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**CAPTURING THE HARM: DEFINING "TAX LOSS"  
FOR USE IN FEDERAL SENTENCING**

by

Bruce Zucker\* and Michelle Carey\*\*

The United States Sentencing Guidelines have set forth the system by which tax offenders are punished for violating the federal income tax laws. This Article explores the various methods that the appellate courts have used to define "tax loss" under the United States Sentencing Guidelines for purposes of sentencing enhancement for tax related offenses. It discusses the concept of "tax loss" for federal sentencing purposes, including the guideline provisions that drive the tax offender's offense level and ultimate guideline imprisonment range. It explores major circuit decisions which interpreted the proper implementation of the guideline sentencing factors. Finally, it examines issues that remain unresolved and critiques some of the positions and methods that the reviewing courts have taken with respect to issues discussed in this article.

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## I. INTRODUCTION

In 1984, Congress passed the Sentencing Reform Act of 1984<sup>1</sup>, which revamped the federal sentencing system in the United States. As part of this change of law, Congress established the United States Sentencing Commission<sup>2</sup> and charged it with creating and disseminating a compilation of binding sentencing guidelines for use in the federal criminal justice system.<sup>3</sup> The Commission is free to amend any provision of the guidelines, but Congress must approve each new guideline provision before it may take effect.<sup>4</sup> These guidelines have the same weight and have the same force and effect as rules and regulations promulgated by federal agencies.<sup>5</sup>

The United States Sentencing Guidelines contain nineteen separate categories of offense behavior, each having several subclasses within them.<sup>6</sup> Offenses involving taxation are found at Chapter Two, Part T ("Offenses Involving Taxation"), which contains ten separate subcategories of tax-related offenses.<sup>7</sup>

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<sup>1</sup> Pub. L. No. 98-473, §§ 211-239, 98 Stat. 1837, 1987 (1984).

<sup>2</sup> 28 U.S.C. § 991(b) (1997).

<sup>3</sup> 28 U.S.C. § 994(a) (1997). *See also* U.S. SENTENCING GUIDELINES MANUAL § 1A intro. comment (1998). "The [Sentencing Reform Act of 1984] delegates broad authority to the [Sentencing] Commission to review and rationalize the federal sentencing process." *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> *Stinson v. United States*, 508 U.S. 36, 45, (1993).

<sup>6</sup> U.S. SENTENCING GUIDELINES MANUAL Ch. 2 (1998) "Chapter Two pertains to offense conduct. The chapter is organized by offenses and divided into parts and related sections that may cover one statute or many. Each offense has a corresponding base offense level and may have one or more specific offense characteristics that adjust the offense level upward or downward." *Id.*

<sup>7</sup> U.S. SENTENCING GUIDELINES MANUAL § 2T (1998), *et. seq.* The tax guidelines are categorized into three main areas: offenses involving income, employment, estate, gift, and excise taxes; alcohol and tobacco taxes; and customs taxes. Specifically, these categories have ten individual offense guidelines as follows: U.S. SENTENCING GUIDELINES MANUAL §2T1.1 (1998) (Tax Evasion; Willful Failure to File Return, Supply Information or Pay Tax; Fraudulent or False Returns, Statements or Other Documents); U.S. SENTENCING GUIDELINES MANUAL §2T1.4 (1998) (Aiding, Assisting, Procuring, Counseling, or Advising Tax Fraud); U.S. SENTENCING GUIDELINES MANUAL §2T1.6 (1997) (Failing to Collect or Truthfully Account for and Pay Over Tax); U.S. SENTENCING GUIDELINES MANUAL §2T1.7 (1997) (Failing to Deposit Collected Taxes in Trust Account as Required After Notice); U.S. SENTENCING GUIDELINES MANUAL § 2T1.8 (1998) (Offenses Relating to Withholding Statements); U.S. SENTENCING GUIDELINES MANUAL § 2T1.9 (1998) (Conspiracy to Impede, Impair, Obstruct, or Defeat Tax); U.S. SENTENCING GUIDELINES MANUAL § 2T2.1 (1998) (Non-Payment of [Alcohol and Tobacco] Taxes);

The Sentencing Commission defined the overriding goals and objectives in its introductory commentary to this guideline:

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. Recognition that the sentence for a criminal tax case will be commensurate with the gravity of the offense should act as a deterrent to would-be violators.<sup>8</sup>

The Sentencing Commission set forth its goals in the policy statement. Moreover, it lists several application instructions for courts to follow when applying the guidelines to a particular offense, including the method for selecting the applicable guideline,<sup>9</sup> the base offense level and offense characteristic enhancements,<sup>10</sup> other adjustments for victim, role, and obstruction of justice,<sup>11</sup> and criminal history.<sup>12</sup>

Notwithstanding these mandates and the care the Commission used when drafting the guidelines,<sup>13</sup> and notwithstanding the additional guidance it provided through commentary and application notes to the various individual guideline sections, several questions remain as to the proper application of the tax guidelines to specific offenses. For example, how should a sentencing court interpret "tax loss" for purposes of determining the offense level? May it consider collateral

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U.S. SENTENCING GUIDELINES MANUAL § 2T2.2(1998) (Regulatory Offenses); U.S. SENTENCING GUIDELINES MANUAL § 2T3.1 (1998) (Evading Import Duties or Restrictions (Smuggling); Receiving or Trafficking in Smuggled Property).

<sup>8</sup> U.S. SENTENCING GUIDELINES MANUAL intro. comment § 2T1.1 (1998). This introductory comment became effective on November 1, 1987 and, to date, has not been revised. THOMAS W. HUTCHINSON, FEDERAL SENTENCING LAW AND PRACTICE, at 675 (1998).

<sup>9</sup> U.S. SENTENCING GUIDELINES MANUAL § 1B1.1(a) (1998).

<sup>10</sup> U.S. SENTENCING GUIDELINES MANUAL § 1B1.1(b) (1998).

<sup>11</sup> U.S. SENTENCING GUIDELINES MANUAL § 1B1.1(c) (1998).

<sup>12</sup> U.S. SENTENCING GUIDELINES MANUAL § 1B1.1(f) (1998).

<sup>13</sup> The Sentencing Commission attempted to incorporate as many possibilities and situations as possible by examining the data and conducting statistical analyses of over 40,000 convictions. U.S. SENTENCING GUIDELINES MANUAL § 1A5 (1998). "The Commission emphasizes that it drafted the initial guidelines with considerable caution." *Id.*

state, local, foreign, or any other non-federal tax loss in the computations? Does the statute of limitations that otherwise cuts off the ability for the government to prosecute a particular taxable year not apply when determining tax-loss for purposes of sentencing enhancement?

This Article examines these and other issues and explores the various methods that the appellate courts have used to define "tax loss" under the United States Sentencing Guidelines for purposes of sentencing enhancement for tax-related offenses. It discusses the concept of "tax loss" for federal sentencing purposes, including the guideline provisions that drive the tax offender's offense level and ultimate guideline imprisonment range. It explores major circuit decisions which address certain ambiguous provisions in the tax section of the Guidelines. Finally, it examines issues that remain unresolved and critiques some of the positions and methods that the reviewing courts have taken with respect to issues discussed in this article.

## II. TAX LOSS

### A. Guideline Definitions

The Sentencing Guidelines employ the concept of "tax loss" as the foundation for deciding the proper sentence for tax fraud and related revenue laws.<sup>14</sup> As a starting point, most of the tax guidelines call for the determination of the base offense level by referring to the Tax Table found at U.S.S.G. section 2T4.1,<sup>15</sup> referencing the appropriate tax loss.<sup>16</sup> The Tax Table ranges from \$1,700 or less

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<sup>14</sup> United States v. Harvey, 996 F.2d 919 (7<sup>th</sup> Cir. 1993). See also U.S. SENTENCING GUIDELINES MANUAL § 2T1.1 (1997), comment (backg'd).

"This guideline relies most heavily on the amount of loss that was the object of the offense. Tax offenses, in and of themselves, are serious offenses; however, a greater tax loss is obviously more harmful to the treasury and more serious than a smaller one with otherwise similar characteristics. Furthermore, as the potential benefit from the offense increases, the sanction necessary to deter also increases."

*Id.*

<sup>15</sup> U.S. SENTENCING GUIDELINES MANUAL § 2T4.1 (1998).

<sup>16</sup> The following tax guidelines utilize the Tax Table found at U.S. SENTENCING GUIDELINES MANUAL § 2T4.1 (1998) as the method for setting the base offense level, provided a "tax loss" exists: U.S. SENTENCING GUIDELINES MANUAL § 2T1 (1998) (Income Taxes, Employment Taxes, Estate Taxes, Gift Taxes, and Excise Taxes (Other Than Alcohol, Tobacco, and Customs Taxes)); U.S. SENTENCING GUIDELINES MANUAL § 2T1.4 (1998) (Aiding, Assisting, Procuring, Counseling, or Advising Tax

(calling for a base offense level of six) to more than \$80,000,000, (calling for a base offense level of twenty-six). For a first time offender with no criminal history, these offense levels may translate into sentences ranging from probation on the low-end to six years incarceration on the high-end.

The Tax Table alone does not explain how a sentencing court determines the appropriate loss figure. However, U.S.S.G. § 2T1.1(c) provides the basic mechanisms for the courts to follow when making these determinations.

The majority of tax offenses stem from violations of 26 U.S.C. § 7201 (false statement on tax returns), the guideline for which is found at U.S.S.G § 2T1.1.<sup>17</sup> As such, a plethora of case law and disputes have arisen over issues surrounding it. Although there is substantial overlap among all of the guidelines, especially those that are "loss driven,"<sup>18</sup> this Article will focus primarily on U.S.S.G. § 2T1.1.

