jan. 26, 2001).

⁵ The synopsis of this amendment provides: "If a decision is made to use the same table, the effect would be to sentence the offenses under both guidelines in a similar manner. This would represent a change from the current relationship in which tax offenses generally face slightly higher offense levels for a given loss amount than fraud and theft offenses." 66 Fed. Reg. 7992 (Jan. 26, 2001).

⁶ United States v. Martinez-Rios, 142 F.3d 662 (2d Cir. 1998); United States v. Harvey, 996 F.2d 919 (7th Cir. 1993).

because to do otherwise would overstate the loss to the government.⁷ However, that analysis gives the defendant the benefit of an assumption that defies the reality of the evasion scheme.

U.S.S.G. § 2T1.1(c)(1) provides that "... tax loss 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)."⁸ § 2T1.1 also states that "[i]n determining the total tax loss attributable to the offense, all conduct violating the tax laws should be considered as part of the same course of conduct..."⁹ Two separate crimes are committed when an offender executes a scheme to evade taxes or files false returns that affect two taxpayers: one crime arises from the individual income tax being defeated and the second crime arises from the evasion of tax by the corporation. Therefore, since the crimes are separate, the tax losses should be calculated separately and then added together to achieve the aggregate loss to the government.

Evading one's individual tax and evading corporate tax are separate violations, and the total tax loss should not be calculated as if only one offense was committed. In our view, the Sixth Circuit properly concluded in United States v. Cseplo, 42 F.3d 360 (6th Cir. 1994), that – "Mr. Cseplo had the opportunity and ability to limit the criminal consequences to one or other of the returns...[B]y choosing to falsify both returns, Cseplo made the deliberate decision to produce separate harm to the government with respect to both tax liabilities."¹⁰ Even the Court in Harvey noted that "the Sentencing Commission wants the judge to consider the entire tax loss produced by the defendant's criminal conduct. If one person causes two taxpayers to understate their incomes, both underpayments count."¹¹ The Sixth Circuit's methodology results in a higher aggregate tax loss which is the more accurate reflection of the criminal behavior.

The Statutory Mission of the Sentencing Reform Act of 1984 is to provide "for the development of guidelines that will further the basic purposes of criminal punishment: deterrence, incapacitation, just punishment, and rehabilitation."¹² In order to accomplish that mission the tax guideline uses tax loss to determine the seriousness of

⁷ Harvey, at 921.

⁸ U.S.S.G. § 2T1.1(c)(1).

⁹ Id., at application note 2.

¹⁰ Cseplo, at 364-365.

¹¹ Harvey, at 921.

¹² U.S.S.G. Ch.1, Pt. A.2.

the offense and appropriate punishment, not to determine what the loss to the government would actually have been if the taxpayer had properly filed. See U.S.S.G. § 2T1.1, commentary. Moreover, the tax guideline provides that if the court is unable to calculate the exact tax loss, it should use "any method of determining the tax loss that appears appropriate to reasonably calculate the loss that would have resulted had the offense been successfully completed."¹³ Clearly, the Guidelines prioritize determining an appropriate offense level to reflect the criminal behavior of the tax offender over determining the actual loss to the government.

B. Definition of Tax Loss

We also oppose adoption of an amendment that would except state and local tax loss from consideration. In our view, basing the sentence exclusively upon federal tax losses does not adequately take all relevant conduct into consideration. Currently, the Guidelines do not limit the computation of tax loss to federal tax loss, nor do the Guidelines limit relevant conduct to federal offenses. Where federal tax and state tax violations have occurred in the same years and for the same type of tax, the state and local tax loss is relevant conduct and therefore should properly be included in computing the base offense level. See United States v. Powell, 124 F.3d 655 (5th Cir. 1997)(the text of the Guidelines permit consideration of state taxes evaded if they constitute relevant conduct), *cert. denied*, 522 U.S. 1130, 140 L. Ed. 2d 139, 118 S. Ct. 1082 (1998); United States v. Fitzgerald, 232 F.3d 315 (2nd Cir. 2000)(state and city tax losses included as relevant conduct to determine base offense level).

