

CIVIL AND CRIMINAL TAX PENALTIES
IMPORTANT DEVELOPMENTS - CRIMINAL

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***United States v. Jeffrey Stein, et al.* 05 Crim. 0888 (S.D.N.Y.) (KPMG)**

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 has been 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 included 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 charged 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 charged 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 were charged with evasion based on payments made in exchange for opinion letters provided to tax shelter investors. Counts Forty-five and Forty-six charged certain defendants with obstructing the investigations into the tax shelters (26 U.S.C. § 7212). KPMG is not a defendant in the *Stein* indictment, having executed a deferred prosecution agreement.

As noted, in furtherance of this fraud, the defendants allegedly issued opinion letters containing false representations that the tax shelter losses would “more likely than not” survive an IRS challenge, as well as other false documentation regarding the tax shelter transactions. The superseding indictment alleged 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 contended 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) (“*Stein I*”), 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.

At that time, 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), [certain of] the 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, 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.”

RECENT DEVELOPMENTS

Having declined to dismiss the charges in June of 2006, one year later, in *United States v. Stein, et al.* 495 F.Supp. 2d 390 (S.D.N.Y.) (July 16, 2007), Judge Kaplan dismissed the indictments as to thirteen of the remaining defendants (all of whom had been employed by KPMG) after (a) the Second Circuit overruled his decision that the U.S. District Court for the Southern District of New York had ancillary jurisdiction over the claims of certain defendants against KPMG for advancement of defense costs and after (b) the government filed a Memorandum of Law essentially conceding (as a predicate to an appeal) that, based on Judge Kaplan’s holding in *Stein I*, the indictments as against thirteen of the defendants must necessarily be dismissed.

Judge Kaplan began that Opinion by stating “The government threatened to indict, and thus to destroy, the giant accounting firm [KPMG]. It coerced KPMG to limit and then cut off its payment of the legal fees of KPMG employees. KPMG avoided indictment by yielding to government pressure. Many of its personnel did not. They now await trial, four of them deprived of counsel of their choice and most of the others unable to afford the defenses that they would have presented absent the government’s interference.” *Id.* at 393.

In his Opinion, Judge Kaplan reviewed much of the factual history and legal considerations, including the deprivation of defendants’ substantive due process rights, that had

led to his Opinion in *Stein I* and also analyzed whether the actions of the U.S. Attorney's Office "shocks the conscience in the constitutional sense." Judge Kaplan determined that, "[t]heir actions were not justified by any legitimate governmental interest. Their deliberate interference with the defendants' rights was outrageous and shocking in the constitutional sense because it was fundamentally at odds with two of our most basic constitutional values -- the right to counsel and the right to fair criminal proceedings." The Court went on to note that even a "deliberate indifference" to constitutional rights would be sufficient to conclude that a constitutional violation, in addition to the deprivation of substantive due process rights, had occurred.

After rejecting the government's argument that the defendants should have applied for assistance under the Criminal Justice Act (which permits a maximum \$7,000 fee for felony defendants) rather than seeking dismissal, the Court further examined the circumstances surrounding each of the individual defendants. Judge Kaplan concluded that three defendants who could not afford their counsel of choice after KPMG ceased paying their legal bills were denied their Sixth Amendment rights. With regard to ten of the other defendants, the Court found that the government's conduct, interfering "with the payment of defense costs that KPMG would otherwise have paid" left them unable to "defend this case as he or she would have defended it had KPMG been paying the cost." With regard to each of those defendants, Judge Kaplan found that without dismissing the case, it would be impossible to restore them to the position they would have been but for the misconduct.

With regard to three other defendants, Judge Kaplan declined to dismiss the indictments because he found that the government's conduct had not deprived them of their right to counsel. Two of the defendants left KPMG many years earlier and much of the conduct with which they were charged occurred after they left so that KPMG likely would not have paid their legal fees. The third defendant left KPMG under "strained circumstances" and signed a release of claims, so that KPMG likely would not have paid his legal fees.

On July 17, 2007, Judge Kaplan temporarily stayed the effect of the Order dismissing the indictments as to thirteen defendants "to the extent, and only to the extent, if any, that the Order, otherwise might have allowed any of the defendants' counsel to withdraw."

Judge Kaplan's decision left five defendants. On August 3, 2007, Judge Kaplan rejected the Motion of those defendants for a continuance of the October 16, 2007 trial date as well as the government's motion to sever the case of one of the defendants so that his case could be tried first. The Motion for severance was denied insofar as the government had made no showing of prejudice. In rejecting the Motion for continuance the Court determined that, "[h]aving considered all of the circumstances in light of the Court's experience with this case for nearly two years, the Court has concluded that the proper balance between the public interest in getting on with this matter and the defendants' rights would be struck best by proceeding as scheduled." In reaching that conclusion, Judge Kaplan rejected defendants' arguments that the government might reconfigure its case, that their preparation for trial had been disrupted by the Motion for Dismissal, that the government had not completed its electronic database, and that additional document production by the government would need to be reviewed.

On September 10, 2007, David Amir Makov, pled guilty to "participating in a conspiracy to defraud the United States Treasury, evade taxes and file false tax returns" in connection with "Bond Linked Issue Premium Structures" ("BLIPS"). With regard to the remaining four defendants, this case is calendared for trial on October 16, 2007.

OTHER NEWS

Rita v. United States, --- U.S. ---, 127 S. Ct. 2456 (2007) - the Supreme Court held that the appellate courts may apply a “presumption of reasonableness” in their review of sentences within the advisory Guideline range without violating 18 U.S.C. § 3553(a) or the Sixth Amendment. However, district courts may not apply such a presumption. Instead, the district court must impose a sentence in accordance with § 3553(a)(2) that is sufficient but not greater than necessary. *Rita*, 127 S. Ct. at 2465.

Sidley Austin pays \$39.4 million penalty and DOJ drops charges – The law firm of Sidley Austin LLP paid a \$39.4 million civil tax shelter promoter penalty, stemming from its promotion of abusive tax shelters and failure to comply with registration requirements. The shelters included listed transactions such as BOSS (bond & option sale strategy), COBRA (currency options bring reward alternatives), BLIPS (bond linked issue premium structures), and COINS (currency option investment strategy). The government’s investigation of Sidley Austin began with the investigation of Raymond J. Ruble, a former partner of Sidley Austin Brown & Wood LLP, and a defendant in *United States v. Stein* (the KPMG prosecution). The government has agreed not to pursue criminal charges against the firm, and the firm has stated that it will continue to cooperate with ongoing civil and criminal tax shelter investigations.

Ernst & Young Partners Indicted for Tax Fraud Conspiracy – In *United States v. Coplan*, S.D.N.Y., No. 1:07-cr-00453-SHS (May 30, 2007), four current and former partners of Ernst & Young pled not guilty to conspiring to commit tax fraud and other offenses based on the creation and promotion of tax shelters for their wealthy clients and, with respect to 3 of the defendants, use of a shelter to evade personal taxes. The government alleges that the defendants concealed the nature of the shelters by obtaining opinion letters from law firms claiming that the shelters would survive scrutiny.

Treasury Inspector General for Tax Administration (TIGTA) issues report on IRS Criminal Investigation – On June 6, 2007, TIGTA issued its report, *Statistical Portrayal of the Criminal Investigation Function’s Enforcement Activities From Fiscal Year 2000 Through Fiscal Year 2006* (Report No. 2007-10-083). TIGTA found that while CI initiated more tax-related investigations and spent more time on tax investigations, overall investigations initiated decreased. The report attributed the decrease to more time being spent on investigations and complex tax cases, as well as staffing shortages.

United States v. Josephberg, 04 Crim. Cir. 2002 (S.D.N.Y., White Plains) - Josephberg was the subject of a 17-count indictment that alleged, *inter alia*, obstruction in violation of 26 U.S.C. § 7212, and substantive offenses under 26 U.S.C. § 7201, § 7206 and § 7203. He is a founding partner of J.R. Cralin & Co. and was accused of (a) directing income and assets to deposited into nominee bank accounts, including those of his children, to conceal his true income, (b) directing income and to be paid to certain entities and diverting that income to pay personal expenses to conceal his income, (c) submitting false information to the IRS, including a false Form 433-A, to conceal his income and assets, and (d) causing bankruptcy petitions to be filed on behalf of himself and his wife resulting in false and misleading claims being made about his assets. After a trial, on April 19, 2007, the defendant was convicted on all counts and sentenced on September 5, 2007 to more than 4 years in prison, 3 years of supervised release, and to pay restitution of \$21,000 and the costs of prosecution.