First, the guidelines direct that "tax loss" may be determined by computing 28% of the unreported gross income or improper claim of deduction<sup>19</sup> or exemption (34% if the defendant is a corporation).<sup>20</sup> In addition, if any false tax credits<sup>21</sup> were

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Fraud); U.S. SENTENCING GUIDELINES MANUAL § 2T1.6 (1998) (Failing to Collect or Truthfully Account for and Pay Over Tax); U.S. SENTENCING GUIDELINES MANUAL § 2T1.7 (1998) (Failing to Deposit Collected Taxes in Trust Account as Required After Notice); U.S. SENTENCING GUIDELINES MANUAL § 2T1.9 (1998) (Conspiracy to Impede, Impair, Obstruct, or Defeat Tax); U.S. SENTENCING GUIDELINES MANUAL § 2T2.1 (1998) (Non-Payment of Taxes); U.S. SENTENCING GUIDELINES MANUAL § 2T3.1 (1998) (Evading Import Duties or Restrictions (Smuggling); Receiving or Trafficking in Smuggled Property).

<sup>17</sup> See U.S. SENTENCING GUIDELINES MANUAL App. A (1998) (Statutory Index).

<sup>18</sup> See, e.g., U.S. SENTENCING GUIDELINES MANUAL § 2B1.1(b)(1) (1998) (Loss table increasing offense level for offenses involving larceny, embezzlement, theft, and receipt of stolen property); U.S. SENTENCING GUIDELINES MANUAL § 2F1.1(b)(1) (1998) (Loss table increasing offense level for offenses involving fraud, deceit, forgery, and counterfeit instruments); U.S. SENTENCING GUIDELINES MANUAL § 2S1.1(b)(2) (1998) (Loss table for offenses involving laundering monetary instruments).

<sup>19</sup> A tax "deduction" "reduces the amount of taxable income." U.S. SENTENCING GUIDELINES MANUAL § 2T1.1 (1998), comment. (n. 5).

<sup>20</sup> U.S. SENTENCING GUIDELINES MANUAL § 2T1.1(c)(1)(A),(B) (1998). "Gross income" is defined as

"all income from whatever source derived, including (but not limited to) the following items: compensation for services, including fees, commissions, fringe benefits, and similar items; gross income derived

claimed as part of the offense, that entire amount will be added to the "tax loss" figure.<sup>22</sup> If the offense involved the failure to file a tax return (with a consequential loss to the government), a failure to pay tax, or a fraudulent claim for a tax refund, the "tax loss" is the respective amount that the defendant failed to pay.<sup>23</sup>

Second, contrary to the heightened burden of proof which normally operates in a criminal case for purposes of achieving a criminal conviction or suppressing evidence, for sentencing purposes, the government need only prove the conduct supporting the loss figure by a preponderance of the evidence. Also contrary to trial or other law and motion proceedings, information concerning any sentencing factor is admissible, even if it violates the Federal Rules of Evidence.

"In resolving any dispute concerning a factor important to the sentencing determination, the court may consider relevant information *without regard* to its admissibility under the rules of evidence applicable at trial, provided that the information has sufficient indicia of reliability to support its probable accuracy."<sup>24</sup> Provided that the sentencing court's conclusions are supported by a preponderance of the evidence, the reviewing court must affirm the decision below.<sup>25</sup>

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from business; gains derived from dealings in property; interest; rents; royalties; dividends; alimony and separate maintenance payments; annuities; income from life insurance and endowment contracts; pensions; income from discharge of indebtedness; distributive share of partnership gross income; income in respect of a decedent; and income from an interest in an estate or trust."

26 U.S.C. § 61(a).

<sup>21</sup> A "credit claimed against tax" "reduces the amount of tax directly." U.S. SENTENCING GUIDELINES MANUAL §2T1.1, comment. (n.5) (1998).

<sup>22</sup> U.S. SENTENCING GUIDELINES MANUAL § 2T1.1(c)(1)(A),(B) (1998).

<sup>23</sup> U.S. SENTENCING GUIDELINES MANUAL § 2T1.1(c)(3), (4) (1998).

<sup>24</sup> U.S. SENTENCING GUIDELINES MANUAL § 6A1.3, p.s. (1998); 18 U.S.C. § 3661 (emphasis added). This practice carries forward from the pre-guidelines era. However, many factors that ordinarily would not automatically have had a direct bearing on the length or type of sentence during the pre-guidelines era (such as evidence of criminal history and other offense conduct or behavior) is no longer the case under sentencing guidelines. *Id.*, at § 6A1.3, comment (1998).

<sup>25</sup> *United States v. Whitson*, 125 F. 3d 1071, 1074 (7<sup>th</sup> Cir. 1997); *United States v. Hopson*, 18 F. 3d 465, 467 (7<sup>th</sup> Cir. 1994), *cert. denied*, 512 U.S. 1243 (1994); *United States v. Chandler*, 12 F. 3d 1427, 1434 (7<sup>th</sup> Cir. 1994). *See also* *Witte v. United States*, 515 U.S. 389, 399-401 (1995); *Nichols v. United States*, 511 U.S. 738, 747-48 (1994); *United States v. Petty*, 982 F. 2d 1365, 1367 (9<sup>th</sup> Cir. 1993), *cert. denied*, 510 U.S. 1040 (1994) (stating that hearsay evidence may be considered at sentencing hearing, provided it contains sufficient indicia of reliability), *accord*, *United States v. Sciarrino*, 884 F. 2d 95, 97 (3d Cir. 1989), *cert. denied* 493 U.S. 997 (1989). *See also*, *United States v. McIver*, 186 F.3d 1119

It is important to note that the government is *not* required to show that it actually suffered a loss of these respective amounts in tax.<sup>26</sup> Similarly, once the offense is committed (such as the commission of a false statement on a tax return or the failure to withhold and submit tax by the due date), the tax loss will not be reduced by a subsequent payment of the unreported or evaded tax.

For example, in *United States v. Tandon*,<sup>27</sup> a Cleveland, Ohio physician was convicted of multiple counts of willfully filing false personal income tax returns and one count of aiding and assisting in the filing of a false corporate income tax return.<sup>28</sup> When sentencing the defendant, the court included the amount of tax that the defendant willfully failed to report on the tax years in question. The court did not reduce the tax loss by the amounts the defendant subsequently paid to the Internal Revenue Service (IRS) for two of the tax years at issue, but prior to the date of conviction and sentencing. The defendant argued that the court should have offset the tax loss figure by the total amount of money that he paid to the IRS. This adjustment, the defendant noted, would result in a tax loss figure that includes only the total amount of actual harm to the government.<sup>29</sup>

The Sixth Circuit Court of Appeals disagreed. The proper measure of harm to the government necessarily includes the "amount by which the income was understated on the false tax returns and not on whether the government ultimately lost money."<sup>30</sup> To find otherwise would permit offenders to reduce the severity of their sentences by remitting payment to the government once it uncovers the commission of the crime. Such an approach violates the very notion fundamental to American jurisprudence—criminals, by virtue of their wealth and financial position, should not be in any better position to avoid a criminal conviction or lessen the impact of their sentences than one who lacks money.

As noted above, sentencing courts have taken the position that "tax loss" may not be reduced by amounts subsequently paid to the IRS. This position is fair, reasonable, and consistent with the rules concerning loss in other sections of the Sentencing Guidelines.

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(9<sup>th</sup> Cir. 1999)(explaining that evidence suppressed at trial may be used for purposes of determining sentence under the Sentencing Guidelines).

<sup>26</sup> See *United States v. Noske*, 117 F. 3d 1053, 1060 (8<sup>th</sup> Cir. 1997).

<sup>27</sup> 111 F. 3d 482 (6<sup>th</sup> Cir. 1997).

<sup>28</sup> *Id.* at 484.

<sup>29</sup> *Id.* at 490.

<sup>30</sup> *Id.*



The government may use the percentage method of approximating the loss and, therefore, approximate the level of criminal culpability. But, in all of these situations, if a "more accurate determination of the tax loss can be made" that method will prevail over the guideline defined methods.<sup>31</sup>

The rules for determining "tax loss" for criminal culpability purposes are not necessarily the same for those used to determine civil liability under the regulatory statute.<sup>32</sup> The Guidelines focus on other methods and mechanisms for extrapolating information independent of the various civil statutes and regulations establishing measures of tax liability.

### *B. "Reasonable Estimate" Method*

There may be instances where it is not possible or reasonable to use the percentage of income evaded in order to reach a just and fair tax loss figure. However, under such circumstances, the district court is not bound to use any of the methods discussed above. In such situations, the guidelines permit the court to make a "reasonable estimate" of the tax loss.<sup>33</sup> The guidelines thus empower the district court with broad latitude in order to arrive at the proper harm caused by the defendant's activities.

However, it should be noted that the authority for establishing this "reasonable estimate" method for determining tax loss has been called into question by at least one commentator who was critical of the Sentencing Commission

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<sup>31</sup> U.S. SENTENCING GUIDELINES MANUAL § 2T1.1(c)(1)(B) (1998).

<sup>32</sup> See *United States v. Furkin*, 119 F. 3d 1276, 1281 (7<sup>th</sup> Cir. 1997).

<sup>33</sup> "In some instances, such as when indirect methods of proof are used, the amount of the tax loss may be uncertain; the guidelines contemplate that the court will simply make a reasonable estimate based on the available facts." U.S. SENTENCING GUIDELINES MANUAL § 2T1.1, comment. (n. 1) (1998). This approach is consistent with the spirit of the application of loss for all sections of the Sentencing Guidelines. See also U.S. SENTENCING GUIDELINES MANUAL § 2F1.1, comment. (n. 8) (1998)

For generic fraud and deceit cases, "... loss need not be determined with precision. The court need only make a reasonable estimate of the loss, given the available information. This estimate, for example, may be based on the approximate number of victims and an estimate of the average loss to each victim, or on more general factors, such as the nature and duration of the fraud and the revenues generated by similar operations."

