

CIVIL AND CRIMINAL TAX PENALTIES  
**IMPORTANT DEVELOPMENTS - CRIMINAL**

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ABA SECTION OF TAXATION

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Presented by:

Caroline D. Ciruolo  
Sub-Committee Chair on  
Important Criminal Tax Developments

Rosenberg | Martin | Greenberg, LLP  
25 South Charles Street, Suite 2115  
Baltimore, Maryland 21201  
Phone: (410) 547-7852  
Facsimile: (410) 727-1115  
Email: [cciraolo@rosenbergmartin.com](mailto:cciraolo@rosenbergmartin.com)

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## THE *STEIN* (KPMG) CASE

***Stein* (KPMG)** ([www.usdoj.gov/usao/nys/pressrelease2005](http://www.usdoj.gov/usao/nys/pressrelease2005))  
*United States v. Jeffrey Stein, et al.*, 05 CRIM. 888 (S.D.N.Y.)

### ***Background***

On October 17, 2005, the government filed a 46-count superseding indictment in *United States v. Jeffrey Stein, et al.*, adding 10 additional defendants to what is billed as “the largest criminal tax case ever filed.” Press Release (October 17, 2005), United States Attorney, Southern District of New York. The 19 defendants include the former Deputy Chairman of KPMG, several former heads of KPMG’s Tax Practice, the former CFO of KPMG, the former head of KPMG’s Department of Professional Practice, a former KPMG Associate General Counsel, a former tax partner of a prominent national law firm, and numerous other KPMG tax partners. Count One charges all defendants with conspiracy to defraud (18 U.S.C. § 371) for allegedly devising, marketing, and implementing fraudulent tax shelter schemes, which generated at least \$11.2 billion in phony tax losses. Counts Two through Forty charge all defendants with tax evasion (26 U.S.C. § 7201) based on their own tax returns and those of tax shelter clients. In Counts Forty-one through Forty-four, certain defendants are charged with evasion based on payments made in exchange for opinion letters provided to shelter investors. Counts Forty-five and Forty-six charge certain defendants with obstructing the investigations into the shelters (26 U.S.C. § 7212). KPMG is not a defendant in the *Stein* indictment, having executed a deferred prosecution agreement. [www.usdoj.gov/usao/nys/pressrelease2005](http://www.usdoj.gov/usao/nys/pressrelease2005).

As noted, in furtherance of this tax shelter fraud, the defendants allegedly issued opinion letters containing false representations that the tax shelter losses would “more likely than not” survive IRS challenge, as well as other false documentation regarding the tax shelter transactions. The superseding indictment alleges that the defendants fraudulently concealed the tax shelters from the Service by failing to register the tax shelters and by preparing tax returns that fraudulently concealed phony losses. The government contends that the defendants obstructed the IRS and United States Senate investigations into their tax shelter scheme by: (1) attempting to conceal documents and information with sham attorney-client privilege claims; (2) failing to turn over requested documents; and (3) falsely testifying before both the IRS and Senate.

In *United States v. Stein, et al.*, 435 F. Supp. 2d 330 (S.D.N.Y. 2006) (June 26, 2006), Judge Lewis Kaplan ruled that the government unconstitutionally pressured KPMG not to pay legal fees for the defendants. “Those who commit crimes – regardless of whether they wear white or blue collars – must be brought to justice. The government, however, has let its zeal get in the way of its judgment. It has violated the Constitution it is sworn to defend.” *Id.* at 336. Judge Kaplan noted that while the government did not literally request or direct that KPMG do anything with respect to the legal fees, it was clear that “KPMG refused to pay because the government held the proverbial gun to its head.” *Id.*

In the earlier stages of the investigation, and in an attempt to demonstrate cooperation and avoid prosecution, KPMG put significant pressure on its employees, using legal fees as

leverage. According to a form letter KPMG sent to counsel for its employees and to the government, the firm authorized \$400,000 in fees for employees willing to cooperate. If an employee failed to cooperate or was charged with a crime, KPMG would pay nothing. Judge Kaplan also pointed to the Memorandum from then-Deputy Attorney General Larry D. Thompson to Heads of Department Components and United States Attorneys, entitled: Principles of Federal Prosecution of Business Organizations (Jan. 20, 2003), which advised prosecutors to grant more lenient treatment to firms under criminal investigation if they stop paying legal fees on behalf of potentially culpable employees.

Judge Kaplan stopped short of dismissing the charges or ordering the government to pay the legal fees, which would literally require an act of Congress, but said the defendants could proceed against KPMG in an ancillary civil action, over which he would preside and move expeditiously. He suggested that KPMG pay the fees to avoid “more unpalatable relief” being granted to the defendants.

In *United States v. Stein, et al.*, 252 F. Supp. 2d 230 (S.D.N.Y. 2006) (September 6, 2006), the criminal defendants filed suit against KPMG seeking advancement of legal defense costs, and KPMG filed a motion to dismiss for lack of subject matter jurisdiction and on the merits. In particular, KPMG argued that the defendants are obliged, by the terms of their employment contracts, to arbitrate these claims. KPMG further argued that the claims by some of the defendants were foreclosed by the partnership agreement or released.

Judge Kaplan held that the district court had ancillary jurisdiction over the advancement claim. He further held that, assuming the existence of a valid arbitration agreement regarding the claim, the enforcement of any such agreement would violate public policy by compromising the court’s ability to ensure a speedy trial, protect the public interest by avoiding possible dismissal of the criminal charges, safeguard the defendants’ rights to a fundamentally fair trial, and seek to avoid imposing defense costs on the taxpayers if any of the defendants are required to seek appointed counsel. Finally, Judge Kaplan held that the allegations stated a claim for contract implied in fact and, with the possible exception of one defendant whose claim may be subject to dismissal on summary judgment, the claims would proceed to trial. KPMG appealed the ruling.

On January 8, 2007, by invitation from the Second Circuit pursuant to Federal Rule of Appellate Procedure 21(b)(4), Judge Kaplan filed a 47-page brief urging the court to treat KPMG’s appeal as a petition for writ of mandamus. Judge Kaplan argued that the petition should be denied, as there was “little likelihood that the issue” would recur, and described the entire case as “the perfect storm.” Kaplan further argued that even if the Second Circuit considered the merits of the petition, his exercise of ancillary jurisdiction should be upheld pursuant to *Garcia v. Teitler*, 443 F.3d 202 (2d Cir. 2006), and the three-part test set forth in *Kokkonen v. Guardian Life Insurance Co.*, 511 U.S. 375 (1994).

## **Recent Developments**

*United States v. Stein, et al.*, 473 F. Supp. 2d 597 (S.D.N.Y. 2007) (February 9, 2007) – Defendants filed motion for disclosure of internal IRS documents, stemming in part from an email sent by an IRS attorney to his supervisors on May 17, 2004. The email summarized a

recent meeting, the purpose of which was to discuss “any hazards that the prosecution team may face in addressing the tax shelter registration requirements.” 473 F. Supp. 2d at 599. During the meeting, IRS representatives presented a power point presentation on tax shelter registration requirements and a draft Technical Advice Memorandum (“TAM”) on registration of the BLIPS. Defense counsel argued that the email proves that even the IRS was unsure whether registration of BLIPS was required, and that the prosecution may have stopped the IRS from finalizing the TAM for fear that the finding – that registration was not required – would undermine the government’s case. The defense argued that any documents related to the meeting and the TAM, as well as communications between the prosecution team and the IRS (other than the CID agents on the prosecution team) should be produced. Prior to the court’s ruling on the motion to compel, the government produced the draft TAM and the Power Point presentation.

The court first noted that “there can be no violation of the government’s *Brady* obligation unless the defendant has been prejudiced by the government’s failure to disclose. Claims under *Brady* therefore may be assessed only after a conviction.” *Id.* at 600. Thus, the court considered whether the defendants’ request was in the interest of “sound case management.” *Id.*

The court noted that the BLIPS registration issue is but a small part of the prosecution’s case. Moreover, whether the defendants willfully failed to register the BLIPS would depend on what each defendant knew during the periods at issue. The views of IRS representatives on the issue would be pertinent “only to the extent that those views were known and relied upon by the defendants.” *Id.* at 601. The court considered the cases raised by the defendants – *James v. United States*, 366 U.S. 213 (1961); *United States v. Critzer*, 498 F.2d 1160 (4th Cir. 1974); and *United States v. Garber*, 607 F.2d 92 (5th Cir. 1979) – but ultimately decided that the defendants were not entitled to the internal documents requested.

***United States v. KPMG, LLP***, 2007 WL 541956, 99 A.F.T.R.2d 2007-1118 (S.D.N.Y.) (February 15, 2007) – Under the Deferred Prosecution Agreement (“DPA”) executed on August 26, 2005, KPMG waived its right to indictment and consented to the filing of a one-count information charging KPMG with conspiracy to defraud the United States in violation of 18 U.S.C. § 371. The DPA required KPMG to:

- (i) pay \$456 million to the government (criminal fine of \$128 million, criminal restitution to the IRS of \$228 million, and civil penalty of \$100 million);
- (ii) adopt various permanent restrictions on and elevated standards for its tax practice;
- (iii) implement new compliance procedures and practice standards;
- (iv) accept an independent monitor to oversee KPMG’s compliance with the DPA; and
- (v) cooperate with the government’s investigation into the conduct detailed in the Information.