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

In *United States v. Kayser*, 488 F.3d 1070 (9th Cir. 2007) (May 31, 2007), Kayser, an independent contractor for A2Z, incorporated Aspen Ventures, Inc. to receive his A2Z income and take related business deductions. He filed his 1998 - 2000 returns in August, 2001, and was indicted on two counts of evasion in violation of 26 U.S.C. § 7201 for tax years 1999 and 2000.

The government alleged that Kayser structured his corporate and individual returns to evade tax by reporting his 1999 income on his corporate return rather than his individual return and not reporting his 2000 income at all. Kayser did report deductible business expenses on his 2000 corporate return and carried back the net operating loss to offset the tax due for 1999.

Kayser argued that his unreported 2000 A2Z income should be offset by the expenses claimed on the 2000 corporate return. Kayser offered evidence that he paid the expenses in connection with the production of his A2Z income, and that an independent contractor's allowable business deductions can be used to reduce business income on an individual return. Kayser requested a jury instruction stating that if he had unclaimed deductions that would eliminate his tax liability, then there is no deficiency. The government successfully objected, arguing that Kayser introduced no evidence of unclaimed deductions and that the instruction was erroneous as a matter of law because Kayser's theory of defense was improper under *United States v. Miller*, 545 F.2d 1204 (9th Cir. 1976). Kayser was convicted and appealed.

The Ninth Circuit noted that a defendant may negate a deficiency with unreported deductions and is entitled to demonstrate such deductions at trial. *Kayser*, 488 F.3d at 1073 (citing *United States v. Marabelles*, 724 F.2d 1374, 1378-79 (9th Cir. 1984), and *Elwert v. United States*, 231 F.2d 928, 933 (9th Cir. 1956)). The court rejected the government's contention that *Miller* precludes a defendant who reports income and deductions in one manner from arguing for an alternative treatment at trial. Instead, *Miller* "allows a defendant to present evidence at trial regarding the facts of the transaction at issue, notwithstanding the defendant's improper or 'scrambled' reporting of those facts." *Kayser*, 488 F.3d at 1074 (quoting *Miller*, 545 F.2d at 1215-16)). Accordingly, the court held that Kayser's theory of defense was proper.

The court next turned to whether Kayser's evidence was sufficient to warrant the instruction. "[A] defendant is entitled to an instruction concerning his theory of the case if the theory is legally sound and evidence in the case makes it applicable, even if the evidence is weak, insufficient, inconsistent, or of doubtful credibility." *Kayser*, 488 F.3d at 1076 (quoting *United States v. Washington*, 819 F.2d 221, 225 (9th Cir. 1987)). The court found that Kayser presented evidence that he incurred the expenses, maintained records of those expenses and that the expenses were incurred in connection with his work for A2Z. Accordingly, the Ninth Circuit held that the trial court abused its discretion in refusing Kayser's requested jury instruction on his theory of defense, and reversed Kayser's conviction.

In *United States v. Cryer*, 2007 WL 1805031 (W.D. La.) (June 20, 2007), Cryer was charged with two counts of evasion in violation of 26 U.S.C. § 7201 (counts 1 and 2) and two counts of willful failure to file a return in violation of 26 U.S.C. § 7203 (counts 3 and 4). Cryer moved to dismiss counts 3 and 4 on the grounds that they represent lesser included offenses.

The district court acknowledged that, under the statutory elements approach set forth in *Schmuck v. United States*, 489 U.S. 705 (1989), the Sixth, Seventh and Ninth Circuits have held that that § 7203 is not a lesser included charge of § 7201. However, since the district court was bound by the Fifth Circuit's decision in *United States v. Doyle*, 956 F.2d 73, 74-75 (5th Cir. 1992), it held that a § 7203 violation was a lesser included charge requiring counts 3 and 4 to be dismissed for multiplicity. *Id.*

In *United States v. Stierhoff*, --- F. Supp. 2d ---, 2007 WL 2238243 (D. R.I.) (Aug. 3, 2007), Stierhoff was convicted of four counts of evasion in violation of 26 U.S.C. § 7201. At trial, the government introduced evidence that Stierhoff failed to file returns and pay tax due, and conducted business, received mail and opened accounts under alter egos to conceal income.

Stierhoff moved to dismiss the indictment on the grounds that, while the indictment stated that he “willfully” attempted to evade tax, it did not allege that he had actual knowledge of the specific statute violated. The district court rejected this argument, noting that “willfulness” is a term of art that provides adequate notice to a defendant of the charges lodged. The court also summarily rejected Stierhoff's arguments that, in the absence of a signed return, the indictment must allege an assessment before there can be a tax due, and that the indictment must specify the amount due. *Stierhoff*, at *3.

Stierhoff also argued that the indictment was defective because it failed to specify the statute that required him to file a return and pay tax due. The court rejected this argument, noting that the reference to § 7201 was sufficient to put Stierhoff on notice of the nature of the charges. *Id.* at *5 (citing *United States v. Vroman*, 975 F.2d 669, 670-71 (9th Cir. 1992)). Stierhoff also contends that the indictment is duplicitous, because it charges more than one offense in a single count – evasion of assessment and evasion of payment. The district court disagreed, citing *United States v. Huguenin*, 950 F.2d 23, 25 (1st Cir. 1991), for the position that the indictment's reference to “failing to pay” was “overborne by the clear and unequivocal evasion-of-assessment charges.” *Stierhoff*, at *6 (quoting *Huguenin*, at 26 (internal quotes omitted)). The court further noted that Stierhoff was aware well in advance of trial that the government was pursuing an evasion of assessment theory.

The court also denied Stierhoff's motion for new trial, finding, *inter alia*, that the IRS revenue agent did not exceed the scope of a summary witness when he testified regarding his conclusions and calculated the tax owed based on the evidence presented. *Stierhoff*, at *9 (citing *United States v. Pree*, 408 F.3d 855, 869 (7th Cir. 2005) and *United States v. Moore*, 997 F.2d 55, 58 (5th Cir. 1993)).

26 U.S.C. § 7202 (failure to account for and pay over tax)

In *United States v. Blanchard*, 2007 WL 1976359 (E.D. Mich.) (July 3, 2007), the Blanchards, who owned an underground excavating business, were charged with five counts of evasion in violation of 26 U.S.C. § 7201 (1998 through 2002), 15 counts of willfully failing to truthfully account for and pay over withholdings of employment taxes in violation of 26 U.S.C. § 7202 (for 1st quarter of 1999 through the 4th quarter of 2002, excluding the 3rd quarter of 2002), and three counts of making false claims against the United States in violation of 18 U.S.C. § 287 and § 2 (1999 through 2001). The Blanchards moved to dismiss the majority of the § 7202 counts as time-barred, arguing that the general 3-year statute of limitations under 26 U.S.C. §

6531 applied to the offenses of willfully failing to *pay over* a tax, not the extended 6-year period which applied to offenses of willfully failing to *pay* any tax.

The district court noted that the question was an issue of first impression for the Sixth Circuit, and therefore looked to other jurisdictions. In *United States v. Block*, 497 F. Supp. 629 (D. Ga. 1980) and *United States v. Brennick*, 908 F. Supp. 1004 (D. Mass. 1995), the courts held that the 3-year statute of limitations applied. *Blanchard*, at *2. These courts are far outweighed, however, by those that applied the 6-year period of limitations: *United States v. Adams*, 296 F.3d 327, 332 (5th Cir. 2002); *United States v. Gilbert*, 266 F.3d 1180, 1186 (9th Cir. 2001); *United States v. Musacchia*, 900 F.2d 493, 499-500 (2d Cir. 1990), *vacated on other grounds*, 955 F.2d 3 (2d Cir. 1991); *United States v. Porth*, 426 F.2d 519, 522 (10th Cir. 1970); *United States v. Creamer*, 370 F. Supp. 2d 715 (N.D. Ill. 2005). *Id.* The district court rejected the reasoning of *Block* and *Brennick*, held that the 6-year statute of limitations applies to § 7202 offenses, and denied Blanchard's motion to dismiss.