*Id.* See, e.g., *United States v. Bryant*, 128 F. 3d 74 (2<sup>nd</sup> Cir. 1997).

establishing evidentiary standards for the court to follow.<sup>34</sup> Nonetheless, courts throughout the country have endorsed and followed the "reasonable estimate" method.<sup>35</sup>

Given that the sentencing process in tax cases may become quite time consuming, complex, and unduly burdensome upon the court, it seems that the "reasonable estimate" method is a fair attempt by the Sentencing Commission to give the district court the ability to achieve some sense of balance and fairness to follow when fashioning a proper sentence. The "reasonable estimate" standard has not been tested by the appellate courts, so whether it passes constitutional muster has yet to be addressed. No matter what method the court ultimately employs, a reviewing court will be very deferential to the district court's often fact-based decision as to which permissible method.<sup>36</sup>

### C. Relevant Conduct

#### 1. Overview of Relevant Conduct Generally

One of the most controversial aspects of the Sentencing Guidelines involves the use of conduct outside the scope of the count or counts of conviction for purposes of sentence enhancement.<sup>37</sup> Regardless of whether an individual

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<sup>34</sup> T. HUTCHISON, FEDERAL SENTENCING LAW AND PRACTICE, at 589 (West 1997). "The [Sentencing] Commission...has no authority under 28 U.S.C. § 994 to establish evidentiary standards; it is for the courts to determine what proof will suffice to establish various facts underlying application of the guidelines." *Id.*

<sup>35</sup> *See, e.g.,* Bryant, 128 F. 3d at 76 (explaining that the court saw "no reason why [the methodology of engaging in estimates or extrapolations for determining loss in a theft case as discussed at U.S. SENTENCING GUIDELINES MANUAL § 2F1.1, comment. (n. 8) (1998) or at U.S. SENTENCING GUIDELINES MANUAL § 2B1.1, comment. (n. 2) (1998)] may not be used in a [tax case.]")

<sup>36</sup> *See, e.g.,* United States v. Valenti, 121 F. 3d 327, 334 (7<sup>th</sup> Cir. 1997) (holding that district court followed the proper application of the Sentencing Guidelines when it estimated the tax loss caused by the defendant at 20% of total gross income and denied defendant's request to offset that amount by his alleged estimated business expenses—such actions by the district court did not amount to "clear error."); *See also* United States v. Jackson, 95 F. 3d 500, 506 (7<sup>th</sup> Cir. 1996), *cert. denied*, 519 U.S. 973, (1996); United States v. Benitez, 92 F. 3d 528, 536 (7<sup>th</sup> Cir. 1996); United States v. Carmack, 100 F. 3d 1271, 1276 (7<sup>th</sup> Cir. 1996).

<sup>37</sup> U.S. SENTENCING GUIDELINES MANUAL § 1B1.3 (1998).

"[T]he applicability of [Guideline Section 1B1.3(a)(2)] does not depend upon whether multiple counts are alleged. Thus, in an embezzlement case, for example, embezzled funds that may not be specified in any count

defendant stands convicted of any particular criminal conduct, any reasonably foreseeable actions committed by the defendant or by a co-participant that is deemed to be in furtherance of the criminal activity will be considered relevant conduct.<sup>38</sup> Thus, in a tax offense case, the district court is free to examine all of the evidence proffered by the government in order to determine the "tax loss."<sup>39</sup>

The authority for considering all "relevant conduct" is found at U.S.S.G. section 1B1.3, which states that the base offense level, specific offense characteristics, and cross references in Chapter Two shall be determined by considering

"all acts and omissions committed, aided, abetted, counseled, commanded, induced, procured, or willfully caused by the defendant, and, in the case of jointly undertaken activity,<sup>40</sup> all reasonably foreseeable acts and omissions of others in furtherance of the jointly undertaken criminal activity, that occurred during the commission of the offense of conviction, in preparation for that

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of conviction are nonetheless included in determining the offense level if they were part of the same course of conduct or part of the same scheme or plan as the count of conviction."

U.S. SENTENCING GUIDELINES MANUAL § 1B1.3, comment (backg'd) (1998). *See also* United States v. Ritsema, 31 F. 3d 559, 567 (7<sup>th</sup> Cir. 1994) (noting that the "relevant conduct provision directs a court to sentence a defendant for uncharged conduct germane to the charge-offense by authorizing it to consider events before, during, and after the offense conduct"); United States v. Tucker, 20 F. 3d 242, 245 (7<sup>th</sup> Cir. 1994) (explaining that "conduct that is not formally charged or is not an element of the offense of conviction may enter into the determination of the applicable guideline range"); United States v. Smith, 5 F. 3d 259, 262 (7<sup>th</sup> Cir. 1993) (explaining that "no limitation shall be placed on the information concerning the background, character, and conduct of a person convicted of an offense which a court of the United States may receive and consider for the purpose of imposing an appropriate sentence.").

<sup>38</sup> "The principles and limits of sentencing accountability under [the relevant conduct guideline] are not always the same as the principles and limits of criminal liability." U.S. SENTENCING GUIDELINES MANUAL § 1B1.3, comment. (n.1) (1998).

<sup>39</sup> United States v. Valenti, 121 F. 3d 327, 333 (7<sup>th</sup> Cir. 1997).

<sup>40</sup> "Jointly undertaken criminal activity" is defined as "a criminal plan, scheme, endeavor, or enterprise undertaken by the defendant in concert with others, whether or not charged as a conspiracy." U.S. SENTENCING GUIDELINES MANUAL § 1B1.3, comment. (n. 2) (1998). In order to qualify as "jointly undertaken," the relevant conduct at issue must be both "in furtherance of the jointly undertaken criminal activity" and "reasonably foreseeable in connection with that criminal activity." *Id.*

offense, or in the course of attempting to avoid detection or responsibility for that offense."<sup>41</sup>

In addition, relevant conduct includes all acts and omissions that were part of the same course of conduct or common scheme or plan as the offense of conviction.<sup>42</sup>

## 2. Relevant Conduct and Tax Loss

It is easy to see how the doctrine of relevant conduct is applied to tax cases. For example, in *United States v. Noske*,<sup>43</sup> several individuals, including James L. Noske, a law school graduate, and his sister, Joan M. Noske, an accountant, operated a business whereby they assisted individuals, who owed the IRS unpaid tax, disguise their income and assets through a scheme involving the use of sham non-profit corporations.<sup>44</sup> The defendants had their clients transfer their assets and other property to the dummy corporations in order to keep the IRS away.<sup>45</sup> However, the clients retained full control over their income and property.<sup>46</sup>

The defendants were charged and convicted of conspiracy to defraud the IRS with respect to three separate individuals' tax situations.<sup>47</sup> However, the defendants were also involved in many other similar transactions involving other taxpayers and using the same artifice to hide income and assets.<sup>48</sup>

Although the counts of conviction only involved conduct centering around the three separate taxpayers, the district court took into account information concerning uncharged conduct, provided by the IRS, whereby other taxpayers utilized the defendants' fraud scheme in order to evade the payment of tax owed to the government. The Eighth Circuit affirmed the inclusion of this uncharged conduct as consistent with the relevant conduct provisions found at Section 1B1.3, stating that "the district court also properly included for uncharged relevant criminal conduct the amounts of tax, computed from IRS files, evaded by [other] clients. . .<sup>49</sup>

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<sup>41</sup> U.S. SENTENCING GUIDELINES MANUAL § 1B1.3(a) (1998).

<sup>42</sup> *Id.*

<sup>43</sup> 117 F. 3d 1053 (8<sup>th</sup> Cir. 1997).

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

<sup>47</sup> *Id.* at 1056-57.

<sup>48</sup> *Id.*

<sup>49</sup> *Noske*, 117 F. 3d at 1060.

The Tenth Circuit reached a similar conclusion in *United States v. Meek*.<sup>50</sup> In *Meek*, the defendant was convicted of failure to pay required federal income tax and failure to file income tax returns for 1987 and 1988. At sentencing, the district court based its guideline calculations on the actual tax avoided for the two years at issue in the indictment. In addition, it included in its computation an approximation of unpaid income tax for tax years 1984, 1985, 1986, 1989, 1990, and 1991, by calculating 28% of gross income for those years. The other years were not included in the indictment.<sup>51</sup>

The defendant contested the district court's method of calculating the tax loss. He argued that the district court should not have included any loss for tax years that were not presented in the indictment, nor should it have included tax loss involving a time period for which he was not convicted.<sup>52</sup>

The Court of Appeals disagreed. "The aggregation determination is addressed by [Sentencing Guideline] section 3D1.2, which requires aggregation of all counts of conviction involving substantially the same harm, and [Sentencing Guideline] section 1B1.3, which requires aggregation of all 'relevant conduct' when determining a defendant's base offense level."<sup>53</sup> Even though the defendant was not charged for the other years in question, the 'relevant conduct' guideline at section 1B1.3(a)(2) directs the sentencing court to consider all acts . . . or omissions that were part of the same course of conduct or common scheme or plan as the offense of conviction,<sup>54</sup> regardless of whether the defendant stands convicted of such conduct, and irrespective of whether it had even been charged in the first place.<sup>55</sup>

As a second matter, the Court of Appeals found that the failure to file income tax returns resulting in tax loss to the government for the uncharged years was properly considered relevant conduct because the failure to file was "the same course of conduct" as contemplated by the "relevant conduct" guideline.<sup>56</sup> The government may establish that tax loss for the uncharged years is the result of the "same course of conduct" in either of two ways.

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<sup>50</sup> 998 F. 2d 776 (10<sup>th</sup> Cir. 1993).

<sup>51</sup> *Id.* at 776-778.

<sup>52</sup> *Id.* at 781.

<sup>53</sup> *Id.*

<sup>54</sup> *Id.* at 781, quoting U.S.S.G. § 1B1.3(a)(2) (1998).

<sup>55</sup> *Id.* at 781, citing U.S.S.G. § 1B1.3, comment. (n. 2) (1998) and § 1B1.3, comment. (backg'd) (1998).