*Id.* at \*1. The DPA provided that if KPMG complied with the conditions, the government would recommend to the court that prosecution be deferred until December 31, 2006, at which time the government would seek to dismiss the Information without prejudice. If KPMG was not in full

compliance with the agreement at that time, the DPA provided for extensions. The DPA also provided that, regardless of the length of the prosecution deferral or date of dismissal, KPMG was required to cooperate indefinitely.

On December 21, 2006, the government filed a proposed order to dismiss the Information. The court issued the order of dismissal on January 2, 2007. Defendant Stein moved to intervene and appear as *amicus curiae* to oppose the dismissal. The court accepted Stein's filing and granting leave to appear as *amicus curiae*. Other defendants later joined in Stein's motion. Stein argues that the order of dismissal should be vacated, and KPMG should remain the subject of the Information, "for so long as KPMG continues to obstruct the proceedings in [*United States v. Stein*] ... because it would be against the public interest to dismiss when KPMG is actively and in bad faith interfering with the due administration of justice." *Id.* at \*3. The other defendants argue that the order of dismissal should be vacated because "the DPA's criminal fine and criminal restitution provisions violated fundamental constitutional principles of separation of powers." *Id.*

The court held that the defendants lacked standing to challenge the order of dismissal, as they have no "judicially cognizable interest in the prosecution or nonprosecution of another." *Id.* at 6 (citing *Linda R.S. v. Richard D.*, 410 U.S. 614, 619 (1973)). Even if standing was established, the court noted that under Federal Rule of Criminal Procedure 48(a), the government may dismiss charges with leave of court and that the denial of such a request should be limited to "extraordinary cases where it appears the prosecutor is motivated by considerations clearly contrary to the public interest." *Id.* at \*5 (citing *United States v. Hamm*, 659 F.2d 624, 628 (5th Cir. 1981)). The court found no such evidence.

*United States v. Stein, et al.*, --- F. Supp. 2d ---, 2007 WL 1138699 (S.D.N.Y.) (April 17, 2007) - The government moved to depose four foreign witnesses in Norway. Each witness is a citizen and resident of the country, and is expected to testify about two tax shelters involved in this case – FLIP and OPIS. Under Federal Rule of Criminal Procedure 15, the court may order that prospective witnesses be deposed to preserve testimony in "exceptional circumstances and in the interest of justice." *Id.* at \*2. The factors to be considered include whether the witness is unavailable, whether the testimony is material, and whether the testimony is necessary to prevent a failure of justice. *Id.* (citations omitted).

The court first noted the tremendous financial burden imposed in this case, with the cost falling on the shoulders of the individual defendants as a direct result of the government's unconstitutional conduct. The court further noted that two of the witnesses were available for trial. As to the remaining witnesses, the government had failed to show a "good faith effort to produce" them at trial, and failed to prove that their testimony was material in light of the availability of the other witnesses, who would provide similar testimony. The court denied the request to depose the witnesses.

*United States v. Stein, et al.*, 2007 WL 1224040 (S.D.N.Y.) (April 23, 2007) – All but 2 of the 18 defendants moved for severance based on the government's increased estimate of the duration of the trial (from three months to four months or more), and increased witness and exhibit lists. The government opposed the prior motions for severance and filed an opposition to

the current motion, but the new lead prosecutor stated at oral argument that a “single trial of 18 defendants ... is [not] the best way to try the case.” *Id.* at \*1.

The government proposed severance organized by level of involvement in the tax shelters – “less senior” players in group A, and “upper echelon” leaders in group B. Most of the defendants suggest dividing the defendants into those that approved the shelters (group A) and those involved in sales (group B). The court denied the motion, noting that the aggregate expected length of individual trials would far exceed the length of a joint trial.

*United States v. Stein, et al.*, --- F. Supp. 2d ---, 2007 WL 1258926 (S.D.N.Y.) (May 1, 2007) – Defendants moved pursuant to Federal Rule of Criminal Procedure 16 to compel the government to produce certain materials in the files of KPMG, while KPMG moved to quash a Rule 17(c) subpoena seeking the same materials. The court reviewed the events leading up to the DPA, which contains an agreed Statement of Facts providing a detailed account of alleged wrongdoing by the firm, and an extensive cooperation agreement that requires KPMG to, among other things, disclose and produce information and documents requested by the government, including privileged materials, subject to limited exceptions.

In November, 2006, Defendants applied for a subpoena pursuant to Rule 17(c) requiring KPMG to produce documents falling into three categories:

1. Documents relating to expert opinions prepared by or for KPMG during the period January 1, 1996 to date concerning the legality or propriety of any aspect of the tax shelters here at issue as well as documents prepared by counsel retained by KPMG that discuss or relate to any defendant or any of the events set forth in the indictment. (Specifications 1-3)
2. Documents relating to communications between KPMG and the government regarding the production of documents, waiver of the attorney-client privilege, or the tax shelters and events here at issue, including privilege logs. (Specifications 4-6)
3. Copies of certain KPMG manuals, calendars kept by or for all but three of the defendants, and deposition transcripts from litigation relating to the tax shelters at issue here in which KPMG was a party. (Specifications 7-9)

*Id.* at \*3. At oral argument, the defendants also moved to compel the government to produce documents identified in the KPMG subpoena. The court issued the subpoena to KPMG with the understanding that KPMG would move to quash and the government would have an opportunity to be heard on its objections. Following service of the subpoena, KPMG and the defendants reached agreements with respect to all requests except documents in Specification 6.

The court first addressed the government’s obligations, analyzing each item requested under Specification 6. The court held that each of the following items were “material”: (a) correspondence between and among KPMG, the Senate subcommittee and the IRS; (b) drafts of the Statement of Facts; (c) White Paper (correspondence between KPMG, the U.S. Attorney’s

Office and the Justice Department arguing that the firm should not be indicted); (d) other correspondence between KPMG and the prosecution team that relate to facts at issue in the indictment; and (e) internal KPMG documents relating to communications between KPMG and the government.

The court next analyzed Rule 16 and the provisions of the DPA. It found that the items requested, with the limited exception of documents falling into the privilege “carve-out,” were within the government’s possession, custody or control.

Finally, the court considered KPMG’s motion to quash the subpoena with respect to the items requested in Specification 6, on the grounds that the documents in dispute are privileged, that compliance would be unduly burdensome, and that the defendants failed to meet the standard set forth in *United States v. Nixon*, 418 U.S. 683 (1974).

Under *Nixon*, a moving party must establish the following to compel pretrial production: “(1) that the documents are evidentiary and relevant; (2) that they are not otherwise procurable reasonably in advance of trial by exercise of due diligence; (3) that the party cannot properly prepare for trial without such production and inspection in advance of trial and that the failure to obtain such inspection may tend unreasonably to delay the trial; and (4) that the application is made in good faith and is not intended as a general ‘fishing expedition.’” *Id.* at 699-700.

While the court refused to apply the *Nixon* factors without regard for the particular facts and circumstances of this case, it did consider the principles upon which *Nixon* was based. It analyzed the relationship between the restrictive discovery granted under Rule 16, the more expansive right to pretrial production under Rule 17, and the purpose of the *Nixon* standard. The court held that the broad language of Rule 17 applies and no rational purpose would be served by quashing the subpoena and forcing the defendants to seek the requested material from the government, material that KPMG may or may not decide to voluntarily produce. In the end, the court declined to quash the subpoena to the extent the documents are material to the defense and within the possession, custody or control of the government.

With respect to the privilege arguments raised by KPMG, the court noted that most of the items at issue were not communications between attorney and client, were not intended to be and were not kept confidential, and were not made for the purpose of providing legal advice. Thus, the materials are not privileged. As to KPMG internal documents, the court held that KPMG bears the burden of establishing the privilege and, as it offered no evidence that the materials sought were attorney-client communications or attorney work product, the burden was not met.

Finally, the court rejected KPMG’s argument that the production of items in Specification 6 would be unduly burdensome, which was based entirely on the number of civil suits involving KPMG regarding the alleged shelters.

## OTHER NEWS

On February 2, 2007, **Stephen A. Whitlock**, was appointed as the first director of the IRS Whistleblower Office. IR 2007-25. The IRS Whistleblower Office, established by the Tax Relief and Health Care Act of 2006, is designed to receive information regarding potential tax fraud and abuse and to provide rewards where appropriate. Mr. Whitlock previously served as Deputy Director of the IRS Office of Professional Responsibility, where he administered regulations governing the practice of attorneys, accountants and other tax professionals.

On February 26, 2007, **Eileen Mayer**, former director of the IRS SB/SE Division Office of Fraud/Bank Secrecy Act, was named as head of the IRS Criminal Investigation Division. IR-2007-41. Ms. Mayer follows Nancy Jardini, who left the IRS to become vice president (anti-fraud) of the Federal National Mortgage Association (Fannie Mae).

**Jenkins & Gilchrist** – On March 29, 2007, the Department of Justice announced a non-prosecution agreement with Jenkins & Gilchrist, a 56-year law firm based in Dallas. Under the terms of the agreement, the firm will close its doors and pay a \$76 million civil penalty for its role in developing and marketing fraudulent tax shelters and issuing fraudulent opinion letters. The firm made the following statement:

We believe certain J&G attorneys developed and marketed fraudulent tax shelters, with fraudulent tax opinions, that wrongly deprived the U.S. Treasury of significant tax revenues. The firm's tax shelter practice was spearheaded by tax practitioners in J&G's Chicago office who are no longer with the firm. Those responsible for overseeing the Chicago tax practice placed unwarranted trust in the judgment and integrity of the attorneys principally responsible for that practice, and failed to exercise effective oversight and control over the firm's tax shelter practice. . . . We deeply regret our involvement in this tax practice, and the serious harm it caused to the United States Treasury.