On the other hand, and for the same reasons outlined above, we support the amendment that would include interest and penalties in the definition of tax loss for evasion of payment tax cases, because it accurately reflects the total harm to the government in an evasion of payment case. See United States v. Pollen, 978 F.2d 78, at 91, n.29 (3d Cir. 1992)("while such a limitation [not to include interest or penalties in calculating tax loss] may be appropriate in an evasion of assessment case, it is not always so when imposing sentence for tax evasion committed through evasion of payment." *Id.*).

C. Grouping

We also oppose adoption of the amendment that mandates grouping tax offenses with other crimes committed in connection with the tax crimes. The amendment in its current form eliminates any incentive to charge a tax crime separately from the crime from which the income for the tax crime was derived, and we oppose it. Although

¹³ U.S.S.G. § 2T1.1, application note 1.

clarification is necessary on this issue because of the circuit conflict, this proposed amendment reaches the wrong conclusion.¹⁴

The purpose of grouping is to limit double counting while at the same time provide incremental punishment for significant additional criminal conduct.¹⁵ The proposed amendment requires that tax counts be grouped with counts relating to the source of funds that were the subject of the tax crimes. This resolves the circuit conflict in favor of the defendant, because it effectively eliminates the separate tax crime conduct and harm, and only holds the defendant responsible for the underlying criminal conduct from which income was derived. In Vitale, for example, the court did not group the tax evasion count and the wire fraud count, because if the counts were grouped, the offense level would be determined by the higher offense level applicable to the wire fraud count and would result in the tax conviction having no effect on the sentencing.¹⁶ A tax crime is significant additional criminal conduct which would be completely ignored under the proposed amendment.

D. Sophisticated Concealment

We support the amendment that would apply "sophisticated means" to the tax guideline to conform with the fraud guideline. This amendment would provide clarity and consistency in application. As recently as two years ago, § 2T1.1 had a "sophisticated means" enhancement which was changed to "sophisticated concealment." We have previously advocated the need for clarification to ensure consistent application of the two terms.

¹⁴ For case law reflecting the circuit conflict on this issue, compare United States v. Vitale, 159 F.3d 810 (3d Cir. 1998) (grouping separate wire fraud and tax evasion convictions was improper; the two counts were not so closely related that such grouping was required under the Sentencing Guidelines); United States v. Haltom, 113 F.3d 43 (5th Cir. 1997) (separate mail fraud and tax evasion convictions should have been grouped for sentencing purposes, as the offenses could be said to have caused substantially the same harm as required under the Guidelines). See also United States v. Astorri, 923 F.2d 1052 (3d Cir. 1991); United States v. Morris, 229 F.3d 1145 (4th Cir. 2000) (Table); United States v. McCormick, No. 98 CR 416, 1998 U.S. Dist. LEXIS 18010 (S.D.N.Y. Nov. 16, 1998).

¹⁵ U.S.S.G. Ch. 3, Part D, Intro. Commentary, P 2).

¹⁶ United States v. Vitale, 159 F.3d at 813-16.

Proposed Amendment Fourteen: Sentencing Table Amendment and Alternative to Sentencing Table Amendment

For reasons set forth in the transmittal letter, we strongly oppose adoption of either alternative detailed in proposed amendment fourteen. They each operate to undermine the goals served by criminal tax enforcement and should not be adopted.

A. Option One

Option One expands Zones B and C of the sentencing tables, increasing the offense level at which Zone D starts to seventeen in Criminal History Category I. Currently, imprisonment for at least the minimum term¹⁷ would be required at offense level thirteen for a Criminal History Category I offender. If adopted, such imprisonment would not be required until an offense level of seventeen is established.