The district court next considered the Blanchards' motions to sever their trials pursuant to Federal Rule of Procedure 14(a). Mrs. Blanchard argued that the trials should be severed because the evidence regarding Mr. Blanchard would result in "transference of guilt" from him to her that would not be dissolved with a curative jury instruction. She further argued that she would be unable to present a defense antagonistic to Mr. Blanchard on account of the spousal privilege that allows either spouse to prevent the disclosure of confidential communications made during the marriage. Mr. Blanchard raised similar arguments and relied on *United States v. Breinig*, 70 F.3d 850 (6th Cir. 1995), in which the Sixth Circuit reversed Breinig's conviction based on the denial of his pretrial motion for severance.

The court granted Mrs. Blanchard's motion, finding that failure to sever would place her in an impossible Catch-22 – "(1) choose to exercise her right to testify on her own behalf and necessarily waive her privilege not to testify against her spouse, or (2) choose not to testify against her spouse but thereby forego her right to testify on her own behalf." *Blanchard*, at *7.

In *United States v. Easterday*, 2007 WL 2023500 (N.D. Cal.) (July 12, 2007), Easterday was charged with 109 counts of willfully failing to collect, truthfully account for and pay over payroll taxes. At trial, Easterday admitted that he owed and failed to pay over the tax, but argued that did not do so "willfully." He requested and the court granted the following jury instruction derived from *United States v. Poll*, 521 F.2d 329, 333 (9th Cir. 1975):

The word "willfully" means a voluntary, intentional violation of a known legal duty. In other words, the defendant must have acted voluntarily and intentionally, not through ignorance, mistake, or accident and with the specific intent to do something he knew the law prohibited; that is to say, with the intent either to disobey or disregard the law.

In the context of this case, in order for the government to establish willfulness beyond a reasonable doubt, it must prove that on the date the taxes were due, the taxpayer possessed sufficient funds to be able to meet his legal obligations to the government, or that the lack of sufficient funds on such date was created by or was the result of a voluntary and intentional act, and the taxpayer voluntarily and intentionally, without justification in light of all the financial circumstances of the taxpayer, did not pay such taxes.

Easterday, at *1. In response to a jury question, the court provided the following additional instruction:

Evidence that the defendant caused the corporation to pay other expenses may be evidence that the defendant's failure to assure that the corporation paid its taxes was willful. Evidence that the defendant caused the corporation to pay other expenses in a particular quarter knowing that the taxes had not been paid in previous quarters, and that funds would not be available to pay the taxes in the current quarter, may be evidence that the defendant's failure to assure that the corporation paid its taxes was willful.

Id. Easterday unsuccessfully argued that the court was eliminating his “ability to pay” defense. The court also refused to give a good faith instruction.

Following his conviction, Easterday moved for a judgment of acquittal or new trial. The court agreed that the supplemental instruction eliminated his “ability to pay” defense and ordered a new trial. On retrial, the court refused to give the *Poll* instruction, but gave a good faith instruction. Easterday was again convicted and moved for judgment of acquittal or a new trial, arguing that the court erred in refusing to give the *Poll* instruction.

The district court denied Easterday’s motions, stating that *Poll* was no longer good law because it was premised on the belief that “willfulness” requires an evil motive or improper purpose. This reasoning was rejected by the Supreme Court in *United States v. Pomponio*, 429 U.S. 10, 12 (1976) and *Cheek v. United States*, 498 U.S. 192 (1991). The government did not need to prove that Easterday had an “ability to pay,” but that, even if he had an ability to pay, he knowingly violated the law by not paying the tax due. The court noted that Easterday was “free to argue that he did not believe he was violating the tax laws because to pay the amounts owed he would have to close his nursing homes or at least not make full payroll.” *Easterday*, at *3.

In *United States v. Ellis*, 2007 WL 2316486 (S.D. Ind.) (Aug. 2, 2007), Ellis was convicted for failing to account for and pay over employment taxes for 8 consecutive quarters in violation of 26 U.S.C. § 7202, and sentenced to 63 months. She appealed and moved for release pending appeal pursuant to 18 U.S.C. § 3413(b). The issue in dispute was whether Ellis’ appeal raises a substantial question of law or fact likely to result in a reversal, new trial, or sentence with no imprisonment or imprisonment for a period less than the expected duration of the appeal.

Ellis argued, *inter alia*, selective and vindictive prosecution. The district court disagreed, pointing to the mountain of evidence presented by the government. Ellis also argued that she was entitled to a lesser included offense charge under § 7512 and § 7215(a), misdemeanors for failing to account for withheld taxes. The court rejected Ellis’ request because the misdemeanor offense requires proof of an additional element – that the defendant is notified, by notice hand delivered to such person, of any such failure to account for withheld taxes. *Ellis*, at *4 (citing *Schmuck v. United States*, 489 U.S. 705 (1989) (applying the statutory elements approach)). The court held that Ellis’ issues were not sufficient to satisfy the requirement of § 3413(b).

26 U.S.C. § 7206 (false statement)

In *United States v. Borden*, 2007 WL 1128969 (M.D. Fla.) (April 16, 2007), Borden was convicted of 27 counts of preparing false returns in violation of 26 U.S.C. § 7206(2). Borden moved for judgment of acquittal with respect to Count 14, relating to the 1999 tax return of Brian White. White's return was prepared by Borden, but Borden instructed White not to file it. Borden's wife mistakenly filed the return. White contacted the IRS and asked that the return not be processed because it was not accurate. Borden argues that because White's return was not "filed," he did not violate § 7206(2) with respect to that return.

Although the Eleventh Circuit Pattern Jury Instructions suggests that "filing" is a required element of § 7206(2), the district court noted that the statute refers to "preparation or presentation" of a false return. The court reviewed *United States v. Dahlstrom*, 713 F.2d 1423 (9th Cir. 1983), which held that § 7206(2) does not have a filing requirement, but rejected the majority opinion in favor of Judge Goodwin's dissent, in which he opined that a filing requirement would render the words "preparation or" surplusage and superfluous. *Borden*, at *2. The court also noted that a filing requirement would prevent any prosecution stemming from an undercover investigation, since the "taxpayer" would never intend to file the false return, and the false return would never be "filed." *Id.* at **2-3. Borden's motion was denied.

In *United States v. Holy Land Found., et al.*, 2007 WL 1498813 (N.D. Tex.) (May 23, 2007), defendants moved to dismiss a superseding indictment stemming from their donations to various organizations allegedly affiliated with or controlled by Hamas, a specifically designated Foreign Terrorist Organization. Among the various charges, defendants are accused of knowingly submitting false information on Holy Land Foundation's tax returns in violation of 26 U.S.C. § 7206(1). The government alleges that defendants included donations to organizations allegedly affiliated with or controlled by Hamas as "program services" (Line 13 of the return). "Program services" include "(1) activities which 'form the basis of the organization's current exemption from tax'; and (2) 'the organization's unrelated trade or business activities,' the income from which is taxable." *Holy Land Found.*, at * 4 (quoting Instructions for Line 13). The court found that since donations to Hamas are illegal and cannot form the basis of tax exempt status, the inclusion of those donations as "program services" constituted a false statement. Defendants' motion to dismiss was denied.

In *United States v. Cordell*, 2007 WL 2348664 (5th Cir. 2007) (Aug. 16, 2007), Cordell was convicted of failing to account for and pay over withheld taxes in 1998 and 1999 in violation of 26 U.S.C. § 7202, and filing false individual returns for 1997-1999 in violation of 26 U.S.C. § 7206(1). The false return charge stemmed from Cordell's claim of withholding credits on his individual returns when he knew that, as his own employer, he failed to deposit that withholding with the IRS. Cordell appealed the § 7206(1) convictions, arguing that the returns were accurate, since he only received his net wages, and that he was being punished solely because he was his own employee. The Fifth Circuit affirmed the conviction, finding that he was responsible for withholding, willfully failed to withhold, and knowingly filed false returns claiming refunds for taxes that were not paid. The court also affirmed an "abuse of position of trust" enhancement based on Cordell's position of trust with respect to the employees and his duty to account for and pay over withholding tax.