The non-prosecution agreement ends an investigation of the firm that began in 2003. Former members of the firm are still subject to prosecution.

**Jackson Hewitt franchises** – On April 3, 2007, the Department of Justice filed four related civil lawsuits to shut down more than 125 stores in Michigan, Illinois, Georgia and North Carolina, principally owned and/or operated by Farrukh Sohail. DOJ alleges that the stores have assisted in filing fraudulent returns resulting in \$70 million of false refunds and credits. The defendants include five corporations, which own the stores at issue, Sohail and 24 employees, including Sohail's wife. The suits do not name the corporate headquarters of Jackson Hewitt.

## 26 U.S.C. § 7201 (intent to evade or defeat tax)

In *United States v. Loglia*, 2007 WL 81925, 99 A.F.T.R.2d 2007-434 (D. Nev.) (January 5, 2007), and *United States v. Kahre*, 2007 WL 119147, 99 A.F.T.R.2d 2007-600 (D. Nev.) (January 5, 2007), Loglia and Kahre were accused of conducting business using gold and silver coins for the purpose of boycotting the Federal Reserve System and evading the assessment and payment of income tax. Rather than report the true value of the coins they received, they only reported the face value of the coins. They were charged with evasion in violation of 26 U.S.C. § 7201, conspiring to attempt to evade or defeat tax in violation of 18 U.S.C. § 371, filing false returns in violation of 26 U.S.C. § 7206(1), and wire fraud in violation of 18 U.S.C. § 1343.

Loglia and Kahre indicated their intent to raise a good faith defense based on their belief that the law permitted them to report their income in this fashion. The government responded with a motion *in limine*, asking the court to preclude the defendants from raising this defense or introducing any evidence in support of their incorrect legal position.

The district court held that Loglia and Kahre could present a good faith defense that they believed they could report the income as they did for the *limited* purpose of negating willfulness. However, the court precluded them from arguing or presenting evidence that their belief was legally correct or that they had a legal right to exclude the value of the coins from income.

In *United States v. Pesaturo*, 476 F.3d 60 (1st Cir. 2007) (February 16, 2007), the First Circuit was faced with interpreting the complex statutes and regulations, and amendments thereto, imposing federal fuel excise taxes. Pesaturo owned and operated Covenant Oil, a fuel delivery company that delivered fuel to customers for on and off-road use. The government alleged that Pesaturo failed to pay taxes due on substantial amounts of fuel he sold for on-road vehicles during 1995 and 1996. He was charged with evading federal excise tax in violation of 26 U.S.C. § 7201, conspiring with his drivers to evade excise tax in violation of 18 U.S.C. § 371, and filing false returns in violation of 26 U.S.C. § 7206(1).

On appeal, Pesaturo argued that, as a matter of law, he was not liable for the excise taxes allegedly evaded. The court analyzed the statutes (26 U.S.C. §§ 4041, 4081 and 4082) and the regulations at issue. It ultimately determined that Pesaturo had in fact violated the statutes and failed to pay federal excise tax on fuels sold for on-road use. It further determined that Pesaturo knowingly committed this offense.

Pesaturo further argued that the government failed to prove that he willfully made a material false statement on his company's return, as required by § 7206(1). The First Circuit disagreed, pointing to evidence that Pesaturo's accountant told him that the company's cash balance exceeded its receipts by \$62,359 (representing untaxed sales) and, in response, Pesaturo told his accountant to inflate company sales and cost of goods sold in an attempt to avoid the excise tax. *Id.* at \*\* 71-72.

With respect to the conspiracy charge, Pesaturo maintained that there was insufficient evidence of an agreement between himself and his drivers, who sold untaxed fuel to undercover IRS agents. The First Circuit accepted Pesaturo's argument "that neither mere employment in a

common business enterprise ... nor mere association with conspirators” are sufficient to establish a conspiracy. 476 F.3d at 72 (citations omitted). Pesaturo concedes, however, that he controlled all company business decisions, including the purchase, pricing and sale of fuel. The court held that given the extent of the evidence regarding the tax evasion, the small size of the business, and the extent of Pesaturo’s control, any finding that the drivers were working independently of Pesaturo would be erroneous. The conspiracy charge was affirmed.

## **26 U.S.C. § 7206 (false statement)**

In *United States v. Biller*, 2007 WL 325798 (N.D.W. Va.) (January 31, 2007), after years of reporting his income, Biller began working with the Aegis Company (“Aegis”) and utilizing its business trust system to reduce or eliminate his taxable income. Biller filed returns for 1999 through 2002 showing little or no income, despite receiving taxable income in those years in excess of one million dollars, as evidenced by amended returns later filed by Biller. Biller was charged with filing false returns in violation of 26 U.S.C. §7206(1), and obstruction in violation of 26 U.S.C. §7212(a). Biller waived his right to a jury.

Following a bench trial, the district court addressed each element of § 7206. It found that Biller’s returns for 1999 through 2002 contained materially false information, and that the returns were signed under penalties of perjury. With respect to knowledge, Biller argued that he had a good faith belief that his reduction of income was legitimate income deferral, rather than an illegal elimination of tax. The court considered and rejected the reasonableness of this position, based on Biller’s advanced degrees, business sophistication, and prior return filing experience.

The court considered whether Biller acted willfully in filing the false returns. It considered Biller’s amended returns, pattern of under-reporting large amounts of income, and repeated omissions of certain types of income. The court rejected Biller’s argument that his filing of the amended returns showed a lack of willfulness – the returns were filed prior to indictment but years after the Service commenced the civil audit in which Biller failed to produce requested information and cooperate with the Service. While the court acknowledged that the filing of amended returns alone does not establish willfulness, it noted that it could consider whether Biller acted with “willful blindness” and “deliberating and purposely closed his eyes to avoid knowing that the Aegis business trust system was fraudulent.” *Id. at \*5 (citing United States v. Martin*, 773 F.2d 579, 584 (4th Cir. 1985)). The court pointed to a letter Biller received from the Aegis company prior to filing any of this returns at issue, in which the company advises that Biller’s use of the trusts was fatally flawed and transformed the transaction from lawful to fraudulent. Despite this letter, and even after Biller was advised by counsel the Aegis system was fraudulent and he was under criminal investigation, Biller continued to utilize the Aegis system on his 2002 return. Therefore, the court found that Biller acted willfully.

Finally, the court considered whether the government carried its burden in negating Biller’s good faith defense based on advice received from accountant and attorneys. The court discussed the history of Biller’s relationship with the Aegis system and noted that none of the attorneys representing Biller ever defended the legitimacy of the Aegis program. The court held

that Biller's good faith defense could not stand because Biller failed to provide his advisors with all necessary information (*citing United States v. Butler*, 211 F.3d 826, 833 (4th Cir. 2000)), failed to follow advice received (*citing United States v. Custer Channel Wing Corp.*, 376 F.2d 675, 683 n.15 (4th Cir. 1967)), and, to the extent the Aegis accountants validated the system, failed to take corrective action when he discovered the advice was incorrect (*citing United States v. Benson*, 941 F.2d 598, 614 (7th Cir. 1991)).

The court also convicted Biller of obstruction based on his filing of false returns, active attempts to impede the civil audit, and threatening letters sent to the IRS agents assigned to his case. The court conceded that an individual is not required to cooperate in a civil exam, but found that Biller's cancellation of appointments and refusal to produce documents was sufficient to constitute a method of obstruction in this case.

### **18 U.S.C § 371 (conspiracy)**

In *United States v. Pursley*, 474 F.3d 757 (10th Cir. 2007) (January 11, 2007), Pursley was charged with filing false tax returns, and obtaining fraudulent refunds, on behalf of himself and other inmates of a Colorado state prison. He was convicted of conspiring with another inmate, Wardell, to defraud the United States in violation of 18 U.S.C. § 371, and aiding and abetting the preparation of false returns in violation of 26 U.S.C. § 7206(2). Pursley raises several issues on appeal, including insufficient evidence to support the conspiracy conviction and violation of the Double Jeopardy Clause by imposing consecutive sentences for different offenses based on the same evidence.

The Tenth Circuit rejected Pursley's argument that the government failed to prove that he conspired with each of the inmates identified on the false returns. Pursley conceded involvement in 6 of the 19 false returns at issue, but claimed that because the government offered no direct evidence of his relationship with the inmates on the remaining 13 returns, he could not be convicted for conspiring to file those returns. The court noted that the government charged a narrow conspiracy between Pursley and Wardell to file false returns, not a broader conspiracy involving all of the inmates identified on the returns. The court further cited the well established principles that the government is not required to prove the conspiracy by direct evidence alone, and a jury may consider circumstantial evidence in support of the conspiracy charge.

Pursley next argued for the first time on appeal that the same evidence supports the conspiracy charge and substantive offenses and therefore, the consecutive sentences violate the Double Jeopardy Clause. Applying a plain error standard of review, the court considered whether each offense "requires proof of an additional fact with the other does not." 474 F.3d at 769 (*citing Blockburger v. United States*, 284 U.S. 299, 304 (1932)). It noted that if each offense requires proof of fact not required by the other offense, then a defendant may be convicted of both offenses even if the charges stem from the same facts.