<sup>56</sup> *Meek*, 998 F. 2d at 782.

First, it may demonstrate by direct evidence that the defendant engaged in a "continuing pattern of tax violations."<sup>57</sup> For example, a defendant who fails to file tax returns for five consecutive years without fail clearly demonstrates a "continuing pattern" of behavior such that a conviction of any one tax year in question, may result in the proper consideration of the other four years in the determination of tax loss for sentencing. If the government demonstrates these facts, a conclusive presumption is raised that establishes the tax loss for relevant conduct purposes.

Where direct evidence is lacking or unavailable, the government may alternatively demonstrate a "continuing pattern" by indirect methods. If the government opts for this latter method of proof, the government advances the position that all of the conduct in the aggregate amounts to tax code violations.<sup>58</sup> However, this only raises a rebuttable presumption of relatedness for relevant conduct purposes,<sup>59</sup> allowing the defendant to overcome the presumption by "coming forward with evidence that his non-charged conduct was clearly unrelated to his conviction."<sup>60</sup>

In the *Meek* case, the Court of Appeals noted that the government demonstrated the tax loss for the collateral years resulted from the same course of conduct through direct methods of proof because the defendant's tax violations involving failure to file returns dated back as far as 1976 and were consistent with the behavior with respect to the years of conviction.<sup>61</sup> As such, the uncharged tax loss for the collateral years in question were properly considered by the district court as relevant conduct to the offenses of conviction for purposes of guideline computations and sentence enhancement.<sup>62</sup>

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<sup>57</sup> *Id.*

<sup>58</sup> *Id.*

<sup>59</sup> *Id.*

<sup>60</sup> *Id.*

<sup>61</sup> *Meek*, 998 F.2d at 782.

<sup>62</sup> The *Meek* court distinguished the facts of its case with those in *United States v. Daniel, infra*. In *Daniel*, the Sixth Circuit held that any conduct that merely violates civil provisions of the tax code may not be used to enhance a sentence under U.S.S.G. § 2T1.1. Only "relevant criminal conduct underlying the charged offense" may be used for determination of the base offense level under §2T1.1. *Daniel*, 956 F. 2d at 944. However, the *Meek* court noted that *Daniel* turned on the government's failure to prove that any of the uncharged conduct at issue in that case violated anything but various civil provisions of the tax code. *Meek*, 998 F.2d at 783. Accordingly, such conduct could not be used as "relevant conduct" for calculating the base offense level. *Id.*

Even acquitted conduct may be used to enhance the sentence under the guise of relevant conduct, as long as the government establishes its existence by a preponderance of the evidence.<sup>63</sup> Any conduct that forms the basis of a separate and related charge to which a jury acquitted a defendant may still be used to enhance the sentence with respect to the count of conviction.<sup>64</sup>

### 3. The Danger of Using Relevant Conduct in Tax Cases

There is credence and logic in most of the principles and methods promulgated by the court in its analysis of "tax loss." However, the court's extensive definition of relevant conduct raises troubling fairness and justice issues that are not easily dismissed.

As noted above, the courts have concluded that for guideline calculation and sentencing purposes, "relevant conduct" includes uncharged conduct, acquitted conduct, and conduct which falls outside the applicable statute of limitations period. Application Note No. 1 to U.S.S.G. section 1B1.3 acknowledges that the guidelines differentiate between sentencing accountability and criminal liability. Thus, the guidelines hold the defendant responsible not only for the acts committed in the offense of conviction, but other conduct "relevant" to that offense.<sup>65</sup>

Because the government determines the counts on which to indict the defendant, this procedure raises fairness concerns. The government is likely, it is argued, to choose the strongest counts for indictment, and after obtaining a verdict or plea, advocate to the probation office and the court that uncharged conduct should be considered at sentencing. In this manner, the government avoids an

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<sup>63</sup> See *United States v. Barakat*, 130 F.3d 1448, 1452 (11<sup>th</sup> Cir. 1997). See also *United States v. Watts*, 519 U.S. 148, (1997), *reh'g denied*, 519 U.S. 1144, (1997). The United States Supreme Court held that the inclusion of acquitted conduct in the sentencing computation formula with respect to the counts of conviction does not raise due process or double jeopardy concerns. *Id.* The court relied, in part, on the broadly worded language of 18 U.S.C. § 3661 and U.S.S.G. § 1B1.3, and § 1B1.4, which directs sentencing courts to consider a variety of information, including the background, character, and conduct of the defendant, regardless of whether the particular conduct had been originally charged and irrespective of whether a conviction had been obtained. *Id.* However, in some cases, the government may have the burden of demonstrating the acquitted conduct by a "clear and convincing standard" where the "sentencing factor has an extremely disproportionate effect on the sentence relative to the offense of conviction." *United States v. Hopper*, 177 F.3d 824, 833 (1999).

<sup>64</sup> See *Id.* at 1452.

<sup>65</sup> U.S. SENTENCING GUIDELINES MANUAL § 1B1.3, comment (N. 1) (1998).

acquittal on the weaker charges and impedes the defendant from having the charges heard by a jury. Further, the burden of proof for sentencing purposes is much lower than the burden at trial.

Although these concerns have some merit, the current procedure does not appear to promote an unfair sentencing outcome. First, under the pre-guideline schema, the court could consider uncharged conduct in its sentence determinations.<sup>66</sup> Thus, the guidelines do not give the court any power that it did not already possess. Second, the government must prove the facts supporting the conduct by a preponderance of the evidence. While this is certainly a less stringent standard than the "beyond a reasonable doubt" standard imposed at trial, it certainly places a burden on the government to support its contention that certain acts constitute "relevant conduct" for sentencing purposes. And, as noted above, courts pre-guidelines had the ability to consider this same conduct with the same standard of proof. Third, the government is not really unrestrained in its sentencing presentation to the probation office and the court. The government must always limit the facts it presents to "relevant conduct." For tax offenses, this means the tax loss must be part of the "same course of conduct" as the offense of conviction, usually evidencing that the defendant engaged in a "continuing pattern of tax violations."<sup>67</sup>

A further benefit of permitting the court to consider uncharged conduct in its sentencing determination is the conservation of judicial resources. If the court could not consider uncharged conduct, in most cases, the government would file an all-encompassing indictment. If a case went to trial, valuable court and jury time would be spent on the presentation of evidence concerning these additional counts, which essentially represent "the same course of conduct."<sup>68</sup>

However, under the Sentencing Guidelines, the government can avoid wasting judicial resources and time by simply prosecuting examples of the conduct. After conviction and plea, the government can then request that the court consider for sentencing purposes the full range of related activity. This procedure shortens the length of the trial and conserves judicial resources. Further, the defendant is not treated unfairly because he still has an opportunity to contest the alleged relevant

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<sup>66</sup> "[T]he pre-guidelines sentencing system was, in a sense, [a real offense] system. The sentencing court and the parole commission took account of the conduct in which the defendant actually engaged." U.S. SENTENCING GUIDELINES MANUAL § 2T1.1, comment. (backg'd.) (1998).

<sup>67</sup> See *supra* text accompanying notes 57 through 60.

<sup>68</sup> See U.S. SENTENCING GUIDELINES MANUAL § 1B1.3(a)(1)(B)(2) (1998).



conduct in his response to the Presentence Report<sup>69</sup> and again at the sentencing hearing.<sup>70</sup>

A related, but much more controversial issue, is the court's consideration of acquitted conduct. In this type of case, the government charges the conduct, but is then unable to meet its burden at trial. Yet, the government presents the facts underlying the acquitted conduct to the probation office and the court, and seeks a sentence that considers this conduct.

At first glance, consideration of this conduct appears extremely unfair. However, upon further analysis, it appears consistent with the principles enunciated above. Inclusion of acquitted conduct at the sentencing phase is logically proper because, as the Supreme Court held in *United States v. Watts*,<sup>71</sup> a jury cannot be said to have necessarily rejected any facts when it returns a general verdict of not guilty. An acquittal only demonstrates that the government was unable to prove its case beyond any reasonable doubt. However, sentencing facts need only be established by a preponderance of the evidence.<sup>72</sup>

Thus, as for uncharged conduct, it is consistent with pre-guidelines sentencing practice to factor into the equation all applicable acquitted conduct. Once again, the government is not entirely unrestrained because it must show that the conduct is indeed "relevant" to the offense of conviction.<sup>73</sup>

<sup>69</sup> "Within 14 days after receiving the presentence report, the parties shall communicate in writing to the probation officer, and to each other, any objections to any material information, sentencing classifications, sentencing guideline ranges, and policy statements contained in or omitted from the presentence report." FED. R. CRIM. P. 32(b)(6)(B).

<sup>70</sup> "For good cause shown, the court may allow a new objection to be raised at any time before imposing sentence." FED. R. CRIM. P. 32(b)(6)(D).

<sup>71</sup> 519 U.S. 148 (1997). "[A] jury's verdict of acquittal does not prevent the sentencing court from considering conduct underlying the acquitted charge, so long as that conduct has been proved by a preponderance of the evidence." *Id.* at 157.

<sup>72</sup> "The [Sentencing] Commission believes that use of a preponderance of the evidence standard is appropriate to meet due process requirements and policy concerns in resolving disputes regarding application of the guidelines to the facts of a case." U.S. SENTENCING GUIDELINES MANUAL § 6A1.3 (1998), comment. Although most information and evidence may be considered by the sentencing court, only such information having "sufficient indicia of reliability to support its probable accuracy" may be taken into account. U.S. SENTENCING GUIDELINES MANUAL § 6A1.3(a) (1998). *See also* *United States v. Marshall*, 519 F. Supp. 751 (E.D. Wis. 1981), *aff'd*, 719 F. 2d 887 (7<sup>th</sup> Cir. 1983); *United States v. Fatico*, 579 F. 2d 707 (2d Cir. 1978) *cert. denied*, 444 U.S. 1073 (1980).