In *United States v. Greene*, 2007 WL 2326089 (10th Cir. 2007) (Aug. 16, 2007), Greene was charged with evasion of payment in violation of 26 U.S.C. § 7201 (count one) and subscribing a false tax document in violation of 26 U.S.C. § 7206(1) (count two), stemming from his filing of a false and fraudulent Offer in Compromise, accompanied by a false declaration on a

Form 433A (financial statement). His underlying tax liability arose in part from his 1990 tax return, on account of which he pled guilty in 1996 for filing a false return and was sentenced to 18 months. Upon his release in 1998, the government alleged that he willfully attempted to evade the payment of tax due for 1990, 1991, 1994 and 1995 by concealing assets and filing the false Offer in Compromise. After a two-week trial with more than 30 witnesses, he was convicted on both counts and sentenced to 60 months on count one, 10 months on count two, to be served consecutively, and fined \$250,000 (twice the recommended maximum) on each count.

Among the numerous grounds raised on appeal, Greene argued that the indictment was multiplicitous because he was convicted on both counts of the same act – filing a false Form 433A. The Tenth Circuit disagreed, finding that based on the “statutory elements” test set forth in *Blockburger v. United States*, 284 U.S. 299 (1932), each offense (§ 7201 and § 7206) requires proof of at least one fact that the other does not. The court noted that under § 7201, the government must prove “that a substantial tax was owed and that the defendant intended to evade payment of that tax.” *Greene*, at 4. Since § 7206 does not require proof of those facts, Greene’s multiplicity argument failed.

Greene also argued that count one was duplicitous since it charged both evasion of taxes and submitting a false declaration under oath. The Tenth Circuit disagreed, noting that “where the evidence is sufficient to prove one of the two charged offenses, even a general verdict may be upheld.” *Id.* The court remanded on the fines imposed, holding that the district court failed to state its reasons for the fines in violation of 18 U.S.C. § 3553(c).

In *United States v. Palivos*, 486 F.3d 250 (7th Cir. 2007) (Aug. 22, 2007), Marin was a loan broker in a complex, fraudulent real estate transaction. Bouzanis, a coconspirator, acted as the “buyer” of a problem-plagued restaurant and applied to The Money Store (“the lender”) for an SBA loan. Because Bouzanis did not have sufficient income to qualify for the loan, Marin instructed his accountant to prepare false tax returns, which were then presented to the lender. Although Bouzanis signed forms authorizing the lender to obtain copies of his actual returns from the IRS, which reflected much lower income, it did not make that request. After the purchase was complete, Bouzanis defaulted on the loan and a criminal investigation ensued.

Marin was charged and convicted of assisting in the preparation and presentation of a false tax return in violation of 26 U.S.C. § 7206(2). On appeal, Marin argued that he was charged with the wrong offense. The Seventh Circuit stated, without citation to any authority, “[t]here seems to be no dispute that to be a violation of this section the return must have been filed with the Internal Revenue Service.” 486 F.3d at 258. The court agreed that Marin aided in the commission of the fraud, but because Bouzanis’ false return was only sent to The Money Store and not filed with the IRS, the court vacated Marin’s conviction.

18 U.S.C § 371 (conspiracy)

In *United States v. Rozin*, 2007 WL 2155849 (S.D. Ohio) (July 24, 2007), Rozin filed a motion to dismiss a Klein conspiracy charge under 18 U.S.C. § 371 (the defraud portion of the statute), arguing that the facts alleged fit squarely within the elements of 26 U.S.C. § 7206(1) and therefore, he should have been charged specific offense portion of the statute. The district court considered *United States v. Minarik*, 875 F.2d 1186, 1193-94 (6th Cir. 1989), which held that where a defendant’s conduct fell within a specific statute, the conspiracy charge under § 371

must be for the specific offense, not the defraud portion of the statute. The *Minarik* court stated that the purpose of the defraud clause “was to reach conduct not covered elsewhere in the criminal code.” *Id.* The Sixth Circuit has limited *Minarik* to its particular facts and reversed dismissals of Klein conspiracies on arguments similar to those raised by Rozin. *Rozin*, at *3 (citing *United States v. Mahoney*, 949 F.2d 899, 901 (6th Cir. 1991)). Finding that this case was more akin to *Mahoney* than *Minarik*, the court denied Rozin’s motion, finding that the indictment gave him fair notice of the conduct underlying the charges.

Motions to Suppress based on *United States v. Tweel*, 550 F.2d 297 (5th Cir. 1997)

In *United States v. Greve*, 490 F.3d 566 (7th Cir. 2007) (June 4, 2007), Greve was indicted on four counts of preparing false returns in violation of 26 U.S.C. § 7206(1). He moved to dismiss the indictment and suppress evidence on the ground that the IRS “violated his Fourth and Fifth Amendment rights by conducting a covert criminal investigation under the guise of a civil audit.” *Id.* at 568. Greve also requested discovery and an evidentiary hearing on his motions. The district court denied Greve’s motions and Greve appealed.

Greve owned and operated Greve Construction since 1990. In 1999, the IRS began a civil audit of Greve’s 1997 tax year and proposed adjustments. After the examination report was issued, Greve met with the revenue agent (“Luke”) and admitted that he underreported his 1997 income by \$107,888. Luke issued an Information Document Request (IDR) for bank records, which Greve provided. Based on her belief that some of the documents had been altered, Luke discussed potential fraud with her manager, who agreed that the case had fraud potential. Luke then met with an IRS District Fraud Coordinator (“Welu”) who “helps develop potential fraud cases and instructs revenue agents and tax auditors how to investigate cases that may involve civil fraud or result in a criminal referral.” 490 F.3d at 568.

Welu told Luke to expand the audit into 1998, obtain the 1996 return, summon the account records from the bank and confirm whether Greve altered the documents. When Luke called Greve to request additional documents and another interview, he admitted that he only reported income from customers that issued Forms 1099. Welu later provided Luke with information that Greve had taken steps to conceal assets and income. Luke requested permission to expand the audit to 1998 to develop the case for fraud. She issued the IDR to Greve and advised her manager that she developing the fraud case.

During a meeting with Luke, Greve and his counsel, Luke stated that she would propose additional tax and penalties and that the audit would be “wrapped up pretty quickly.” 490 F.3d at 569. Greve produced the documents requested and admitted that he underreported his income for 1997 and 1998. Four months later, when Greve called Luke for a status report, she requested documents on a newly-discovered bank account and stated that she may need an extension of the limitations period. Three months later, Luke read the IRS fraud handbook and noted that she needed to either write up a referral or close the case. Several weeks later, Welu instructed Luke to contact Greve’s customers and inquire why Forms 1099 has not been issued. A month later, Luke finally drafted her CID referral report. Four years later, Greve was indicted.

The Seventh Circuit held that the indictment was valid, despite Greve’s allegations of illegally obtained evidence. With regard to Greve’s motion to suppress, the court considered

whether Luke “affirmatively misled” Greve as to the true nature of her examination. 490 F.3d at 571 (citing *United States v. Serlin*, 707 F.2d 953, 956 (7th Cir. 1983)). The court agreed that Luke was required to cease her investigation when she had a firm indication of fraud, 490 F.3d at 571 (citing I.R.M. §§ 4565.21(1), 9311.83(1)), but noted that “[a] failure to terminate a civil investigation when the revenue agent has obtained firm indications of fraud does not, without more, establish the inadmissibility of evidence obtained by [the agent] in continuing to pursue the investigation.” 490 F.3d at 571 (quoting *United States v. Kotney*, 238 F.3d 815, 820 (7th Cir. 2001)). “Greve must prove that Luke induced his compliance through false promises.” *Id.*

Greve argued that Luke falsely promised on more than one occasion that if he cooperated, he would only be faced with civil assessments. The court disagreed, finding that no express promises were made and Luke’s failure to advise Greve that she was considering a fraud referral did not amount to affirmative deceit. 490 F.3d at 572 (citing *Serlin*, 707 F.2d at 956)).

In *United States v. Rutherford*, 2007 WL 1703521 (E.D. Mich.) (June 12, 2007), Rutherford and his co-defendant, Bugaiski, were charged with multiple counts of evasion in violation of 26 U.S.C. § 7201, willful failure to pay over tax in violation of 26 U.S.C. § 7202, fraud and false statements in violation of 26 U.S.C. § 7206 and conspiracy in violation of 18 U.S.C. § 371. Defendants moved to suppress evidence and dismiss, arguing that the civil audit should have terminated due to firm indicators of fraud. Following an extended evidentiary hearing and post-hearing submissions, the court found firm indicators of fraud prior to the defendants’ second interview in June, 2004.