The court cited *Goldsmith v. Cheney*, 447 F.2d 624, 628 (10th Cir. 1971) and *United States v. Johnson*, 977 F.2d 1360, 1371 (10th Cir. 1992) for the position that conspiracy and aiding and abetting a crime are different criminal acts, with the conspiracy requiring proof of an agreement to commit a substantive offense. 474 F.3d at 769. Pursley argued that, in this case,

the aiding and abetting conviction necessarily required an agreement with Wardell. The court disagreed, noting the elements of § 7206(2), none of which require that the government prove that Pursley entered into an agreement with others. *Id.* (citing *Pereira v. United States*, 347 U.S. 1, 11 (1954) (“Aiding, abetting and counseling are not terms which presuppose the existence of an agreement.”))

In *United States v. Lewis*, 2007 WL 420118, 99 A.F.T.R.2d 2007-878 (N.D.Cal.) (February 6, 2007), Lewis was convicted of one count of conspiracy to defraud the United States by impeding and impairing the IRS in the ascertainment, computation, assessment and collection of federal income tax in violation of 18 U.S.C. § 371, and 4 counts of evasion in violation of 26 U.S.C. § 7201. Lewis moved for judgment of acquittal, arguing, among other things, that the government failed to establish willfulness. The court disagreed, noting that the evidence of willfulness was substantial, including that Lewis sent more than \$300,000 of income offshore and failed to report that income on his returns, created false invoices and loan documents to conceal his income and support fraudulent deductions, concealed assets under alter egos, refused to cooperate in the audit, sent harassing letters to the IRS, and claimed the tax laws did not apply to him.

Lewis also objected to the jury instruction, submitted at the government’s request, on the defense of good faith reliance on a qualified tax accountant. Lewis argued that this instruction confused the jury, leaving it with the erroneous belief that he had the burden of disproving willfulness. The court disagreed, noting that the jury instructions, including the instruction for conspiracy, tax evasion and good faith, clearly established that the government had the burden of establishing each element of each offense beyond a reasonable doubt.

In *United States v. Pierce*, 479 F.3d 546 (8th Cir. 2007) (March 8, 2007), defendants owned and operated a not-for-profit charter school that was funded by the state and federal governments and was subject to the same audit procedures and requirements as a public school district. Defendants were accused of diverting funds from the charter school, either directly or indirectly through false invoices, and failing to report the diverted funds on their personal returns. They were convicted of conspiracy to defraud the United States in violation of 18 U.S.C. § 371, filing false returns in violation of 26 U.S.C. § 7206, mail fraud in violation of 18 U.S.C. § 1341 and wire fraud in violation of 18 U.S.C. § 1343. Among the issues raised on appeal, defendants argued that the district court erred in “instructing the jury that it “should,” rather than “may,” find each defendant vicariously liable for the substantive crimes of his/her co-conspirator, if certain circumstances were proven, under *Pinkerton v. United States*, 328 U.S. 640, 66 S. Ct. 1180, 90 L.Ed. 1489 (1946).

Defendants objected to the government’s proposed *Pinkerton* instruction on co-conspirator vicarious liability, which read as follows:

A defendant who has entered into a criminal conspiracy is responsible for offenses committed by fellow conspirators if the defendant was a member of the conspiracy when the offense was committed and if the offense was committed in furtherance of and as a foreseeable consequence of the conspiracy. Therefore, if you find a defendant guilty of the conspiracy charged in Count 1 and if you find

beyond a reasonable doubt that while the defendant was a member of the conspiracy, a fellow conspirator committed an offense charged in Counts 2 through 13 in furtherance of and as a foreseeable consequence of that conspiracy, then you *should* find the defendant guilty of that offense as well.

479 F.3d at 549 (emphasis added). Defendants argued that the word “should” requires reversal of their convictions.

In *Pinkerton*, the Supreme Court held that the overt act of one member of a conspiracy is attributable to all other members of the conspiracy. 328 U.S. at 646. Defendants point to pattern jury instructions of the Fifth, Ninth, Tenth and Eleventh Circuits, which use permissive language – “may” – instead of the mandatory instruction submitted by the district court. The Eighth Circuit agreed that other circuits have approved the use of permissive language, and even noted that Eighth Circuit had used such language in the past (*United States v. DeLuna*, 673 F.2d 897, 918 (8th Cir. 1985) (overruled on other grounds)). However, the court further cited cases in each of those circuits that either approved the use of the mandatory language, or “interpreted *Pinkerton* as requiring a jury to find a co-conspirator vicariously liable when the *Pinkerton* factors are met.” 479 F.3d at 550. Thus, even if there is a preference for permissive language in other circuits, there is no precedent that mandatory *Pinkerton* instructions are erroneous. 479 F.3d at 551.

In *United States v. Moran*, --- F.3d ---, 2007 WL 959896 (9th Cir. (Wash.)) (April 2, 2007), Pamela and James Morans were “Executive Education Officers” who trained the sales force of Anderson’s Ark and Associates (“AAA”), a firm well known for promoting fraudulent “tax reduction plans” to clients who paid and successfully completed an application process. The Morans were charged along with 8 other defendants with numerous counts of conspiring to defraud the United States in violation of 18 U.S.C. § 371, wire and mail fraud, aiding and assisting in the preparation of false returns and other substantive offenses. At trial, the government successfully objected to the testimony of Pamela’s accountant as to what he told her regarding filing statement in place of returns, and to Pamela’s testimony regarding legal opinions she received regarding the AAA program. After a 37-day jury trial, the Morans were convicted on 36 counts each.

On appeal, the Morans argued that the testimony of the government’s expert that one of the AAA programs was a “sham” was an impermissible legal conclusion and provided a nonstatutory basis for conviction. The court noted that an expert is not permitted to opine as to the ultimate issue of law, and only the court can instruct the jury as to applicable law. 2007 WL 959896, at \*2. The court held that use of the word “sham” did not address a legal conclusion, in that it only related to the second element of the offense – “that the return was false as to something that was necessary to a determination of whether income tax was owed.” *Id.* It noted that even if the jury accepted that the transaction was a sham, it still had to determine whether tax was owed.

Pamela Moran further argued that the court committed reversible error by excluding her testimony regarding opinions she received from an accountant and other experts, upon which she based her good faith belief that the AAA programs were legal. The Ninth Circuit acknowledged

that a “defendant is entitled to testify about the tax advice he received – subject, of course, to cross-examination – and exclusion of this testimony is error.” *Id.* at \*5 (citing *United States v. Bishop*, 291 F.3d 1100, 1111 (9th Cir. 2002)). “Not only is testimony about the reliance on qualified experts relevant to establishing this defense, but the defendant ‘[has] the right to tell the court his own version of the tax advice on which he claims[s] to have relied.’” *Id.* Finally, the court noted that such testimony would not be hearsay, since it is not offered for the truth of the matter asserted. *Id.* Therefore, the court agreed that Pamela was permitted to testify and that the district court erred in sustaining the government’s objections. The court further held that the error was not harmless, noting the government’s failure to provide “fair assurance that the verdict was not substantially swayed by the error.” *Id.* at \*6 (quoting *United States v. Seschillie*, 310 F.3d 1208, 1214 (9th Cir. 2002)).

James Moran likewise argued that, since he also asserted a good faith defense, he is entitled to any relief stemming from the court’s error in excluding his wife’s testimony. The court agreed, noting that the Morans were coconspirators and any evidence of professional opinions about the AA programs obtained by Pamela Moran would be relevant as circumstantial evidence of James Moran’s state of mind. *Id.* at \*7. Based on the foregoing, the Ninth Circuit vacated both convictions and remanded the case for a new trial.

### **18 U.S.C. § 1001 (false statement)**

In *United States v. Mubayyid*, 476 F. Supp. 2d 46 (D. Mass. 2007) (March 8, 2007), Mubayyid and Muntasser were accused of fraudulently attempting to obtain a charitable exemption under IRC § 501(c)(3) for Care International, Inc. (“Care”). The government alleged that defendants intentionally omitted from the application the facts that Care solicited and distributed funds for, and issued publications supporting and promoting, Islamic holy war and holy warriors. They were charged with making false statements in violation of 18 U.S.C. § 1001, conspiring to defraud the United States in violation of 18 U.S.C. § 371, and filing false returns in violation of 26 U.S.C. § 7206(1).

Defendants moved to dismiss the Indictment on the grounds that the prosecution violates their right to free speech, arguing that the government is criminalizing constitutionally protected activities including charitable fundraising and expressing religious beliefs. The court quickly dispenses with this contention, noting that the defendants were not being prosecuted for engaging in these activities, but for concealing those activities in their exemption application.

Defendants next argue that the prosecution violated their First Amendment right to the free exercise of religion. The court considered the Religious Freedom Restoration Act (“RFRA”), 42 U.S.C. § 2000bb, but noted that the defendants’ religion did not require them to conceal information, defraud the government or make false statements. It held that providing complete information of an organization’s activities to obtain tax-exempt status does not violate the First Amendment.

The defendants argued that the concealed information was not material in that it could not properly have influenced the Service’s determination as to whether Care qualified for § 501(c)(3) status. The court considered the “unconstitutional conditions” doctrine, under which “the

government may not condition the granting of a benefit on the beneficiary's surrender of a constitution right." \*5 (citing *Regan v. Taxation Without Representation*, 461 U.S. 540, 545 (1983), and others). The court rejected the defendants' argument in this regard, stating that they did not have a right to provide false responses to the IRS. Moreover, while the government can not deny a benefit to a person exercising a constitutional right, it is not required to subsidize First Amendment activities with public funds. *Id.* at \*6 (citing *Regan*, 461 U.S. at 545). The court found that the information requested was material in that it would have a natural tendency to influence the investigation of Care's § 501(c)(3) eligibility.