<sup>73</sup> U.S. SENTENCING GUIDELINES MANUAL § 6A1.3(a) (1998).

Further, the fact that there are different standards of proof at trial and sentencing places the defendant on notice that if he should be convicted on any count of the charging instrument, the court may find that related conduct, even acquitted conduct, has been proven by a preponderance of the evidence and will be considered in the court's determination of the appropriate sentencing range.<sup>74</sup> Simply stated, the basic question in terms of uncharged and acquitted conduct becomes whether or not the standard of proof for sentencing purposes differ from the standard used at trial.

#### *D. Double Jeopardy Concerns*

Defendants have raised the issue of whether an IRS civil assessment of interest and penalties precludes the government from proceeding against the taxpayer as a possible violation of the Fifth Amendment.<sup>75</sup> If the government has already "penalized" the defendant by assessing and/or collecting fines or penalties for the defendant's failure to remit income tax, then perhaps the government has renounced its ability to proceed against him through criminal prosecutions.

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<sup>74</sup> U.S. SENTENCING GUIDELINES MANUAL § 6A.1.3 (1998), Comment.

<sup>75</sup> U.S. CONST. amend. V provides,

"No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb. . . ."

*Id.* The courts have reached similar results in other substantive areas as well. *See, e.g.,* *United States v. Price*, 914 F. 2d 1507 (D.C. Cir. 1990) (holding no double jeopardy issue exists where government invokes civil forfeiture provisions under Comprehensive Drug Abuse Prevention and Control Act following the disposition of related criminal portion of case because forfeiture involves civil action); *Manocchio v. Kusserow*, 961 F. 2d 1539 (11th Cir. 1992) (explaining that no double jeopardy violation occurred where Florida physician is excluded from accepting Medicare reimbursements for five years and stands criminally convicted of Medicare fraud because the debarment was a civil action meant to remedy the government of harm inflicted by defendant rather than to impose punishment); *Urbina-Mauricio v. Immigration and Naturalization Service*, 989 F. 2d 1085 (9th Cir. 1993) (holding that an illegal immigrant ordered deported and convicted of narcotics trafficking crimes did not constitute double jeopardy within the meaning of the Fifth Amendment because the deportation order is a civil action and does not constitute punishment); *United States v. \$145,139, U.S. Currency* (noting that no double jeopardy concerns exist where criminal defendant convicted of illegally smuggling United States currency and travelers checks out of the United States following government's seizure of the monetary instruments because the seizure and ultimate forfeiture was remedial in nature).

In *Noske*,<sup>76</sup> the defendants raised the argument that a prosecution for tax fraud is precluded when the IRS has already assessed civil tax fines in an amount of 100% of income derived from the illegal activity.<sup>77</sup> In their situation, since the IRS implemented such a penalty, they argued that the government could not thereafter prosecute them criminally for tax evasion or tax fraud.

The district court disagreed with the defendants and ruled accordingly. On appeal, the Eighth Circuit affirmed the district court's decision. The defendants were not penalized by the imposition of the 26 U.S.C. § 6700 penalties because the penalties are "remedial rather than punitive in nature."<sup>78</sup> According to the Court, the defendants were "assessed a penalty of \$ 490,174, representing 20% of the income derived from their abusive activity."<sup>79</sup> Such a penalty is not "overwhelmingly disproportionate" to the harm they inflicted upon the government as a result of the criminal tax scheme.<sup>80</sup> "Although no final tally has been calculated, the district court found the Government had incurred 'obviously substantial' costs and 'significant expenses' because of the defendants' behavior, including lost tax revenue and costs of investigation and prosecution over a ten-year period."<sup>81</sup>

As such, the IRS's imposition of civil penalties is not more than what could be considered as "compensation for the Government's damages."<sup>82</sup> The penalties were "remedial" or restitutional in nature in that the provisions sought to reimburse the government for its "significant expenses" associated with "lost tax revenue" and "costs of investigation."<sup>83</sup> Consequently, provided the purpose of the civil action is not punitive, the double jeopardy provision of the Fifth Amendment is not triggered.

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<sup>76</sup> 117 F. 3d at 1056.

<sup>77</sup> *Id.* The defendants argue that the government's case with respect to the conspiracy charges amounts to a violation of the Fifth Amendment's double jeopardy clause because the government previously assessed civil penalties on the unreported and unpaid tax. *Id.* See also 26 U.S.C. § 6700 (1999) (creating a penalty of the greater of either \$1000 or 100% of all money realized from the illegal activity).

<sup>78</sup> *Id.*

<sup>79</sup> *Id.* at 1057.

<sup>80</sup> *Id.* at 1057. See also *United States v. Halper*, 490 U.S. 435, 439, 104 L. Ed. 2d 487, 109 S. Ct. 1892 (1989) (holding that a penalty exceeding 220 times that of the actual loss to the government may be deemed double punishment for purposes of the Fifth Amendment).

<sup>81</sup> *Id.*

<sup>82</sup> *Noske*, 117 F. 3d at 1057.

<sup>83</sup> *Id.* at 1056-1057.

### *E. Accrued Interest*

When the Sentencing Commission originally established the guidelines in November 1, 1987, accrued interest was included as part of the determination of tax loss.<sup>84</sup> When making the tax loss assessment, the sentencing court had to review each tax year at issue for purposes of determining accrued interest. The Sentencing Commission feared this would lead to governmental abuse (such as delaying indictment in order to increase accrued interest and manipulation of sentencing factors) and complications at sentencing (the IRS changes interest rates each year, thus requiring multiple computational analyses for purposes of determining accrued interest).<sup>85</sup> Therefore, effective November 1, 1989, the Sentencing Commission eliminated the inclusion of interest for this purpose. It also elected to exclude any IRS added civil or statutory penalties.<sup>86</sup>

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<sup>84</sup> As originally established, U.S. SENTENCING GUIDELINES MANUAL § 2T1.1(a) defined tax loss as "the greater of (A) the total amount of tax that the taxpayer evaded or attempted to evade, *including interest to the date of filing an indictment...*" HUTCHISON, *supra* note 8, at 680.

<sup>85</sup> T. HUTCHISON, FEDERAL SENTENCING LAW AND PRACTICE at 589 (West 1997). However, at least one court commented (prior to the enactment of Section 2T1.1, application note 1) that including interest as part of tax loss is within the Sentencing Commission's power under 18 U.S.C. § 994 (f) and would not lead to governmental abuse. "Including interest in computing tax loss merely recognizes the time value of money. Far from being beyond the [Sentencing] Commission's authority, it is a rational calculation of the real loss sustained as a consequence of the taxpayer's illegally concealing his income from assessment." *United States v. McLaughlin*, 126 F. 3d 130 (3<sup>rd</sup> Cir. 1997) (reviewing a tax offense that occurred and a sentence imposed prior to the enactment of U.S. SENTENCING GUIDELINES MANUAL § 2T1.1, comment. (n. 1)). "[I]t is always within the taxpayer's power to pay the deficiency and to stop interest from accruing." *Id.* at 139.

However, assuming such an approach were taken, a defendant who has the present ability to pay the deficiency could reduce the subsequent tax loss and, therefore, have an impact on the ultimate sentence he receives. A tax offender who has the resources to pay a deficiency, the amount of which is used to determine the tax loss for purposes of assessing the guideline imprisonment range, could successfully reduce the amount of prison time to be served. On the other hand, an individual lacking the financial resources would not be able to mitigate the loss, thus incurring potentially a higher offense level and imprisonment range. The ability to reduce one's time in custody through subsequent remedial measures (such as repaying tax loss) is discouraged under the Sentencing Guidelines and offends traditional notions of financial infirmities causing lengthened prison terms. For example, U.S. SENTENCING GUIDELINES MANUAL § 2T1.1(c)(5) (1998) states that the "tax loss is not reduced by any payment of the tax subsequent to the commission of the offense."

<sup>86</sup> *Id.* See also U.S. SENTENCING GUIDELINES MANUAL § 2T1.1, comment (n.1) (1998) (reiterating that "[t]he tax loss does not include interest or penalties."). See also,

### 1. Actual vs. Intended Loss

Courts often face the situation where a defendant intends to evade tax, but fails to successfully complete the crime prior to its discovery. For example, a defendant may falsify an individual income tax return by underreporting income and seeking an income tax refund, only to be caught immediately before the IRS issues the check. The government may not have suffered an actual tax loss, but clearly the defendant intended to inflict it. Should the court consider this amount as tax loss for sentencing guideline purposes?

The Sentencing Commission clearly intended that such desired loss be used as part of the offense level computations. "[T]he court 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."<sup>87</sup> The fact that a defendant's attempt to inflict loss has been thwarted should not impact upon the sentencing calculations.

The Sentencing Guidelines have followed this approach for offenses falling under Chapter Two, Part F of the Sentencing Guidelines (offenses involving fraud or deceit). Application Note 8 to Section 2F1.1 states,

"[i]f an intended loss that the defendant was attempting to inflict can be determined, this figure will be used if it is greater than the actual loss. . . . For example, if the fraud consisted of selling or attempting to sell \$40,000 in worthless securities, or representing that a forged check for \$40,000 was genuine, the loss would be \$40,000."<sup>88</sup>

In this regard, it appears that the Sentencing Commission intended that any intended loss that the tax offender attempted to inflict should be considered as part of the "tax loss" for purposes of offense level computations.

#### *F. The Double Loss Problem—Corporate and Personal Income Tax Loss*

In some situations, a single act such as the failure to claim a single source of income may give rise to both personal and corporate income tax loss. For

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Hopper, 177 F.3d at 831-32 (explaining that the calculation of tax loss does not include "penalties and fees into the amount of loss for sentencing").

<sup>87</sup> U.S. SENTENCING GUIDELINES MANUAL § 2T1.1, comment. (n.1) (1998).