The civil exam began in August, 2001, based on an unfavorable newspaper article about Metro Emergency Services (“MES”) involving large amounts of money and political figures. IRS Revenue Agent Tagami, of the Tax Exempt and Government Entities (TE/GE) division, was assigned to investigate MES. When Tagami learned that MES had failed to file several Forms 941, he called in Revenue Officer Mahaffey, who reviewed the records and sent Tagami a memo dated July 31, 2003, in which he noted “very large and significant indicators of fraud” and stated, “Despite my initial excitement when reviewing the case, this case will need some development before submitting to CI (providing the indicators hold up after all facts are discovered). There may be plausible explanations to all the discrepancies here.” *Rutherford*, *2.

Tagami consulted with Fraud Referral Specialist (FRS) Frommer to discuss whether the case involved indicators of fraud. “If Frommer determines that a case does have the first indicators of fraud, the status of a case is updated to ‘Status 17,’ which is a ‘fraud development’ case.” *Id.* (citation omitted). The district court outlined the procedure an FRS follows in assisting agents develop a potential fraud case, and then addressed at length the events that occurred during the civil examination leading up the criminal referral. Of particular note is the fact that during the first interview with a revenue agent, the taxpayers refused to answer further questions and walked out of the room. A second interview was requested and refused. The taxpayers were eventually interviewed again pursuant to a summons issued by the same revenue agent.

The district court recognized that “[t]he question of when a firm indication of fraud is present is not an easy one. It must be determined on a case by case basis from the totality of the facts.” *Id.* at *12 (citing *United States v. Peters*, 153 F.3d 445, 453 (7th Cir. 1998)). The court considered the reasoning of *United States v. McKee*, 192 F.3d 535, 542 n.5 (6th Cir. 1999): “If the revenue agent continues the civil audit even after she has developed ‘firm indications of fraud,’ then she is, in fact, making affirmative misrepresentations to the constitutional detriment

of the taxpayer because she is gathering criminal evidence against the taxpayer under the guise of a civil proceeding.” The court also acknowledged that the revenue agent and supervisor “enjoy great latitude and deference” in this regard. *Rutherford*, at *13.

The court noted that a taxpayer’s intent is the “most critical element” in determining the existence of firm indicators of fraud. *Id.* (citing *United States v. Groder*, 816 F.2d 139, 143-44 (4th Cir. 1987)). “[I]t is the taxpayer’s intent to evade taxes that differentiates a criminal violation from a civil case. For this reason, a revenue agent who discovers potential violations of the revenue laws will almost always give the taxpayer an opportunity to explain the violations before determining the appropriateness of a criminal referral.” *Id.* (quoting *United States v. Peters*, 153 F.3d 445, 455 (7th Cir. 1998)).

The district court found that when the defendants refused to come in for the second interview and provide explanations for their conduct, “the ‘first’ indicators of fraud morphed into ‘firm’ indicators. And once the investigation became so focused on the criminality of the defendants, it would be constitutionally infirm to force their cooperation.” *Rutherford*, at *14.

Post Script: The district court ordered the parties to meet with the case manager. The docket reveals that a conference was held, proposed memoranda and orders were submitted, oral argument was conducted and the court ultimately denied the motion to dismiss.

Sentencing Issues

In *United States v. Baucom*, 486 F.3d 822 (4th Cir. 2007) (May 16, 2007), Baucom and his co-defendant, Davis, were tax protestors who refused to hire or accept counsel. They were convicted of conspiring to defraud the United States in violation of 18 U.S.C. § 371, and willful failure to file tax returns in violation of 26 U.S.C. § 7203. Baucom’s presentence report (“PSR”) calculated his unpaid taxes at \$347,134.40, including \$36,000 in unpaid state income taxes, resulting in a base offense level of 18. The PSR recommended a two level adjustment for acceptance of responsibility, Criminal History Category of I, and an advisory Guideline range of 21 to 27 months. Davis’ advisory range was the same.

At sentencing, the district court overruled the government’s objection to the acceptance of responsibility adjustments. It found that Baucom and Davis went to trial to challenge the constitutionality of the federal tax system, not assert issues that relate to factual guilt, and thus remained eligible for the adjustment pursuant to U.S.S.G. § 3E1.1, comment n.2. The court also refused to consider the state tax loss as relevant conduct:

I don’t think I have the ... jurisdiction to sentence this man for [a] violation of North Carolina law. I mean, it’s conceivable to me that a federal judge would be sitting up here and saying you violated North Carolina law and I’m putting you in jail for it. It’s just – what happened to the whole notion of federalism? I don’t think I have the power to do that. And if I do, if I have discretion, I decline to exercise the discretion to do that. It’s not fair and I ain’t gonna. Y’all can all go to Richmond and they can tell some other judge what to do.

Baucom, 486 F.3d at 828. The court sentenced Baucom to 15 months imprisonment and Davis to four years probation, with 12 months being served in home detention. The court justified

Davis' sentence by noting his charitable works that involved bringing children impacted by the Chernobyl disaster to the United States for medical treatment. The court also noted that Davis' efforts to pay the tax due and the impact incarceration would have on his employees. The court found no need to deter future criminal conduct or protect the public. The government appealed.

The Fourth Circuit vacated and remanded for resentencing. The court held that the plain language of the Guidelines require that state tax losses are relevant conduct to the extent they “‘were part of the same course of conduct or common scheme or plan’ as Appellants’ failure to file federal tax returns.” *Id.* at 829. In response to Appellants’ contention that the amount of state tax loss would not impact their advisory guideline range, the Fourth Circuit instructed the trial court on remand to consider the total state tax loss for all years at issue.

The Fourth Circuit also rejected the adjustments for acceptance of responsibility, finding no demonstration of remorse or acceptance of responsibility contemplated by the Guidelines. In sum, the court opined that the sentences failed to reflect the seriousness of the offense, did not provide sufficient deterrence or just punishment for the criminal tax offenses of failing to file returns for 12 years, and, in Davis’ case, relied to heavily on his charitable works.

In *United States v. Reiss*, 2007 WL 1451809 (8th Cir. 2007) (May 17, 2007), Reiss was convicted of 84 counts of aiding and assisting with the preparation of false returns in violation of 26 U.S.C. § 7206(2). At sentencing, the court imposed a four-level leadership enhancement pursuant to U.S.S.G. § 3B1.1(a). On appeal, Reiss argued that the court erred in imposing the leadership enhancement. The Eighth Circuit found that even if the scheme did not involve five or more participants, it was otherwise extensive based on the dozens of taxpayers, over 80 returns and a tax loss of \$232,226. The court cited *United States v. Senty-Haugen*, 449 F.3d 862, 864 (8th Cir. 2006), which held that “a tax fraud scheme involving 18 taxpayers, 29 returns and a \$71,610.90 tax loss was ‘without question’ otherwise extensive.” *Reiss*, at *2.

In *United States v. Goldsmith*, 486 F.3d 404 (8th Cir. 2007) (May 18, 2007), Goldsmith (an attorney) pled *nolo contendere* to failing to account for and deposit withheld tax in violation of 26 U.S.C. § 7202, and failing to file personal returns in violation of 26 U.S.C. § 7203. He sought a downward departure due to “a major depressive disorder that caused his misconduct.” 486 F.3d at 406. Although the district court found that Goldsmith was mentally ill at the time of sentencing and criticized the Guidelines for putting seriously mentally ill people in prison, it held that Goldsmith’s case was not unusual enough to justify departure. Goldsmith appealed.

The Eighth Circuit found that the district court was aware of its authority to depart and, since a failure to depart was not reviewable on appeal, the Eighth Circuit affirmed Goldsmith’s sentence. *Id.* at 407 (citing *United States v. Dabney*, 367 F.3d 1040, 1044 (8th Cir. 2004)).