## Sentencing Issues

**(grouping)** - In *United States v. Vucko*, 473 F.3d 773 (7th Cir. 2007) (January 12, 2007), Vucko pled guilty to wire fraud in violation of 18 U.S.C. § 1343 and to making a false statement in a tax return in violation of 26 U.S.C. § 7206(1), stemming from her theft of funds from her employer through a credit card processing scheme. The court sentenced Vucko to two years on each count, to run concurrently. On appeal, Vucko argued that the district court erred by failing to group the charges under USSG § 3D1.2(c) or (d).

The Seventh Circuit first considered the applicable guideline provision for wire fraud – USSG § 2F1.1, which provides a list of specific offense characteristics, *not including* failure to report income from the fraud to the IRS. The filing of a false return is addressed by USSG § 2T1.1, which sets forth only two specific offense characteristics – “(1) If the defendant failed to report or to correctly identify the source of income exceeding \$10,000 in any year from criminal activity, increase by 2 levels. If the resulting offense level is less than level 12, increase to level 12; and (2) If the offense involved sophisticated concealment, increase by 2 levels.”

The court restated the grouping rules of USSG § 3D1.2 and agreed with Vucko that the conduct covered by the wire fraud also provided sufficient illegally derived income to trigger USSG § 2T1.1(b)(1). It then reviewed the split that has arisen among the circuits on this issue, noting that the Fifth Circuit has grouped mail fraud and evasion counts (*United States v. Haltom*, 113 F.3d 43 (5th Cir. 1997)), while the First Circuit rejected this approach (*United States v. Martin*, 363 F.3d 35 (1st Cir. 2004)). The First Circuit stated that “even where one count embodies conduct treated as an adjustment to a second count, the counts cannot be properly grouped under § 3D1.2(c) unless they are ‘closely related.’” 473 F.3d at 778 (quoting *Martin*, 363 F.3d at 42). That court found that fraud and tax evasion were not closely related because they involved different harms, victims and conduct. *Id.*

The First Circuit's approach (grouping) is followed by the Third (*United States v. Astorri*, 923 F.2d 1052 (3d Cir. 1991)), Tenth (*United States v. Peterson*, 312 F.3d 1300, 1302-04 (10th Cir. 2002)), and Sixth Circuits (*Weinberger v. United States*, 268 F.3d 346, 353-54 (6th Cir. 2001)). On the other hand, the Second Circuit (*United States v. Petrillo*, 237 F.3d 119 (2d Cir. 2000) and *United States v. Fitzgerald*, 332 F.3d 315 (2d Cir. 2000)) has refused to group.

In this case, the Seventh Circuit opted not to group based on its belief that the two offenses were not sufficiently related. The court did, however, note that in cases whether a defendant faces separate counts for the same conduct that produces unreported income and the

tax crime, and double-counting is possible (not in this case), the sentencing court may “simply refrain from adding the USSG § 2T1.1(b)(1) two-level enhancement to the tax offense.” 473 F.3d at 781.

**(§ 3553(a) factors/reasonableness)** - In *United States v. Trupin*, 475 F.3d 71 (2d Cir. 2007) (January 23, 2007), Trupin engaged in a multi-year, multi-million dollar tax evasion scheme, using family members, trusts and shell corporations to hide assets, creating phony paper trails, and shipping assets out of the country. Trupin was convicted of one count of evasion in violation of 26 U.S.C. § 7201. Based on the tax loss, a sophisticated means enhancement, and a prior conviction for theft of a Marc Chagall painting, the district court set the initial guideline range at 41 to 51 months. Under the mandatory regime, the court denied a downward departure based on his age and family circumstances and sentenced Trupin the low end – 41 months – but noted its frustration with the Guidelines. Trupin appealed and the Second Circuit reversed and remanded for resentencing pursuant to *United States v. Booker*, 543 U.S. 220 (2005).

On remand, the district court took the opportunity to evaluate the § 3553(a) factors and, while noting that it was a serious case, stated that “a few weeks in jail for most of us would be a very, very significant punishment.” The court imposed a sentence of 7 months imprisonment, 7 months home detention and 3 years supervised release. This time, the government appealed.

The Second Circuit acknowledged that the district court considered the § 3553(a) factors and properly calculated the advisory Guideline range, but it objected to the “reasonableness of the sentence as a whole, rather than the process that produced it.” 475 F.3d at 74. The Second Circuit noted that it previously held sentences unreasonable where the district court places too much weight on a single § 3553(a) factor, reflects a general policy disagreement with the Guidelines, or bases its decision on a factor not listed within § 3553(a). *Id.* at 74-75. The court found that Trupin’s sentence involved all three failings - undue consideration for Trupin’s age and family circumstances, general objections to imprisonment and objections to the Guidelines in particular. The court held that the sentence was unreasonable and remanded for further proceedings.

**(special skills enhancement)** - In *United States v. Mercer*, 472 F. Supp. 2d 1319 (D. Utah 2007) (February 6, 2007), Mercer, an accountant, pled guilty to aiding and assisting in the preparation and filing of a false tax return in violation of 26 U.S.C. § 7206(2). In the plea agreement, the government agreed to take the position that Mercer had not used a special skill or violated a position of trust in preparing the returns, and thereby object to the special skills enhancement under USSG § 3B1.3. The district court objected to the government’s position, accusing it of “swallowing the gun.” 472 F. Supp. 2d at 1320 (*citing* Robert H. Edmunds, Jr., *Analyzing the Tension Between Prosecutors and Probation Officers over Fact Bargaining*, 8 Fed. Sent’g Rep. 318 (1996) (“It has been the policy of the Department of Justice from the day the guidelines were implemented not to ‘swallow the gun.’”)).

As an accountant with a graduate degree in tax accountancy and many years as a paid preparer, the court noted that Mercer easily fell within the enhancement. The court held that the government’s position was inconsistent with the stated policy of the Department of Justice, as set forth in a memorandum issued by then-Attorney General John Ashcroft, that “[a]ny sentencing

recommendation made by the United States in a particular case must honestly reflect the totality and seriousness of the defendant's conduct and must be fully consistent with the Guidelines and applicable statutes and with the readily proven facts about the defendant's history and conduct." 472 F. Supp. 2d at 1322 (*citing* Memorandum from John Ashcroft to All Federal Prosecutors, Department Policy Concerning Charging Criminal Offenses, Disposition of Charges, and Sentencing (September 22, 2003)).

The court conceded that the government is certainly permitted to deviate from its internal policies, but stated that the government should articulate a reason for doing so. The court praised the Ashcroft Memorandum for its "goal of fairness in sentencing" and preventing prosecutors from "swallowing the gun." 472 F. Supp. 2d at 1323. The court imposed the special skills enhancement and concluded with a disclaimer that, "[t]he court intends no criticism of the individual trial attorney assigned to argue this matter, as the court understands that he was simply defending the plea agreement that had been approved through normal processes by the Tax Division. The United States Attorney's Office for the District of Utah had no part in formulating the government's position in this matter." *Id.*, n.16.

**(calculation of tax loss)** – In *United States v. Bailey*, 2007 WL 446684, 99 A.F.T.R.2d 2007-944 (4th Cir. (Va.)) (February 8, 2007), Bailey was the general manager of a nursing home and was responsible for the daily operations. He used company funds to pay personal expenses and took affirmative steps to evade the payment of federal income tax owed for prior years. In addition, Bailey failed to file the company's income and employment tax returns, and failed to make timely employment tax deposits. When finally confronted with his personal tax liabilities, Bailey filed false returns, significantly underreporting his income. He then began using third parties to create false loans, and divert company funds to himself and others. Bailey was charged and convicted, following a bench trial, of 4 counts of filing false returns in violation of 26 U.S.C. § 7206(1) and 4 counts of evasion in violation of 26 U.S.C. § 7201. The court calculated a base offense level of 22 (based on the tax loss of approximately \$1.4 million) and added a two-level enhancement for sophisticated means. Phelps was sentenced to concurrent terms of 36 months for failure to file, and 51 months for evasion.

On appeal, Bailey argued that the tax loss should not include the unpaid employment taxes, since he was not a "responsible person" with respect to those obligations. After reviewing the six factors set forth in *Plett v. United States*, 185 F.3d 216, 219 (4th Cir. 1999), to determine who has the requisite authority to be a "responsible person," the Fourth Circuit held that Bailey qualified as a responsible person and therefore the unpaid employment tax was properly included in the tax loss calculation.

Bailey also argued that the district court erred in imposing the sophisticated means enhancement under USSG § 2T1.1(b)(2). The Fourth Circuit acknowledged that "[t]he average criminal tax fraud ... involves some concealment; sophisticated tax fraud must require more." 2007 WL 446684, at \*5 (*quoting United States v. Kontny*, 238 F.3d 815, 820-21 (7th Cir. 2001)). The court held, however, that Bailey's conduct went beyond basic concealment and therefore, the enhancement was warranted.

**(calculation of tax loss)** – In *United States v. Phelps*, 478 F.3d 680 (5th Cir. 2007) (February 12, 2007), Phelps falsely reported funds from his corporations as wages paid to family members. He was charged in a 32-count indictment and ultimately pled guilty to one count of conspiracy to defraud the United States by impeding the IRS in its collection of revenue, in violation of 18 U.S.C. § 371. The district court sentenced Phelps to 42 months. On appeal, the Fifth Circuit remanded in light of *Booker*. On remand, the district court found that the intended tax loss was \$80,463.64, placing Phelps at a level 16 (“more than \$80,000 but less than \$200,000”). He was resentenced to 36 months. Phelps appealed again, arguing that the district court should have reduced the tax loss for the amount of excess social security taxes paid through Phelps’ family members’ “wages.”