<sup>88</sup> U.S. SENTENCING GUIDELINES MANUAL § 2F1.1, comment. (n.8) (1998).

example, a situation may occur where the dominant (or sole) shareholder of an IRS Subchapter "C" Corporation receives income through the business and diverts it for his own use. He has, therefore, issued a dividend and failed to account for it. Thus, the income is not reported (and the tax not paid) on either the corporate or individual income tax returns.<sup>89</sup> Should a sentencing court consider the compound nature of the harm when computing the offense level and "tax loss" under the guidelines for purposes of determining the defendant's imprisonment range?

The Seventh Circuit first addressed this issue in *United States v. Harvey*.<sup>90</sup> In *Harvey*, the defendant was the principal in a closely held Internal Revenue Code Subchapter C corporation, which distributed scrap aluminum. The defendant sold scrap aluminum and received over \$81,000 without properly accounting for it. He did not report the sale of this scrap on either his individual or corporate income tax returns for the relevant taxable years.

Although only one defendant inflicted the tax loss on the government, there were two taxpayers involved in the crime. Both Harvey and the corporation that he controlled had obligations to pay income tax on the \$81,000 sale of aluminum. By failing to properly report and pay the income tax involved, Harvey inflicted this "double tax" loss on the government. But, is it fair to hold Harvey criminally culpable (for guideline imprisonment purposes) for the entire amount of tax loss? If so, the sentencing court must figure 28% of the \$81,000 for individual tax purposes and 34% for corporate tax purposes, resulting in a net tax loss for guideline purposes of 62%. Such a difference would change his base offense level from 11 to 13, which may translate into as much as four additional months in custody.<sup>91</sup>

The *Harvey* court seems to follow this logic. In doing so, it focuses on application note 3 to section 2T1.1, stating that "all conduct which violates the tax laws..." should be considered. It inferred the intent of the Sentencing Commission as wanting the sentencing court to consider all of the tax harm caused by the

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<sup>89</sup> A corporation is an entity separate and distinct from its officers, directors, and shareholders, and has an independent obligation to pay income tax on corporate profits. Therefore, this creates the "double-tax" effect, taxing profits at the corporate level and a second time at the individual shareholder level. *See, e.g.* *United States v. Mews*, 923 F. 2d 67 (7<sup>th</sup> Cir. 1991).

<sup>90</sup> 996 F. 2d 919 (7<sup>th</sup> Cir. 1993).

<sup>91</sup> *See* U.S. SENTENCING GUIDELINES MANUAL § 2T4.1 (1998).

defendant. As such, the tax loss resulting from both the personal income tax return and the corporate income tax return should be considered.<sup>92</sup>

However, the method for computing the tax loss is *not* 62% of the total amount of unreported income (that is, 28% individual plus 34% corporate, yielding 62%). Doing so actually misstates the actual tax loss to the government.<sup>93</sup> For example, in the *Harvey* case, the corporation should have theoretically paid 34% of \$81,000, or \$27,540 corporate income tax. The tax would have been deducted from the \$81,000, leaving \$53,460 for distribution to Harvey. From that amount, Harvey should have paid 28% tax on the distribution, or \$14,969. Therefore, the total aggregate tax loss to the government was \$42,509 (not \$50,220 based upon 62% as aggregate corporate and individual tax rates). The sentencing court must deduct the corporation's income tax liability out of the equation prior to computing the individual income tax liability.<sup>94</sup>

Following *Harvey*, the Sentencing Commission added commentary to clarify its intent: "if the offense involves both individual and corporate tax returns, the tax loss is the aggregate tax loss from the offenses taken together."<sup>95</sup> The Commission effectively follows the Seventh Circuit's conclusion in *Harvey*. However, the commentary does not set forth the proper mechanism for computing the "aggregate tax loss."<sup>96</sup> It therefore appears safe to conclude that the method set forth in *Harvey* survives this guideline amendment.

The Seventh Circuit had occasion to revisit this issue in *United States v. Bhagavan*.<sup>97</sup> In *Bhagavan*, the Court of Appeals described the *Harvey* test using a three-part methodology: "(1) apply the corporate rate of 34% to the unreported profit, which produces the amount of lost corporate taxes; (2) reduce the imputed dividend by the amount of the imputed corporate taxes; (3) apply the personal rate of 28% to the reduced dividend to determine the amount of lost personal taxes."<sup>98</sup> This method assumes that the unreported income is an "imputed dividend" from the corporation to the individual taxpayer.<sup>99</sup> The failure to report this dividend occurs

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<sup>92</sup> "When a single transaction bypasses both corporate and personal taxes, any effort to determine the tax loss must include both." *Harvey*, 996 F. 3d at 920.

<sup>93</sup> *Id.* at 921.

<sup>94</sup> *Id.*

<sup>95</sup> U.S. SENTENCING GUIDELINES MANUAL §2T1.1, comment. (n. 7) (1998).

<sup>96</sup> *Id.*

<sup>97</sup> 116 F. 3d 189 (7<sup>th</sup> Cir. 1997).

<sup>98</sup> *Id.* at 192.

<sup>99</sup> *Id.*

as a single act, but has the consequence of tax loss at both the individual and corporate levels.

However, the *Harvey* rationale has its limits. The method used by the *Harvey* court is premised upon the defendant having committed one act that gives rise to both corporate and individual tax liability and that the money that the taxpayer clandestinely reaped from the corporation would otherwise have been a dividend, reduced by the total amount of tax that the corporation would have paid on net income.<sup>100</sup>

In *United States v. Cseplo*,<sup>101</sup> the sentencing court refused to follow the *Harvey* methodology. The defendant was the sole officer, director, and shareholder of Kimco Products, Inc., a corporation engaged in the production of stainless steel products. Over several years, the defendant diverted over \$250,000 in receipts from the corporation to his personal use. The defendant failed to report this amount on the corporate income tax returns, and he failed to report over \$195,000 of the above amount on his individual income tax returns for the tax years in question.<sup>102</sup> In calculating his sentence, the district court computed 34 percent of \$250,000, representing the corporate income tax loss, and 28 percent of \$195,000, representing the individual income tax loss. The defendant argued that the court should not have aggregated these two figures.

The Sixth Circuit Court of Appeals upheld the district court's method in this situation. It took a very narrow reading of *Harvey* in that it refused to recognize the tax evaded with respect to the corporate and the individual income tax returns as being sufficiently related.

"[Cseplo] pleaded guilty not to having committed a single crime, but to having committed two separate crimes. One offense, involving a corporate tax return, was committed in May of 1990, and the other, involving an individual tax return, was committed five months later. The guidelines are very specific about the necessity of aggregating the tax losses, and we see no justification for proceeding as if only one crime had been committed."<sup>103</sup>

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<sup>100</sup> *United States v. Cseplo*, 42 F. 3d 360 (6<sup>th</sup> Cir. 1994).

<sup>101</sup> *Id.*

<sup>102</sup> *Id.* at 361.

<sup>103</sup> *Id.* at 364.



Another issue with respect to addressing the double tax penalty involves the characterization of income as personal, corporate, or both. Because of the double penalty for tax loss characterized as both corporate and personal, defendants have incentive to attempt to have it perceived by the sentencing courts as personal tax loss. This issue arose in *Bhagavan*.<sup>104</sup> In *Bhagavan*, the defendant was the president, chief operating officer, and controlling shareholder of a closely-held Indiana corporation organized for the purpose of performing engineering and surveying work.<sup>105</sup> The defendant had the corporation's clients pay him directly for work performed by the corporation. These clients believed that they were dealing with the corporation, not with the defendant directly.<sup>106</sup> Not only did he divert payments to his own personal benefit, he also received "secret stock dividends" in varying amounts over the course of the taxable years at issue.<sup>107</sup> He failed to report these payments on either the corporate or personal income tax returns.<sup>108</sup>

Although the defendant pleaded guilty to only one count of income tax fraud involving the non-payment of personal income tax, all of the monies he diverted from clients or received directly from the corporation were at issue during his sentencing hearing.<sup>109</sup> The government argued that all the monies that the defendant received from the corporation's clients should be characterized as corporate income. The defendant, however, argued that the unreported receipts should be characterized as personal income, because he performed these services as a private consultant.<sup>110</sup>

The district court characterized these receipts as corporate income, thus subjecting them to the double tax computation.<sup>111</sup> The clients received their bills on the corporation's invoices.<sup>112</sup> Moreover, when they remitted payment to the defendant, they did so based upon the instructions that he gave, leading them to believe that they were receiving credits or discounts from their total bills.<sup>113</sup> They never issued 1099's to the defendant, even though the amounts they paid each

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<sup>104</sup> 116 F. 3d at 189.

<sup>105</sup> *Id.* at 190.

<sup>106</sup> *Id.* at 191.

<sup>107</sup> *Id.*

<sup>108</sup> *Id.*

<sup>109</sup> See *supra* notes 37-74 and accompanying text for discussion of U.S. SENTENCING GUIDELINES MANUAL § 1B1.3 (1998) (use of relevant conduct for computation of tax loss).

<sup>110</sup> *Bhagavan*, 116 F. 3d at 191.

<sup>111</sup> *Id.*

<sup>112</sup> *Id.* at 192.

<sup>113</sup> *Id.*

totaled over \$600<sup>114</sup> in any one taxable year,<sup>115</sup> and the work he performed was precisely the type the corporation was organized to perform.<sup>116</sup>

Even if the defendant was performing this work in his "spare time," the appellate court grappled with whether he even legally could have accepted such work given his standing in the corporation as a chief operating officer. Under Indiana corporate law, as well as corporate law in the majority of United States jurisdictions, his performance of services, consistent with those that the corporation performed, would be deemed an illegal usurpation of a corporate opportunity.<sup>117</sup> As such, it would be impossible as a matter of law for any such monies to be classified as "personal" in nature. Thus, the district court properly characterized the diverted monies as corporate in nature. By failing to claim them on the corporate income tax return, a tax loss resulted. In addition, since he personally gained by that amount, he should have reported that money on his personal income tax return. Therefore, a double-tax penalty for purposes of computing tax loss under the Sentencing Guidelines is proper.