In *United States v. Dean*, 487 F.3d 840 (11th Cir. 2007) (May 25, 2007), Dean is a doctor, published author, retired naval flight surgeon and tax protester. In 1996, he began filing “0” Forms 1040EZ, despite earning over \$100,000 each year. Dean also revised his Form W4 to claim exempt from withholding. Despite repeated notices from the IRS regarding the frivolous returns, and the submission of credit application on which he claimed substantial income, Dean continued to file “0” returns and claim to be exempt from withholding. In response to IRS summonses, Dean sent letters to the recipients stating that they did not need to respond because the summons was a phony document, not a court order, sent without lawful authority. Dean was indicted on six counts of evasion in violation of 26 U.S.C. § 7201 and one count of attempted

interference with the administration of internal revenue laws in violation of 26 U.S.C. § 7212(a). Dean was convicted on all counts and sentenced to three concurrent 60-month terms on counts 103, and three concurrent 24-month terms on counts 4-6, with the latter sentences running consecutively after the former.

Dean argued that the government failed to introduce sufficient evidence of violations of § 7212(a). The Eleventh Circuit disagreed, finding that the issuance of “strongly worded” letters to the summons recipients, in which he threatens legal action against anyone who complied with the summonses, constituted interference with the administration of the internal revenue laws. Dean also challenged his sentence, which exceeded the advisory guideline range. The Eleventh Circuit affirmed the sentence, finding that after *United States v. Booker*, 543 U.S. 220 (2005), courts are permitted to make additional factual findings by a preponderance of the evidence, and go beyond the facts found by the jury, as long as the court recognizes the Guidelines as advisory. Within this framework, courts are permitted to sentence beyond the Guidelines range.

In *United States v. Griffin*, 494 F. Supp. 2d 1 (D. Mass.) (June 6, 2007), the district court (Judge Young) issued an exhaustive sentencing memorandum that begins with an analysis of the Constitution and the Supreme Court’s recent decision in *Cunningham v. California*, --- U.S. ---, 127 S. Ct. 856 (2007), in which Court stated, “This Court has repeatedly held that, under the Sixth Amendment, any fact that exposes a defendant to a greater potential sentence must be found by a jury, not a judge, and established beyond a reasonable doubt, not merely a preponderance of the evidence.” *Id.* at 863-64.

Griffin was indicted on two counts of filing false returns in violation of 26 U.S.C. § 7206(1), with the government alleging that she underreported income earned as a salesperson for a multi-level marketing company. Pursuant to *United States v. Kandirakis*, 441 F. Supp. 2d 282, 319-329 (D. Mass. 2006), the district court issued a verdict form asking the jury to determine whether the government proved sophisticated means of concealment, and specify the amount of tax loss. The jury hung on count one, convicted on count two, found sophisticated concealment and calculated the tax loss as more than \$30,000 but less than \$80,000.

At sentencing, the district court recited numerous statistics with respect to Griffin’s offense, including the national average sentence (20 months), the First Circuit average (18 months), and the District of Massachusetts average (15 months). Following *United States v. Watts*, 519 U.S. 148, 157 (1997), the court noted its authority to consider conduct for which a defendant is acquitted. It further noted that tax loss need only be proved by a preponderance of the evidence. 494 F. Supp. 2d at 8 (citing *United States v. Antonakopoulos*, 399 F.3d 68, 75 (1st Cir. 2005)). On this foundation, the court determined the tax loss to exceed \$200,000 and sentenced Griffin to 27 months. Six days after sentencing, the Supreme Court issued its opinion in *Cunningham*. Pursuant to Federal Rule of Criminal Procedure 35(a), the district court vacated its judgment and conducted a hearing to correct the original sentence.

The court provided a “survey of the legal framework and the implications of *Cunningham*.” *Griffin*, 494 F. Supp. 2d at 8. The court found that *Cunningham* prohibited a court from basing a defendant’s sentence on acquitted conduct or a tax loss beyond the lowest range indicated by the jury. Under *Cunningham*, “the “statutory maximum” for Sixth Amendment analysis must be determined, in the first instance, by jury-found facts.” *Id.* at 14. Accordingly, based on the jury’s verdict, the court determined that Griffin’s base offense level was 14, resulting in an advisory guideline range of 15-21 months, and a “statutory maximum” of

21 months. The court considered the § 3553(a) factors, and found by a preponderance of the evidence that Griffin should be held accountable for the tax loss alleged in Count 1. Therefore, the court “resentenced Griffin to the statutory maximum of 21 months.” 494 F. Supp. 2d at 21.

In *United States v. Kaushansky*, 2007 WL 1656251 (W.D. Pa.) (June 6, 2007), Kaushansky was charged with appropriating funds allocated by the United States to improve the safety at Russian nuclear facilities. Kaushansky pled guilty to conspiracy to defraud the United States in violation of 18 U.S.C. § 371, evasion in violation of 26 U.S.C. § 7201, and filing a false return in violation of 26 U.S.C. § 7206. The government calculated the tax loss in excess of \$5,000,000, while Kaushansky argued the loss was less than \$70,000.

The government argued that funds received by Kaushansky and related entities was income that he intentionally failed to report on corporate and his individual tax returns. In response, Kaushansky offered testimony from experts on the economic state of the Russian economy and its impact on Russian scientists and scientific institutes in support of his contention that funds received by the entities did not constitute income, since those entities practiced “reciprocal accounting” and were merely conduits used to avoid “the dysfunctional Russian banking system and other economic plagues.” *Kaushansky*, at *10. Kaushansky further argued that he did not assist in the evasion of tax owed by residents of Russia, since those individuals and entities do not owe taxes in the United States under the Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital (the U.S.-Russia Tax Treaty). The court noted that the Guidelines define tax loss as “the loss that was the object of the offense and resulted or would have resulted (if completed) in the loss of tax revenue due to the United States Treasury.” *Id.* at *14 (citing U.S.S.G. § 2T1.1(c)).

The court first addressed the Klein conspiracy (“the conspiracy to defraud the United States by obstructing the lawful function of the IRS in assessing and collecting federal income taxes”). *Id.* (citation omitted). The court noted that Kaushansky’s co-conspirators were all Russian entities or residents of Russia and because the government failed to consider or address this fact in calculating tax due, it failed to demonstrate that the co-conspirators owed any tax to the United States. As a result, the court held that any amounts owed by those individuals could not be attributed to Kaushansky for purposes of sentencing.

The court rejected the government’s argument that Kaushansky evaded tax owed by related entities, since one of the entities was actually a bank account not subject to tax and the other was not required to report income on investments it held on behalf of individual investors.

The court agreed that Kaushansky failed to report income from salary and capital gains on his personal returns for 1999 and 2000. Since the government’s witness calculated the tax loss for these years at approximately \$70,000, the court limited the total tax loss to the amount charged in the indictment - \$63,561.52.

In *United States v. Campbell*, 491 F.3d 1306 (11th Cir. 2007) (July 13, 2007), Campbell, the former mayor of Atlanta, was charged RICO violations pursuant to 18 U.S.C. § 1962(a), accepting cash payments with the intent to be influenced and rewarded with respect to City business in violation of 18 U.S.C. §§ 666(a)(1)(B) and 2, and filing false tax returns in violation of 26 U.S.C. § 7206(1). Campbell was acquitted of the RICO and bribery charges, convicted of the tax fraud charges and sentenced to 30 months.

On appeal, Campbell argued that the district court improperly calculated the advisory Guideline range and that his sentence was unreasonable in light of the facts and circumstances. The Eleventh Circuit reiterated that, notwithstanding the Supreme Court's recent decision in *Rita v. United States*, --- U.S. ---, 127 S. Ct. 2456, 2462 (2007), it does not "presume reasonable a sentence within the properly calculated Guidelines range." 491 F.3d at 1313 (citing *United States v. Hunt*, 459 F.3d 1180, 1185 (11th Cir. 2006)).

The court rejected Campbell's argument that the trial court's use of conduct underlying acquitted charges was unconstitutionally excessive. While recognizing that there are limits to the conduct a court may consider in calculating a reasonable sentence, 491 F.3d at 1314 (citing *United States v. Duncan*, 400 F.3d 1297, 1304 (11th Cir. 2005)), the court held that Campbell's sentence of three concurrent terms of 30 months was below the statutory maximum of 3 years and therefore, authorized by the jury's verdict. The court went so far as to find that the sentence demonstrated "considerable leniency and restraint." *Id.* at 1315.