Under the current Sentencing and Tax Tables, a Criminal History Category I tax offender would face imprisonment for at least the minimum term in Zone D if his or her conduct resulted in a tax loss of greater than \$40,000 -- a tax loss that would result from evasion of tax on taxable income of approximately \$142,857.¹⁸ Under the new proposed Sentencing Table, a convicted tax criminal would not face such imprisonment unless his or her conduct resulted in a tax loss greater than \$325,000 -- a tax loss that would only result if the offender evaded taxation on approximately \$1.16 million in income.

In other words, Option A of amendment fourteen would **raise by eight-fold the amount of the tax loss (and the amounts of income involved the criminal scheme) that would support mandatory imprisonment for at least the minimum term.** Adoption of this amendment would dramatically reduce the number of tax criminals who would face such a term of imprisonment for their offenses and would seriously undermine the deterrent effect of the criminal tax laws.

¹⁷ By illustration, currently a level 13 offender must be imprisoned for at least 12 months. Any additional sentence can be served through the varying alternatives set forth in U.S.S.G. § 5C1.1.

¹⁸ We addressed a proposal to change the Tax Table (effectively changing the offense levels and relative loss amounts) in 1999 and noted then that, according to the Statistics Of Income Bulletin (Summer 1998) approximately four percent of all returns filed had an adjusted gross income of greater than \$100,000. Thus, according to 1996 filing data, only four percent of Americans risk mandatory jail time for evading taxes under the current sentencing table. Under the proposed change (amendment 14 option one) that number would drop to less than one percent.

B. Option Two

The second option set forth in amendment fourteen would categorize a substantial number of tax crimes as "less serious economic crimes."¹⁹ If a tax offender is not violent, does not use a firearm at the time of the tax offense, does not merit enhancements under 2T1.1 and 2T1.4, has no prior criminal history, and volunteers to make restitution, then the offense level will be reduced by two. Although the specific offense adjustments in 2T1.1 and 2T1.4 will operate to exclude some tax offenders from this adjustment, the fact that a first time tax offender stands a good chance of being characterized by the guidelines as a "less serious economic offender" directly contradicts the Sentencing Commission's philosophy that tax offenses are serious offenses.²⁰ In addition, the application of the adjustment also defeats any offense level increases in the proposed Tax Tables.

Proposed Amendment Twenty: Money Laundering

Proposed Amendment Twenty would enhance the guidelines for violations of 18 U.S.C. § 1956(a)(1)(A)(ii) by one or two levels. This subsection of the Money Laundering laws concerns conducting financial transactions with proceeds of specified unlawful activity "with the intent to engage in conduct constituting a violation of section 7201 (tax evasion) or 7206 (filing false return) of the Internal Revenue Code of 1986."²¹ We support this proposed Amendment.

All money laundering offenses are serious, and the guidelines treat them as such. Unlike the other types of money laundering addressed in Section 1956, the conduct proscribed in (A)(ii) is directed at violations of laws which are not necessarily related to the specified unlawful activity. By contrast, (A)(i) is directed at promoting the very specified unlawful activity that gave rise to the proceeds; (B)(i) is directed at concealment which is not necessarily separate criminal conduct; and, (B)(ii) is similarly directed at avoiding (as contrasted from evading) transaction reporting violations, which would also not necessarily constitute separate criminal conduct. Treating (A)(ii) more seriously would be consistent with its unique character.

Moreover, as discussed above, the Internal Revenue Service is attempting to address a

¹⁹ The Chapter Five, Part A would be titled "§ 5A1.2 Adjustment for Certain Less Serious Economic Crimes." 66 Fed. Reg. 8005 (Jan. 26, 2001).

²⁰ U.S.S.G. § 2T1.1, commentary, background.

²¹ 66 Fed. Reg. 8013 (Jan. 26, 2001).

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burgeoning tax gap currently estimated at \$195 billion. Increasing the sentencing level for this part of the money laundering crimes will assist the Service in combating the tax gap by reinforcing the message that tax crimes are serious.

Attachment