In a matter of first impression, the Fifth Circuit rejected Phelps’ argument, noting that “tax loss” for purposes of the Guidelines is “the amount the parties attempted to illegally obtain from the government.” 478 F.3d at 681 (*quoting United States v. Moore*, 997 F.2d 55, 61 (5th Cir. 1993)). In other words, the sentencing court must look to the intended loss, not the actual loss. The court rejected Phelps’ request to consider the Second Circuit’s approach of calculating tax loss by taking into account “legitimate but unclaimed deductions.” 478 F.3d at 682 (*quoting United States v. Martinez-Rios*, 143 F.3d 662, 671 (2d Cir. 1998)). Instead, the Fifth Circuit followed the precedent of the Seventh (*United States v. Chavin*, 316 F.3d 666, 678 (7th Cir. 2002)) and Tenth Circuits (*United States v. Spencer*, 178 F.3d 1365, 1368 (10th Cir. 1999)), finding that the tax loss should not be reduced by the inadvertently paid social security taxes.

**(§ 3553(a) factors/reasonableness)** – In *United States v. Baxter*, 2007 WL 627892 (7th Cir. (Ill.)) (March 1, 2007), Baxter, a certified public accountant, knowingly submitted falsified figures to an IRS auditor in an effort to avoid a significant assessment against one of her clients. Baxter pled guilty to obstructing and impeding the administration of federal tax laws in violation of 26 U.S.C. § 7212(a).

Using the agreed tax loss of \$576,000, the probation officer calculated Baxter’s offense level at 17, yielding an advisory guideline range of 24 to 30 months. The court conducted two sentencing hearings, and at the conclusion of the second hearing, the court addressed the factors in 18 U.S.C. § 3553(a) before imposing a sentence of 24 months. During sentencing, the judge commented, “[t]here are certain factors, of course, that the sentencing guidelines require me not to consider.” *Id.* at \*1 (citations omitted).

Baxter appealed her sentence, arguing that it was unreasonable and that the district court erred when it refused to consider her character evidence. The Seventh Circuit first noted that it accords a rebuttable presumption of reasonableness to sentences within an advisory guideline range, but that in light of the Supreme Court’s pending consideration of *Rita v. United States*, 127 S. Ct. 551 (2006) (challenging that presumption), the court has independently reviewed sentences for reasonableness.

The court held that the district court understood that it had discretion to consider Baxter’s civic and charitable works, and that it allowed Baxter to submit a substantial amount of evidence that pertained to such activities, including witness testimony, letters and oral presentations of her attorneys. The district court also made clear that it had reviewed all of these materials in

determining Baxter's sentence. As such, the Seventh Circuit upheld the district court's sentencing.

**(calculation of tax loss)** - In *United States v. Kosinski*, 480 F.3d 769 (6th Cir. 2007) (March 22, 2007), Kosinski was convicted of one count of conspiring to defraud the IRS and to structure currency transactions to evade IRS reporting requirements in violation of 18 U.S.C. § 371, five counts of submitting false tax returns in violation of 26 U.S.C. § 7206(1), and one count of structuring a currency transaction to evade IRS reporting requirements in violation of 31 U.S.C. § 5324(a)(3) and § 5324(d)(1). The district court calculated the tax loss based on a preponderance of the evidence, resulting in an adjusted offense level of 19 and an applicable sentencing guideline range of 30-37 months. The court granted a downward departure and sentenced Kosinski to two concurrent sentences of thirty months each. On appeal, the Sixth Circuit vacated the sentence pursuant to *United States v. Booker*, 543 U.S. 220 (2005), because Kosinski was sentenced based on the tax loss determined by the court, rather than the jury. The court held that without the court's determination, the offense level would be 10, resulting in sentence of 6 to 12 months.

At resentencing, the district court stated its understanding of the Sixth Circuit's ruling, "under *Booker* [the district court] couldn't consider that [tax loss] amount because ... [the jurors] weren't asked to find that specific amount." 480 F.3d at 773. Based on this understanding, the district court held that it did not have authority to calculate the tax loss or depart from the Guidelines, and sentenced Kosinski to three years probation, with six months to be spent at a halfway house and six months to be spent under home detention. At a later hearing in response to Kosinski's motion to correct sentence (based on the fine imposed), the district court clarified its sentence by noting that it began with the Guidelines and then gave great weight to the factors set forth in 18 U.S.C. § 3553(a). The government appealed, arguing that the sentence was unreasonable because the district court failed to consider the tax loss and in doing so, improperly followed the appellate court's instructions.

The Sixth Circuit agreed, stating that the district court violates the Sixth Amendment if it bases a sentence on judge-made findings of fact under a *mandatory* Guideline regime. However, under an *advisory* Guideline regime, the district court is certainly entitled to consider factors not proven to a jury or admitted by the defendant. "Post-*Booker*, under the advisory sentencing guideline regime, a sentencing enhancement is constitutional as long as it is based on reliable information and supported by a preponderance of the evidence." 480 F.3d at 775 (citing *United States v. Redmond*, 188 Fed. Appx. 377, 381 (6th Cir. 2006)). The Sixth Circuit held that the district court has discretion to calculate a defendant's tax loss as long as it does not feel compelled to do so, and the calculation is based on reliable information and supported by a preponderance of the evidence. 480 F.3d at 777. The court remanded for resentencing "not because the district court failed to calculate or consider the tax loss, but because the district court was under the misapprehension that it simply could not do so." *Id.*

The Sixth Circuit further objected to the district court's belief that a sentence with an advisory guideline range is *per se* reasonable. "[N]othing in *Booker* suggests that sentence within the sentencing guideline range is *per se* reasonable. The sentencing guidelines are to be consulted and appropriately taken into account, but a reasonable sentence requires consideration

of the factors set forth in 18 U.S.C. § 3553. A sentence within the Guidelines carries with it no implication that the district court considered the 3553(a) factors if it is not clear from the record.” 480 F.3d at 777 (*quoting United States v. Johnson*, 467 F.3d 559, 563 (6th Cir. 2006)) (internal citations and quotations omitted). Thus, because the district court failed to articulate its consideration of the § 3553(a) factors, the Sixth Circuit was unable to review whether the sentence was reasonable. The sentence was vacated and the case remanded for resentencing.

**(obstruction enhancement)** – In *United States v. Davist*, 481 F.3d 425 (6th Cir. 2007) (March 29, 2007), Davist engaged in a fraudulent return filing scheme and was charged with one count of conspiring to defraud the United States through false claims in violation of 18 U.S.C. § 286, 18 counts of making false claims and aiding and abetting in violation of 18 U.S.C. § 287 and 18 U.S.C. § 2, and two counts of making false statements to a federal official in violation of 18 U.S.C. § 1001. Davist pled guilty to the indictment without the benefit of a plea agreement. He was sentenced to 40 months. His sole argument on appeal was that the district court improperly imposed a two-level enhancement for obstruction of justice under USSG § 3C1.1. He does not argue “double counting,” where an obstruction charge contributes to both the base offense level and the obstruction enhancement.

In affirming the sentence, the Sixth Circuit stated that an obstruction enhancement under USSG § 3C1.1 is imposed if “(A) the defendant willfully obstructed or impeded, or attempted to obstruct or impede, the administration of justice with respect to the investigation, prosecution, or sentencing of the instant offense of conviction, and (B) the obstructive conduct related to (i) the defendant’s offense of conviction and any relevant conduct; or (ii) a closely related offense....” It further pointed to Application Note 4, which suggests that the enhancements should apply “to any other obstructive conduct in respect to the official investigation, prosecution, or sentencing of the instant offense *where there is a separate count of conviction for such conduct.*” (emphasis added).

The Sixth Circuit noted that Davist pled guilty to making false statements to federal officials, obstructive conduct that warrants the enhancement. In so holding, the court joined the Second, Fifth, Eighth and Eleventh Circuits that have imposed such an enhancement where a defendant is convicted of a separate count for obstructive conduct. 481 F.3d at 427 (citations omitted).

**(calculation of tax loss)** – In *United States v. Robbins*, 2007 WL 949751 (10th Cir. (Okla.)) (March 30, 2007), Robbins was convicted by a jury of fifteen counts of tax fraud for aiding and assisting the preparation and submission of false and fraudulent tax returns in violation of 26 U.S.C. § 7206(2). The tax loss proved at trial amounted to \$376,000. At sentencing, the government produced two additional witnesses whose false returns were not included in the indictment. The additional \$90,675 of tax owed was accepted by the district court in calculating the tax loss for purposes of the advisory guideline range. This resulted in a two-level increase in the base offense level.

On appeal, Robbins challenged the tax loss calculations on the grounds that the “surprise” witness provided evidence not considered by the jury and therefore, the incorporation of such evidence into the tax loss calculation was violation of *Booker*.

The Tenth Circuit stated that it was “well-settled that *Booker* does not preclude judicial fact-finding by a preponderance of the evidence standard at the sentencing stage unless the factual findings operate to increase a defendant’s sentence mandatorily.” *Id.* at \*4 (citations omitted). The court concluded that because the guidelines are advisory and not mandatory, the district court committed no clear error by including the additional liability in determining the appropriate tax loss.