In *United States v. Taylor*, --- F. 3d ---, 2007 WL 2349415 (1st Cir. 2007) (Aug. 17, 2007), Taylor was a well-respected and much loved teacher who, for additional income, prepared false tax returns on the side. The IRS noticed that his clients' returns claimed similar, significant charitable contributions and included the same identical handwritten list of items donated to Goodwill. Taylor told agents that he simply wrote down what his clients gave them. In fact, he prepared the list and to hide his conduct, falsified documents and told clients to lie to the agents. Taylor was convicted of 16 counts of filing false tax returns in violation of 26 U.S.C. § 7206(2). The Presentence Report calculated an advisory Guideline range of 30 to 37 months. Taylor filed 48 letters from the Boston Teachers Union, current and former administrators and teachers, parents and students, family, friends and members of his church and community. Based on his "extraordinary good works," the court sentenced Taylor to five years probation, with one year in a half-way house. The government appealed.

The First Circuit discussed the standard of review of sentences imposed post-*Booker*. The court rejected the overall "reasonableness" standard of the Seventh and Ninth Circuits, and instead held that "where a party challenges a sentence as unreasonable because a district court misconstrued a Sentencing Commission policy statements, appellate review should consist of determining whether the district court has correctly interpreted the policy statement and reasonably applied it to the facts, and if so, whether the sentence was "reasonable." *Taylor*, at *4.

The court held that the district court satisfied the first step – understanding and properly applying the policy statement of U.S.S.G. § 5H1.1 to impose a sentence lower than the advisory guideline range based on Taylor's extraordinary good works. The court noted, however, that Taylor's offenses were essentially theft as part of a business enterprise, and that he obstructed the investigation and failed to accept responsibility for his actions. The court held that the sentence did not adequately recognize the important goal of deterrence and need to avoid unwarranted sentencing disparities among defendants with similar records, accused of similar conduct.

In *United States v. Carlson*, --- F.3d ---, 2007 WL 2350182 (8th Cir. 2007) (Aug. 20, 2007), Carlson pled guilty to willfully failing to account for and pay over trust fund taxes during 24 consecutive quarters in violation of 26 U.S.C. § 7202. The total loss was \$561,223.76, and his advisory Guideline range was 18 to 24 months.

Carlson sought a downward departure based on his restitution efforts and his argument that he would have paid the tax but for the fact that a customer defaulted on its obligations and the downturn in the market. The court sentenced Carlson to 8 months home confinement, 5 years probation and 1,000 hours of community service, noting that “Carlson (1) has a significant record of charitable activities; (2) accepted responsibility and made an exceptional effort to repay the money; (3) suffered damage to his business, reputation, and family relationships; and (4) was not motivated by a desire to defraud the government, but was instead attempting to resolve a financial crisis within the business.” *Carlson*, at *1. The government appealed.

In reviewing the sentence for reasonableness, the Eighth Circuit noted that “[t]he further the district court varies from the presumptively reasonable guideline range, the more compelling the justification based on the § 3553(a) factors must be.” *Id.* at *2 (quoting *United States v. Bryant*, 446 F.3d 1317, 1319 (8th Cir. 2006)). The court stated that criminal tax violations are serious offenses and such prosecutions must punish the offender and serve as general deterrence. Because the district court did not adequately consider the seriousness of Carlson’s offense, the goal of promoting respect for the federal tax laws, the need for general deterrence, the need to avoid unwarranted sentencing disparities, and the need for a just sentence, the Eighth Circuit vacated and remanded for resentencing. *Carlson*, at **2-3 (citing, e.g., *United States v. Ture*, 450 F.3d 352 (8th Cir. 2006) and *United States v. O’Malley*, 364 F.3d 974, 981-82 (8th Cir. 2004)).

In *United States v. Tomko*, --- F.3d ---, 2007 WL 2350765 (3d Cir. 2007) (Aug. 20, 2007), Tomko used his construction company to pay for the construction of his “luxurious new home,” deducted the payments as ordinary and necessary business expenses, and failed to report the payments as compensation on his personal returns, resulting in a tax deficiency of \$228,557. Tomko enlisted subcontractors in this scheme by requesting false invoices and billing the work to various jobs of his company. Tomko pled guilty to a one-count information charging evasion in violation of 26 U.S.C. § 7201. His advisory guideline range was 12-18 months.

At sentencing, Tomko’s counsel proposed volunteer work providing housing for Hurricane Katrina victims in lieu of imprisonment and offered the testimony of the Executive Director of the Pittsburgh affiliate of Habitat for Humanity. The district court agreed and sentenced Tomko to 250 hours of community service, three years probation and a \$250,000 fine. The court noted the following grounds for its departure: “(1) the effect incarceration would have on Tomko's business, causing a job loss to more than 300 innocent employees; (2) Tomko's exceptional charitable and community activities; (3) extraordinary acceptance of responsibility; and (4) a combination of factors.” *Tomko*, at *2. The government appealed.

The Third Circuit agreed with the government, finding that Tomko “did not receive so much as a slap on the wrist – it was more like a soft pat,” for his serious tax offenses. *Id.* at *5 (quoting *United States v. Crisp*, 454 F.3d 1285, 1290 (11th Cir. 2006)). The court discussed in detail each ground for the departure and ultimately determined that the district court abused its discretion in light of the numerous § 3553(a) factors that supported a sentence of imprisonment. The Third Circuit noted that, “[t]he new advisory Guidelines regime leaves ample room for discretion on the part of the District Court, but “discretion, like the hole in the doughnut, does not exist except as an area left open by a surrounding belt of restriction.” *Tomko*, at *12 (internal quotation and citation omitted). In a dissenting opinion, Judge Smith objected to what appeared to be the majority’s *de novo* review of the district court’s analysis of the factors and reasoning in support of its sentence. Smith argued that while he agrees that Tomko is an unsympathetic tax cheat, *Tomko*, at *14, “the majority fashioned a new standard for reasonableness unsupported by

precedent, failed to accord the District Court appropriate deference under our post-*Booker* jurisprudence, and failed to show how the District Court abused its discretion.” *Id.*

In *United States v. Coughlin*, --- F.3d ---, 2007 WL 2416368 (8th Cir. 2007) (Aug. 28, 2007), Coughlin was Wal-Mart’s Chief Operating Officer, Executive Vice President and Vice Chairman of the Board of Directors. From 1997 through 2001, Coughlin embezzled funds from Wal-Mart through false employee travel and expense vouchers, false invoices for personal expenses, and theft of gift cards and equipment. He pled guilty to 5 counts of aiding and abetting wire fraud in violation of 18 U.S.C. § 1343 and § 2, and 1 count of filing false tax returns in violation of 26 U.S.C. § 7206(1). His advisory guideline range was 27 to 33 months. The district court departed downward 8 levels on the grounds of Coughlin’s health pursuant to U.S.S.G. § 5H1.4, and sentenced Coughlin to no imprisonment, 5 years of probation with 27 months of home detention, \$50,000 fine and \$411,218 restitution. The court further noted that if, on appeal, the Eighth Circuit found the departure to be an abuse of discretion, the court alternatively imposed an identical variance sentence pursuant to the factors set forth in 18 U.S.C. § 3553(a). The government appealed.

The Eighth Circuit summarized Coughlin’s health problems: “Coughlin is six feet four inches tall and weighs about 330 pounds. Coughlin survived sudden cardiac death and has had an implantable cardioverter defibrillator since 2003. Coughlin presently suffers from cardiac arrhythmia, severe pulmonary hypertension, double vessel coronary atherosclerosis, type II diabetes, gout, ethmoid sinusitis, obesity, high blood pressure, severe allergies, and back and knee pain. Coughlin also suffers from severe obstructive sleep apnea, which necessitates the use of a continuous positive airway pressure machine at night to prevent a dangerous drop in Coughlin's oxygen levels. Doctors have ordered Coughlin to control his weight and blood pressure since at least 1980, yet these warnings have generally gone unheeded.” *Coughlin*, at *1. Based on testimony provided at sentencing, the Eighth Circuit found that these conditions could be adequately treated by the Bureau of Prisons’ medical facilities and therefore, the district court clearly erred in granting the downward departure. *Id.* at *4.

The court further held that because the district court did not specifically address each of the factors set forth in § 3553(a), including the aggravating factors that warranted a sentence of imprisonment such as the seriousness of the offense and adequate deterrence, the sentence imposed was unreasonable. The court reversed and remanded for resentencing, noting that Coughlin and the government should have an opportunity to supplement the record.