### *G. Federal vs. State and Local Tax Loss*

As discussed above, relevant conduct permits (and in fact requires) sentencing courts to consider offense behavior collateral to the offense of conviction, as long as it meets the definition of U.S.S.G. section 1B1.3.<sup>118</sup> However, should non-federal tax loss be included in that computation, such as offenses that also involve tax loss to state and local jurisdictions?

For example, consider the situation where a defendant fails to report and submit payroll taxes for his employees. He is indicted and subsequently convicted of evading federal income tax. However, the same act also gives rise to the failure to report and pay other taxes, including social security, Medicare, unemployment insurance, and state and local payroll taxes.

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<sup>114</sup> Anyone who pays an independent contractor in excess of \$600 in any one taxable year must file a Form 1099 with the Internal Revenue Service and send a copy to the independent contractor. 26 U.S.C. § 6041A(a) (1999).

<sup>115</sup> *Id.*

<sup>116</sup> Bhagavan, 116 F. 3d at 192.

<sup>117</sup> *Id.* For a discussion of usurpation of corporate opportunity, see JANE P. MALLOR, BUSINESS LAW AND THE REGULATORY ENVIRONMENT 878 (10th ed. 1998).

<sup>118</sup> See *supra* notes 65-74 and accompanying text.

The Fifth Circuit Court of Appeals addressed this issue in *United States v. Powell*.<sup>119</sup> In *Powell*, the defendant was a wholesale distributor of gasoline and diesel fuel. Both the federal government and the State of Texas offered a program that permitted wholesalers to blend mixtures of fuel and resell it. By doing so, both governments offered wholesalers the ability to purchase the additives at reduced excise tax rates. However, they were only permitted to benefit from these reduced rates if they, in fact, mixed the gasoline into the new blended mixture. If a wholesaler failed to mix the gasoline, he could not benefit from the reduced rate.<sup>120</sup>

Powell purchased large quantities of gasoline at the reduced tax rates. He informed the government entities through the appropriate tax statements that he was blending fuel. However, he was not doing so for the majority of these reduced tax rate purchases.

Powell was subsequently named in a five-count federal indictment charging violations of 26 U.S.C. § 7201 (tax evasion).<sup>121</sup> A jury convicted him on all counts. During the sentencing phase, the probation officer based his sentencing recommendation solely on the amount of federal excise tax evaded, exclusive of the state tax. The government objected to the probation officer's findings contained in the Presentence Report. The district court agreed with the government, concluding that the state tax loss<sup>122</sup> was "relevant conduct" within the meaning of U.S.S.G. § 1B1.3.<sup>123</sup>

The Fifth Circuit agreed with the government's position and expressly rejected Powell's argument that only federal tax losses may be considered for purposes of computing the offense level.<sup>124</sup> The state tax loss resulted from the same "core" of criminal offense behavior that gave rise to the federal tax loss and collateral to the offenses of conviction.<sup>125</sup>

To support this conclusion, the appellate court referred to the mandate of the guidelines. "The Sentencing Guidelines permit many factors to be taken into

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<sup>119</sup> 124 F. 3d 655 (5<sup>th</sup> Cir. 1997).

<sup>120</sup> *Id.* at 657.

<sup>121</sup> *Id.* at 660.

<sup>122</sup> The government alleged that Powell violated TEX. TAX. CODE ANN. § 153.403 (Vernon 1992 & Supp. 1997), providing for criminal penalties for the willful evasion of certain excise taxes. *Id.* at 665.

<sup>123</sup> *Id.* at 663.

<sup>124</sup> *Id.* at 664.

<sup>125</sup> Powell, 124 F. 3d at 663.

account in determining a sentence," including all relevant conduct. Courts have held in other federal offenses that purely "state" conduct can be considered as relevant conduct in the federal offense.<sup>126</sup> Therefore, the amount of state tax loss may be considered if it constitutes "relevant conduct" within the meaning of section 1B1.3.<sup>127</sup>

#### H. Civil Tax Liability

Although Application Note 2 to section 2T1.1 provides that "all conduct violating the tax laws" should be included as relevant conduct, "civil" tax liability may not be considered as part of the criminal case and should not be used for determination of sentencing offense level.<sup>128</sup> In addition, if a sentencing court decides to award restitution, it may not include such "civil" liability in its restitution order.

In *United States v. Daniel*,<sup>129</sup> the defendant was convicted of a three-count indictment each charging violations of 26 U.S.C. §7201 (income tax evasion). At sentencing, the district court issued, *inter alia*, a restitution order obligating the defendant to repay the government over \$154,000. The court based its order on the probation officer's assessment of the income tax, interest, and penalties due to the government. The probation officer also calculated the income tax, exclusive of interest and penalties, at just over \$40,000.<sup>130</sup>

The Sixth Circuit reversed the restitution order of the sentencing court. The defendant's criminal culpability involved only the evasion of the \$40,000, and the restitution order should not exceed the amount of actual loss inflicted on the victim

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<sup>126</sup> See, e.g., *United States v. Armstead*, 114 F. 3d 504 (5<sup>th</sup> Cir. 1997), *cert. denied*, 522 U.S. 922, 118 S.Ct. 315, 139 L. Ed. 2d 243 (1997) (explaining that enhancement for committing a burglary while possessing a firearm in violation of 18 U.S.C. § 922(u) is properly considered relevant conduct under U.S. SENTENCING GUIDELINES MANUAL §1B1.3 (1997) for purposes of determining applicability of U.S. SENTENCING GUIDELINES MANUAL §2K2.1(b)(5) (1997)).

<sup>127</sup> *Powell*, 124 F 3d at 664. The appellate court found the state tax loss to constitute "relevant conduct" within the meaning of U.S. SENTENCING GUIDELINES MANUAL § 1B1.3, because it was part of a "common scheme or plan" as the federal offenses and because it constituted the "same course of conduct." *Id.* at 666. For further discussion on relevant conduct, see *supra* notes 37-74 and accompanying text.

<sup>128</sup> *United States v. Pierce* 17 F. 3d 146, 150 (6<sup>th</sup> Cir. 1994).

<sup>129</sup> 956 F. 2d 540 (6<sup>th</sup> Cir. 1992).

<sup>130</sup> *Id.* at 543.

as a result of the commission of the offense.<sup>131</sup> Moreover, the Court reasoned the defendant might be able to subsequently invalidate the civil assessment. "It is theoretically possible that Daniel, after being convicted and serving his sentence, might then prevail in whole, or in part, in a civil action concerning his civil tax liability thus reducing the amount owed as alleged by the government."<sup>132</sup>

However, even though the use of "civil" tax liability may not be used for purposes of relevant conduct leading to sentencing enhancement or for use of fashioning a restitution order, the district court may consider any unpaid taxes when making specific conditions of probation or supervised release, provided that they have either been reduced to judgment or are not otherwise disputed by the defendant or indeterminate.<sup>133</sup>

### *I. Statute of Limitations*

One possible limitation on the use of relevant conduct at sentencing involves the statute of limitations. For example, a defendant intentionally underreports his gross income by fifty percent (violations of 26 U.S.C. § 7201) on his federal income tax returns every year for the last twenty years. The IRS audits his three most recent years' tax returns and discovers the fraud. He is referred to the Criminal Investigations Division who then refers the matter to the United States Attorney for prosecution.

The statute of limitations for a violation of 26 U.S.C. § 7201 is five years.<sup>134</sup> Accordingly, the Assistant United States Attorney seeks a grand jury indictment for those seven years alone, temporarily ignoring the remaining thirteen years that proceeded them. The grand jury returns a seven-count indictment, and the defendant eventually pleads guilty to one or more of those counts.

The case next enters the sentencing phase. A probation officer is assigned to prepare a presentence report and sentencing recommendation, which includes a

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<sup>131</sup> *Id.*, citing *Hughey v. United States*, 495 U.S. 411, (1990) (stating that "loss caused by the conduct underlying the offense of conviction establishes the outer limit of a restitution order.")

<sup>132</sup> *Id.* at 544.

<sup>133</sup> *United States v. Hatchett* 918 F. 2d 631, 644 (6<sup>th</sup> Cir. 1990). *See also United States v. Taylor*, 305 F. 2d 183, 188 (4<sup>th</sup> Cir. 1962), *cert. denied*, 371 U.S. 894, 83 S. Ct. 193, 9 L. Ed. 2d 126 (1962); *United States v. McMichael*, 699 F. 2d 193, 195 (4<sup>th</sup> Cir. 1983); *United States v. Vaughn*, 636 F. 2d 921 (4<sup>th</sup> Cir. 1980).

<sup>134</sup> 18 U.S.C. § 3282 (1999).

computation and analysis of the relevant guideline sentencing factors.<sup>135</sup> The Assistant United States Attorney presents the probation officer with evidence of the five years of tax loss alleged in the indictment, as well as the earlier thirteen years of tax loss following the expiration of the statute of limitations. Does due process permit the probation officer (and the district court) to consider the earlier thirteen years of tax loss as relevant conduct for purposes of sentencing enhancement?

### 1. Prevailing View

The Second,<sup>136</sup> Fifth,<sup>137</sup> Sixth<sup>138</sup>, Seventh, Tenth<sup>139</sup>, Eleventh<sup>140</sup>, and District of Columbia Circuits have followed the approach that permits relevant conduct occurring prior to the expiration of the statute of limitations to be used for purposes of computing tax loss.<sup>141</sup> However, the Seventh Circuit case, *United States v. Valenti*,<sup>142</sup> is a good illustration of this approach.