## Restitution

In *United States v. Novak*, 476 F.3d 1041 (9th Cir. 2007) (February, 22, 2007), the Ninth Circuit held a rehearing *en banc* to determine whether the government can garnish retirement plans covered by ERISA as a means of enforcing criminal restitution orders. In *United States v. Novak*, 441 F.3d 819 (9th Cir. 2006) (March 23, 2006), the court held that a defendant’s pension plan benefits were subject to garnishment by the federal government to collect a criminal restitution order. The court further held that, in requiring the entry of restitution in certain criminal cases pursuant to the MVRA (Mandatory Victim Restitution Act, 18 U.S.C. § 3663A), making those restitution orders liens in favor of the United States, and authorizing enforcement of those orders against all property not exempt from federal tax collection (18 U.S.C. § 3613), Congress enacted a statutory exception to ERISA’s anti-alienation provision.

The court acknowledged that in *United States v. Jackson*, 229 F.3d 1223 (9th Cir. 2000), it held that there was no equitable exception to the anti-alienation provision, and that it was plain error for the district court to order Jackson to draw out his ERISA plan benefits to satisfy a criminal restitution order. The Ninth Circuit distinguished *Jackson* by noting that neither party called attention to the specific provisions of the MVRA applied in *Novak*.

On rehearing, the court again considered and attempted to reconcile the language and principles of the MVRA and ERISA. The court also acknowledged that its current holding conflicts with *United States v. Jackson*, 229 F.3d 1223 (9th Cir. 2000) (no exception to anti-alienation provision of ERISA) and, therefore, overruled *Jackson* to the extent that it conflicts with the court’s current holding.

Finally, the court maintained that the anti-alienation provision of ERISA does not prevent garnishment of retirement plans pursuant to the MVRA. The court analyzed when a participant’s interest in a retirement plan is “property or [a] right[] to property” under 18 U.S.C. § 3613(a), allowing such interest to be reached by a MVRA restitution order. The Ninth Circuit held that “the government can immediately garnish the corpus of a retirement plan to satisfy a MVRA judgment if . . . , but only if, the terms of the plan allow the defendant to demand a lump sum payment at the present time.” *Novak*, 476 F.3d at 1063. However, the government can not unilaterally cash out a retirement plan “when ERISA requires that lump sum payments be made payable only with spousal consent.” *Id.* The case was remanded to the district court to determine Novak’s retirement benefit rights.

## Miscellaneous

**(Severance)** - In *United States v. Pendergrass*, 2007 WL 160956, 99 A.F.T.R.2d 2007-641 (M.D. Tenn.) (January 16, 2007), four defendants were charged with nineteen counts of various criminal tax violations. Two of the defendants, Saturn and Mazer, filed a Joint Motion for Severance of Counts, based on their contention that there were two distinct conspiracies alleged in the Indictment.

Saturn and Mazer were real estate attorneys hired by Pendergrass and charged in Counts One and Two with conspiring to conceal Pendergrass' ownership in certain property to allow Pendergrass to avoid IRS liens and seizures, and with concealing the true extent of his ownership in the property and receipt of proceeds from the sale of that property. Saturn and Mazer argued that Counts One and Two represented one alleged conspiracy separate and distinct from the conspiracy alleged involving Pendergrass and Hammonds, his bookkeeper and return preparer.

The Court agreed with Saturn and Mazer, finding that although there may been a vague connection among the offenses relating to Pendergrass, the charges (and time frames of the alleged violations) against the attorneys and Pendergrass were distinctly different than those against Hammonds and Pendergrass. The court held that a joint trial would present a serious risk of compromising the rights of Saturn and Mazer, and therefore, granted their motion to sever.

**(Pretrial release)** - In *United States v. Franklin*, 2007 WL 486579, 99 A.F.T.R.2d 2007 (D. Kan.) (February 13, 2007), Franklin and Chapin are accountants accused of conspiring to defraud the United States through the preparation of false or fraudulent income tax returns based on positions advocated by Renaissance, The Tax People, Inc., a promoter of tax advantaged transactions. The accountants were also charged with preparation of false returns in violation of 26 U.S.C. § 7206(2). At their initial appearance, the district court imposed as a condition of pretrial release that the defendants, prior to preparing any returns, provide a copy of the indictment to each person for whom they prepared a return.

Franklin and Chapin moved for modification of conditions of pretrial release, arguing that this restriction would cause a significant loss of clients and that the condition violated their constitutional right to the presumption of innocence, due process, the principles of the Bail Reform Act of 1984, the Eighth Amendment's guarantee against excessive bail, and disclosure provisions set forth in 26 U.S.C. § 6103(b).

The court disagreed, finding that the restriction was appropriate to reasonably assure the safety of the community and that it did not violate any of the defendants' constitutional rights. The defendants cited *Mallas v. United States*, 993 F.2d 1111 (4th Cir. 1993), for the position that the Service is prohibited under IRC § 6103(b) from disclosing a defendant's indictment to the public. The court noted the requirements of § 6103, but held that the disclosure condition imposed on the defendants was narrowly drawn and reasonably tailored to address a specific danger to the community. The court upheld the requirement, but stated that the defendants may inform such clients, in writing, that they are disputing the charges.

**(Evidence)** - In *United States v. Jerra*, 2007 WL 580099, 99 A.F.T.R.2d 2007-1097 (9th Cir. (Cal.)) (February 16, 2007), Jerra was convicted of filing false tax returns in violation of 26 U.S.C. § 7206(1). Jerra appealed, arguing that the district court abused its discretion in making several evidentiary rulings, denying his motion for a change of venue and excusing a juror.

The Ninth Circuit agreed with Jerra on several points, holding that the district court erred in permitting testimony of Jerra's bad character, noting that any probative value was outweighed by the risk of prejudice. The district court also erred in limiting Jerra's cross-examination of a key witness by sustaining every government objection concerning Jerra's business dealings. Finally, the district court erred by excluding every piece of written evidence offered by the defense. The Ninth Circuit agreed that taken together, these errors constituted an abuse of discretion and required that the conviction be vacated and that a new trial be granted.

**(Motion to Suppress)** – In *United States v. Daubmann*, 474 F. Supp. 2d 228 (D. Mass. 2007) (February 21, 2007), based on information provided by a former bookkeeper, the Internal Revenue Service obtained a warrant to search the Daubmanns' home and business for pertinent documents dated from 1998 to 2000.

The warrants were executed very early in the morning and during the search of their home, the Daubmanns were separated from each other, their freedom of movement was restricted, and they were not permitted during questioning to get dressed. No *Miranda* warnings were given. Incriminating statements were made during the interviews, which were then used to obtain a supplemental warrant and expand the search for documents through 2002. The Daubmanns sought to suppress the incriminating statements made during the search and all physical evidence, including evidence seized pursuant to the supplemental warrant as “fruit of the poisonous tree.”

The court refused to suppress the physical evidence seized, but granted the Daubmanns' motion to suppress their statements. The court held that no reasonable person in the Daubmanns' positions would believe they were free to leave during the search or had the option of refusing to cooperate with the agents and respond to their questions. Since *Miranda* warnings were not given, any statements, even if voluntarily given, must be suppressed.

With respect to the evidence seized based on the statements made (and supplemental warrant obtained), the court observed that the Supreme Court has not applied the “fruit of the poisonous tree” doctrine to *voluntary* statements made in violation of *Miranda*. 474 F. Supp. 2d at 236 (citing *Oregon v. Elstad*, 470 U.S. 298 (1985); *Oregon v. Hass*, 420 U.S. 714 (1975); *Michigan v. Tucker*, 417 U.S. 433 (1974)). Here, the district court found that the statements were voluntary because there was “no suggestion that the agents made threats of extrajudicial violence, engaged in trickery or deceptive conduct, or made promises of leniency in order to induce the Daubmanns into making incriminating statements.” 474 F. Supp. 2d at 235. Since the statements were voluntary, the supplemental warrant was lawful and the documents seized pursuant to that warrant would not be suppressed.

**(Hyde Amendment)** – In *United States v. Lawrence*, 2007 WL 627887 (7th Cir. (Ill.)) (March 1, 2007), Lawrence was charged with tax evasion in violation of 26 U.S.C. § 7201 and

willful failure to file income taxes in violation of 26 U.S.C. § 7203. Lawrence disputed the charges based on tax protestor-type arguments, including that the Paperwork Reduction Act of 1995 required the IRS to display valid Office of Management and Budget numbers on Forms 1040 and, because no such number is on the forms, the government is prohibited from imposing criminal penalties for failure to file. Prior to trial, the government determined an error in computing the tax amount due and, as a result, successfully moved to dismiss the indictment.

Lawrence moved for legal fees and costs under the Hyde Amendment, Pub. L. No. 105-119, § 617, 111 Stat. 2519 (1997) (*reprinted in* 18 U.S.C. § 3006A, historical and statutory notes), which allows a court to award “a reasonable attorney fee ... where the court finds that the position of the United States was “vexatious, frivolous, or in bad faith....” *Id.* The Seventh Circuit denied the request, finding that Lawrence failed to establish that his position was supported by case law or that the government took a position that satisfied the requirements of the Hyde Amendment.

**(Motion to Quash)** – In *United States v. Crabbe*, 2007 WL 776322 (D. Colo.) (March 9, 2007), Crabbe and Rowan owned and were principal officers of Columbine Healthcare Systems, Inc. (“CHS”). They were charged with a variety of employment tax offenses in violation of 26 U.S.C. § 7201, § 7202, § 7203 and § 7206(1). The evasion charges (§ 7201) stem from the use of a shell company, Global Management LLC (“Global”), to pay management fees which the defendants’ instructed their accountant to report as a note payable to CHS from Global to avoid income tax. The prosecution noted its intent to call the accountant, H. Wayne Hoover (“Hoover”), as a government witness.