In *Valenti*, the defendant was convicted following a jury trial of several counts of tax evasion and failure to file tax returns for tax years 1988 through 1993. The defendant owned and operated a carpentry business. He did not keep any records whatsoever. He did not maintain a regular checking or savings account, insisted on paying all business expenses (including his employees' salaries) with cash, and cashed any checks he received at a local bank. The defendant failed to file tax returns, issue W-2 or 1099 forms to his employees, withhold payroll taxes, and, most importantly, failed to pay tax to the IRS.<sup>143</sup>

At sentencing, the district court considered, *inter alia*, relevant conduct constituting tax loss for the years for which the statute of limitations had previously expired. The defendant argued that the government could not have prosecuted him for taxable years 1986 and 1987 because of the expiration of the statute of limitations. The district court refused to follow the defendant's approach and

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<sup>135</sup> FED. R. CRIM. P. 32(b).

<sup>136</sup> *United States v. Silkowski*, 32 F. 3d 682, 687 (2<sup>nd</sup> Cir. 1994).

<sup>137</sup> *United States v. Lokey*, 945 F. 2d 825, 840 (5<sup>th</sup> Cir. 1991).

<sup>138</sup> *United States v. Pierce*, 17 F. 3d 146, 150 (6<sup>th</sup> Cir. 1994).

<sup>139</sup> *United States v. Neighbors*, 23 F. 3d 306, 311 (10<sup>th</sup> Cir. 1994).

<sup>140</sup> *United States v. Behr*, 93 F. 3d 764, 765 (11<sup>th</sup> Cir. 1996).

<sup>141</sup> *United States v. Wishnefsky*, 7 F. 3d 254, 256-67 (D.C. Cir. 1993).

<sup>142</sup> 121 F. 3d 327 (7<sup>th</sup> Cir. 1997).

<sup>143</sup> *Id.* at 328-29.

nevertheless included the gross income that he failed to report for those years as relevant conduct to further enhance his sentence.<sup>144</sup>

The Seventh Circuit affirmed the district court's approach. "A criminal defendant is entitled to due process at sentencing; it is clear, however, that due process does not extend so far as to grant him full trial rights with regard to other crimes he has committed."<sup>145</sup> In other words, the fact that the expired criminal conduct could not independently give rise to a prosecution for tax fraud alone does not prevent a sentencing court from treating that expired conduct as an enhancement to the crime for the unexpired conduct. Such use of the expired conduct does not amount to a violation of the defendant's due process rights for purposes of guideline computations and utilization at sentencing.

The Second Circuit reaches the same conclusion as the Seventh Circuit, but traces the authority for its approach to the guidelines themselves. In *United States v. Silkowski*,<sup>146</sup> the defendant pleaded guilty to a single-count information charging him with a violation of 18 U.S.C. § 641 (theft of public funds). Specifically, the defendant was alleged to have illegally received social security disability benefits for a twelve-year period, from May 1979 until May 1991.<sup>147</sup> In the Presentence Report, the probation officer calculated the loss beginning November 1980 as the first date of relevant conduct.<sup>148</sup> The defendant filed an objection to the Presentence Report, arguing against the inclusion of loss incurred after the five-year statute of limitations period in the determination of any sentencing factor, including offense level computations and restitution amounts. The sentencing court overruled his objections and followed the loss computations of the probation officer.<sup>149</sup> It therefore increased his offense level using the loss amount and ordered restitution for the full amount.<sup>150</sup>

The Second Circuit split on this issue. With respect to using the loss prior to the expiration of the statute of limitations, the appellate court agreed with the sentencing court's decision to include the full loss as relevant conduct for use in determining his offense level and imprisonment range.<sup>151</sup> "Statute of limitations

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<sup>144</sup> *Id.* at 334.

<sup>145</sup> *Id.* (citing *United States v. Radix Lab., Inc.* 963 F. 2d 1034, 1039 (7<sup>th</sup> Cir. 1992)).

<sup>146</sup> 32 F. 3d 682 (2<sup>nd</sup> Cir. 1994).

<sup>147</sup> *Id.* at 684.

<sup>148</sup> *Id.* at 686.

<sup>149</sup> *Id.*

<sup>150</sup> *Id.*

<sup>151</sup> *Id.* at 687.

jurisprudence does not alter [the relevant conduct analysis] when determining length of incarceration. The Guidelines expressly provide for consideration 'without limitation, [of] any information concerning the background, character and conduct of the defendant, unless otherwise prohibited by law.'<sup>152</sup> Given this instruction from the Sentencing Commission, the relevant conduct provisions have been construed broadly.<sup>153</sup> Therefore, the inclusion of this pre-statute of limitations loss by the sentencing court was proper.<sup>154</sup>

On the other hand, the Second Circuit did not believe that the sentencing court should have included any loss that occurred after the expiration of the statute of limitations for purposes of restitution. This distinction materializes due to the differing authorities for imprisonment range and restitution orders. For purposes of restitution, the court makes its decision of whether to issue a restitution order pursuant to the Victim and Witness Protection Act of 1982, not from the Sentencing Guidelines.<sup>155</sup> As such, the issue does not center on whether relevant conduct may include the statute of limitations' expired conduct.<sup>156</sup>

## 2. Proposal for Alternative View

The potential for abuse by use of this approach is boundless. Consider the following scenario: an individual fails to properly disclose all of his income on his tax returns in violation of 26 U.S.C. § 7201<sup>157</sup> in 1990 and again from 1992 through 1995. In 1996, the defendant is audited by the IRS who, in turn, elects to pursue the matter through the criminal system. The Assistant United States Attorney receives

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<sup>152</sup> Silkowski, 32 F.3d at 687-88, *citing* U.S. SENTENCING GUIDELINES MANUAL § 1B1.4.

<sup>153</sup> *See, e.g.,* United States v. Concepcion, 983 F. 2d 369, 387 (2<sup>nd</sup> Cir. 1992), *cert. denied sub. nom.* Frias v. United States 510 U.S. 856 (1993).

<sup>154</sup> Silkowski, 32 F. 3d at 688.

<sup>155</sup> *Id.*

<sup>156</sup> If the tax offense is charged under title 26 of the United States Code, restitution is generally not applicable, absent an agreement to the contrary by the parties. *See* United States v. Gottesman, 122 F. 3d 150, 151 (2<sup>nd</sup> Cir. 1997); *See also* 18 U.S.C. §§3663-3664.

<sup>157</sup> 26 U.S.C. § 7201 (1999) provides,

"Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than \$100,000 (\$500,000 in the case of a corporation), or imprisoned not more than 5 years, or both, together with the costs of prosecution."

26 U.S.C. § 7201 (1999).



information from the IRS that evidences the failure to file returns for the five years in question. For 1990, the defendant failed to report \$100,000 of income. For each of years 1992 through 1995, the defendant failed to report \$10,000 of income.

By 1996, the statute of limitations expired for proceeding against the defendant for the 1990 unreported and unpaid tax. Nevertheless, the government need only seek an indictment against the defendant for the recent three years. At trial, the government need only prove that the defendant willfully failed to report income for those same years. However, if convicted, the government may elect to present the probation officer with evidence pertaining to unreported income for the 1990 tax year. Even though the government may never have presented such information to the jury for purposes of seeking a conviction, the sentencing court must consider the tax loss for 1990 tax year for purposes of substantially enhancing his sentence.<sup>158</sup>

For the reasons that follow, the authors propose that the Sentencing Commission amend the guidelines to preclude the consideration of tax loss occurring prior to the expiration of the statute of limitations.

There are four primary reasons for having a statute of limitations in federal criminal tax cases: (1) fair opportunity for defense; (2) prevent undue delay in bringing charges; (3) suppress stale charges; and (4) ensure preservation of evidence. For these reasons, the government should not have the ability to seek indictment against an individual for such conduct. Nonetheless, the Circuits have permitted the consideration of conduct outside the statute of limitations in their sentencing determinations,<sup>159</sup> notwithstanding the fact that the defendant's opportunity and ability to meaningfully challenge the validity of the government's presentation may no longer be available.

The purposes of having a statute of limitations discussed above strongly militate against allowing this tax loss to be considered for guideline purposes. The government cannot prosecute such conduct because it falls outside of the applicable statute of limitations period and is *precluded* from bringing charges prior to trial. Under these circumstances, the government actually fails to meet a jurisdictional

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<sup>158</sup> "When a sentencing factor has an extremely disproportionate effect on the sentence relative to the offense of conviction, [however,] the government may have to satisfy a 'clear and convincing' standard." *United States v. Romero-Rendon*, 198 F.3d 745, 747 (9<sup>th</sup> Cir. 1999)(citing *Hopper*, 177 F.3d at 833).

<sup>159</sup> *See supra* notes 137-142.

requirement. Unlike uncharged and acquitted conduct,<sup>160</sup> the government could not bring an action charging this conduct, and the trial court could not entertain an action involving this conduct because it falls outside the statute of limitations. As the rule now stands, the government has an inroad around a jurisdictional requirement, something that is seriously suspect.

Defendants are therefore subject to punishment for conduct that they may no longer have the ability to refute. What is particularly troubling about this concept is that the potential consequences go beyond the payment of back taxes, penalties or interest. The "tacking on" of this tax loss for sentencing purposes usually translates into a longer and harsher custody sentence for the defendant. The idea of statute of limitations therefore becomes meaningless.

### III. CONCLUSION

The Sentencing Guidelines use the concept of tax loss as the basis for imposing a sentence upon the tax offender, as it is the "driving force" behind the severity of the sentence that the tax offender will receive. Tax loss has been interpreted quite broadly by the courts in order to effectuate the Sentencing Commission's intent to "protect the public interest in preserving the integrity" of the tax system, punish the taxpayer, deter others from doing the same, and to "promote respect" for the United States' tax laws.<sup>161</sup> It remains to be seen as to whether the empirical evidence supports the Commission's goals in this area.

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<sup>160</sup> See *supra* notes 71-74 and accompanying text.

<sup>161</sup> U.S. SENTENCING GUIDELINES MANUAL § 2T1 (intro. comment) (1998).