Rowan successfully moved the court to issue a *subpoena duces tecum* to the Colorado Board of Accountancy (“the Board”) to provide all documents related to a complaint filed by Catherine Gebhardt, a former employee of CHS, against Hoover concerning the propriety of reporting management fees as a note payable, as well as all documents related to the Board’s investigation of Hoover in a disciplinary proceeding. The Board moved to quash, arguing that records of dismissed charges are subject to “official information privilege” pursuant to C.R.S. § 12-2-126(1)(b).

In denying the motion to quash, the district court noted that Federal Rule of Evidence 501 governs the assertion of privilege in a federal criminal case and provides that privilege “shall be governed by the principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience,” and not by substantive state law. The court further noted that a defendant’s Sixth Amendment right to confrontation may trump any interest of a state in protecting investigative files. *Crabbe*, at \*3. The court held that the documents should be produced because they were at least relevant to the defendants’ case, even if not necessarily admissible later at trial.

**(Motion to Suppress)** – In *United States v. Stierhoff*, --- F. Supp. 2d ---, 2007 WL 763984 (D.R.I.) (March 13, 2007), Stierhoff was charged with four counts of tax evasion in violation of 26 U.S.C. § 7201. The charges arose from evidence found on Stierhoff’s computer after Stierhoff was arrested for stalking. Stierhoff moved to suppress the tax-related evidence, arguing that the government’s search of his computer exceeded the scope of his consent.

Stierhoff claimed that his consent to search his computer for evidence of stalking was limited to the folder labeled “Creative Writing,” which contained poems he wrote to the woman who accused him of stalking. The tax-related evidence was found in another folder labeled “Offshore.” The government argued, *inter alia*, that Stierhoff’s consent to search his computer was unlimited and that Stierhoff’s direction to the government of where he stored his poems was to assist, not limit, the government in its search.

The court found that Stierhoff had a legitimate expectation of privacy concerning the contents of his computer and that his consent to search his computer was limited to the “Creative Writing” folder. The court held that the government’s opening and viewing of the contents of the “Offshore” folder was a warrantless search. As a result, the evidence obtained would be suppressed unless an exception to the warrant requirement of the Fourth Amendment applied.

The government argued that it was entitled to search the “Offshore” folder under the plain view doctrine. The court accepted that the government lawfully accessed the “My Files” directory and then saw the “Offshore” folder, but rejected the argument that the “Offshore” folder was “clearly incriminating on its face.” *Stierhoff*, at \*19. The court analogized the folder to a closed container, in which Stierhoff had a reasonable expectation of privacy. Thus, the plain view doctrine did not remedy the warrantless search. Moreover, while a warrant was eventually obtained, because the warrant was premised on evidence found in the initial illegal search of the “Offshore” folder, it did not solve the problem. The tax-related evidence was suppressed.

**(Fifth Amendment)** – In *United States v. Taylor*, 2007 WL 805662 (D. Ariz.) (March 14, 2007), the United States commenced an action pursuant to 26 U.S.C. §§ 7402(a) and 7604(a) to enforce an IRS summons issued to Taylor to produce books, records, papers and other data relating to the collection of her tax liability. The district court issued a Motion to Show Cause for Contempt against Taylor and set a hearing date, but Taylor failed to appear. The court found her in civil contempt and issued a bench warrant. Following Taylor’s arrest, the court requested briefing on whether Taylor’s Fifth Amendment privilege against self-incrimination precluded the government from coercing Taylor into disclosing the documents identified in the summons.

Taylor did not claim that the contents of the documents at issue were privileged, but that her Fifth Amendment privilege applies to the act of production, which “may have incriminating testimonial aspects.” *Taylor*, at \*3 (citing *United States v. Hubbell*, 530 U.S. 27, 36 (2000)). The incrimination stems from the concession, by production, that certain documents exist, were in the possession and control of the taxpayer, and were the documents identified in the summons. *Id.* (citing *Fisher v. United States*, 425 U.S. 391, 411 (1976)). In *Fisher*, the Supreme Court noted that there is no Fifth Amendment protection if “[t]he existence and location of the papers are a foregone conclusion and the taxpayer adds little or nothing to the sum total of the Government’s information by conceding that he in fact has the papers.” *Fisher*, 425 U.S. at 411.

The documents at issue include statements of Visa debit cards associated with an offshore financial institution, which the government learned of through its Offshore Credit Card Project (“OCCP”). Taylor claims that the act of producing such documents would be an admission of the existence and her possession of those records.

Citing *United States v. Norwood*, 420 F.3d 888 (8th Cir. 2005), the district court held that because the Service had significant information from the OCCP connecting Taylor to the financial institution at issue, the offshore accounts and use of the cards, the existence of those records is a foregone conclusion. Thus, the Fifth Amendment does not protect Taylor's production of the requested documents.

The court also addressed whether the enforcement of the summons should be stayed in light of the subsequent referral to the Department of Justice. When pursuing a summons enforcement action, the IRS must show that no Justice Department referral is in effect with respect to the taxpayer. 26 U.S.C. § 7206(d). The court noted that the statute limits the prohibition to *commencing* summons enforcement actions while a referral is pending, not *continuing* such action when a referral arises. *Taylor*, at \*7 (citing 26 U.S.C. § 7206(d)(1)).

Taylor argued that the Congressional intent behind § 7206(d)(1) was to prevent the IRS from using the civil summons power after a matter is referred. The district court rejected this approach, looking to the plain language of the statute and finding that the statute only restricts when the IRS may begin a summons enforcement action. *Taylor*, at \*7 (citing *Drum v. United States*, 602 F. Supp. 834 (M.D. Pa. 1985), and *Garpeg, Ltd. v. United States*, 583 F. Supp. 799, 802 (S.D.N.Y. 1984)). Based on the foregoing, the court held that the referral did not preclude the continued execution of the summons.

**(Levy on Bond)** – In *United States v. Taylor*, 2007 WL 926917 (D. Ariz.) (March 23, 2007), Taylor, was released from custody after a third-party, R.J. McBride, posted a \$100,000 cash bond on her behalf. After the bond was posted, the United States filed a Notice of Levy to the district court, claiming that Taylor owed the IRS approximately \$200,000. Upon learning of the levy, McBride filed a letter with the Court claiming ownership of the bond and asserting that the court was not authorized to release it to anyone other than himself.

The court construed McBride's letter as a challenge to the levy, which was premature, since Taylor was still on release pursuant to the bond. More importantly, the court stated that it lacks jurisdiction to consider a challenge to a levy in a bail exoneration proceeding. To challenge the levy, McBride was required to bring a wrongful levy action pursuant to 26 U.S.C. § 7426. Without such an action pending, when it came time to exonerate the bond, the court would be required to turn the proceeds over to the IRS without regard to the validity of the levy or ownership of the funds. *Taylor*, at \*2 (citing *United States v. Badger*, 930 F.3d 754, 756 (9th Cir. 1991)).

**(Discovery)** – In *United States v. Folkers*, 2007 WL 677703, 99 A.F.T.R.2d 2007-1336 (D. Kan.) (February 28, 2007), *reconsideration denied*, 2007 WL 1041770 (D. Kan.) (April 5, 2007), Folkers became involved with Anderson's Ark and Associates ("AAA"), a promoter of tax schemes, and was later charged with willfully filing false tax returns and applications for tentative refunds in violation of 26 U.S.C. § 7206(1). Folkers moved for broad pretrial discovery regarding whether its witnesses, including IRS employees, were presently subject to audit or investigation by the IRS and limited discovery regarding his claim of selective prosecution.

The district court found, pursuant to *Brady v. Maryland*, 373 U.S. 83, 87 (1963), that the tax audit information of government witnesses constituted impeachment evidence, which could demonstrate a possible bias or prejudice of the witnesses. Accordingly, the court granted Folkers' motion.

With regard to his request for discovery regarding selective prosecution, Folkers argued that he was singled out for prosecution among similarly situated Anderson Ark investors because he refused to admit that the AAA loan program was illegitimate and conditioned his continued cooperation with IRS agents on their submission of written questions to his attorney. The government disputes Folkers' contention, maintaining that other investors were not prosecuted because they were cooperating with the government and/or the government lacked evidence that those individuals acted willfully. The district court was not convinced. It granted Folkers' motion but, in recognition of the potential burden on the government, limited discovery to material information the government has knowledge of or access to regarding the 145 individuals identified by the government as "victims" of the alleged investment fraud.

**(Violation of Probation)** - In *United States v. Barry*, 2007 WL 734041 (D.D.C.) (March 12, 2007), Marion S. Barry, Jr. pled guilty to two counts of willful failure to file federal and state income tax returns, and was sentenced on March 9, 2006 to concurrent terms of probation. On February 1, 2007, the United States Attorney moved to revoke Barry's probation based on Barry's failure to timely file his 2005 return, an express condition of his release. Barry opposed the motion, arguing that he had now filed his 2005 returns and that his probation officer had not joined the request for revocation of his probation.

The district court reviewed Federal Rule of Criminal Procedure 32.1, which addresses the rights of a probationer with respect to proceedings to revoke or modify probation or supervised release, and the manner in which a court must conduct preliminary, revocation and modification hearings. The court also noted the absence of a provision in Rule 32.1, or in any rule of criminal procedure or statute, which expressly allows the United States Attorney to move to revoke probation. The Court denied the government's motion based on its finding that the United States Attorney was not authorized to file such a request.