In *United States v. Conlan*, --- F.3d ---, 2007 WL 2538047 (10th Cir. 2007) (September 6, 2007), Conlan was indicted on seven counts of filing false tax returns from 1998 through 2001 in violation of 26 U.S.C. § 7206(1). The indictment involved individuals connected with an organization that marketed and sold fraudulent tax shelter programs or participated in the shelters to evade tax. Conlan pled guilty to one count of filing a false return. His advisory guideline range was 15 to 21 months, but the U.S. Probation Office recommended that the court sentence Conlan to 3 years probation, with 6 months home detention, on the grounds that the advisory range was disproportionately long when compared to other more culpable defendants in the scheme. The government objected, arguing that Conlan “had the burden of overcoming a presumption that the advisory guideline range was reasonable.” The district court agreed and sentenced Conlan to 15 months. Conlan appealed.

The Tenth Circuit addressed the recent decision in *Rita v. United States*, --- U.S. ---, 127 S. Ct. 2456 (2007), in which the Supreme Court held that district courts may not apply a presumption of reasonableness to the advisory guideline range under 18 U.S.C. § 3553(a). The presumption of reasonableness only applies at the appellate level. *Rita*, 127 S. Ct. at 2465. As the Sixth Circuit stated in *United States v. Wilms*, --- F.3d ----, 2007 WL 2077367 (6th Cir. July 23, 2007):

[A] district court's job is not to impose a reasonable sentence. Rather, a district court's mandate is to impose a sentence sufficient, but not greater than necessary, to comply with the purposes of section 3553(a)(2). Reasonableness is the appellate standard of review in judging whether a district court has accomplished its task.

Id. at *2 (quotation marks, emphasis, and citation omitted). The Tenth Circuit held that the district court's application of a presumption of reasonableness coupled with its sentence at the low end of the advisory guidelines demonstrated that the error was not harmless. The court reversed and remanded for resentencing.

Restitution

In *United States v. Anderson*, 491 F. Supp. 2d 1 (D.D.C.) (June 15, 2007), Anderson pled guilty to evasion for tax due for 1998 and 1999 in violation of 26 U.S.C. § 7201 and defrauding the District of Columbia by failing to report or pay taxes on his 1999 income in violation of 22 D.C.C. § 3221(a). The plea agreement provided that, "Mr. Anderson agrees that the court may order restitution pursuant to 18 U.S.C. § 3572 and 16 D.C.Code § 711." 491 F. Supp. 2d at 1. The plea agreement did not provide for supervised release. At sentencing, the government argued that restitution should be imposed as a condition of supervised release. Anderson argued that the Mandatory Victim Restitution Act ("MVRA") (18 U.S.C. § 366A) did not apply to the Title 26 counts and that the collection process should be left to the IRS. Anderson also argued that because the binding Rule 11(c)(1)(C) plea agreement did not provide for supervised release, supervised release could not be imposed and thus, restitution could not be ordered as a condition thereof. In post-hearing briefs, the government retracted its argument for restitution as a condition of supervised release, but asserted that the court could impose restitution pursuant to the Victim and Witness Protection Act, 18 U.S.C. § 3663(a)(3) ("VMPA"), which provides that a court may order restitution "to the extent agreed to by the parties in a plea agreement." The court imposed restitution to the District of Columbia, but refused to order restitution to the IRS. The government moved to correct the sentence pursuant to Fed. R. Crim. P. 35(a).

Anderson argued and the court agreed that Rule 35(a) did not apply with respect to the government's challenge to restitution because that issue is not an "arithmetical, technical, or other clear error." Fed. R. Crim. P. 35(a). The court further noted that, even if Rule 35(a) did apply, it had no legal authority to order restitution for the federal evasion counts. First, because "[f]ederal courts have no inherent power to order restitution," 491 F. Supp. 2d at 5 (citations omitted), the court must find its authority by statute. Neither the MVRA nor the VMPA provide for restitution in cases limited to Title 26 tax offenses. Therefore, the court was left with the government's two remaining arguments – restitution as a condition of supervised release and restitution pursuant to the language of the plea agreement.

The court agreed that “when restitution is imposed as a condition of probation or supervised release, the limitations to certain offenses in the VMPA ... and the MVRA ... do not apply.” *Id.* at 6. And because supervised release is a form of punishment, it “must be part of the agreed-upon ‘sentence’ within the meaning of Rule 11(c)(1)(C).” *Id.* at 7. Here, the binding plea did not provide for supervised release and therefore, the court held that it did not have authority to order supervised release or restitution pursuant thereto.

The government’s final argument was that restitution could be ordered pursuant to the VMPA, since Anderson agreed to pay restitution in the plea agreement pursuant to 18 U.S.C. § 3572. The court agreed that under the VMPA, a defendant may expressly agree to pay restitution, but because the statute cited in the plea was a fine statute, not a restitution statute, it held that it had no authority to order restitution. The government argued that the erroneous citation “was ‘a typo’ and not ‘something that the court should be getting wrapped up about.’” *Id.* at 9. The court rejected this explanation, noting that plea agreements are contract that are construed strictly against the government. *Id.* at 8 (quoting *United States v. Gottesman*, 122 F.3d 150, 152 (2d Cir. 1997)). By citing the wrong statute, the government eliminated the court’s authority to impose restitution on Anderson.

Miscellaneous

(garnishment) In *United States v. Himebaugh*, 2007 WL 1462430 (N.D. Okla.) (May 17, 2007), Himebaugh was charged with conspiracy in violation of 18 U.S.C. § 371 and 39 counts of mail fraud under 18 U.S.C. § 1341. He pled guilty to one count of mail fraud and sentenced to 12 months and 1 day imprisonment and ordered to pay restitution. The United States later issued a garnishment summons to Dunlap & Kyle in an attempt to seize Himebaugh’s interest in the D & L Profit Sharing Plan. D & L objected, stating that the assets were currently held in trust and were not accessible to Himebaugh, his beneficiary or alternate payee. D& L argued that the funds were exempt from garnishment pursuant to . The district court disagreed. It noted that Himebaugh was 100% vested in his account and that the property was subject to collection under 28 U.S.C. § 3202 (Federal Debt Collection Procedures Act), unless it was exempt from levy for payment of federal income taxes as noted in 26 U.S.C. § 6334(a). Since the D & L Profit Sharing Plan did not fit within any of the categories set forth in § 6334(a), no exemption under 18 U.S.C. § 3613 applies. The court also cited *United States v. Rice*, 196 F. Supp. 2d 1196 (N.D. Okla. 2002), which held that the Mandatory Victim Restitution Act (“MVRA”) (18 U.S.C. § 366A) provides an exception to ERISA’s anti-alienation provisions and allows the government to levy funds held in an ERISA qualified pension plan.

(pre-indictment delay) In *United States v. Bordewick*, 2007 WL 1703647 (N.D. Cal.) (June 11, 2007), Bordewick’s mother owed taxes and the IRS filed Notices of Federal Tax Lien (“NFTL”). When Bordewick’s mother tried to sell property in 2000, the title company obtained a payoff from the IRS and told Bordewick that the debt had to be paid. The government alleges that in January, 2001, Bordewick filed a false Certificate of Release of Federal Tax Lien (Release) with the county recorder’s office and sent a copy to the title company. Based on the Release, the property was sold with no payment to the IRS. In March, 2001, the IRS began investigating the transaction and interviewed Bordewick and his mother several times between November, 2001 and January, 2002. The government ended its investigation in May, 2002, but did not indict Bordewick until January 10, 2006, 20 days before limitations expired. Bordewick moved to dismiss on the grounds that his defense was prejudiced by the 44-month delay.

Pre-indictment delay violates due process rights when the defendant suffers actual prejudice and the reasons for the delay “offend those ‘fundamental conceptions of justice which lie at the base of our civil and political institutions.’” *Bordewick*, at *2 (quoting *United States v. Sherlock*, 962 F.2d 1349, 1353-54 (9th Cir. 1992)). This heavy burden is rarely satisfied. *Id.*

Bordewick argued that he suffered actual prejudice because he is now unable to locate the IRS official with whom he negotiated the Release. He asserted that the records that could have located the agent were no longer available (phone records and the title company’s files) or illegible (the Release). The district court disagreed, noting that Bordewick failed to provide independent evidence of how the IRS official would testify if located, failed to explain why Bordewick did not locate this official in 2001 when he was first interviewed by the IRS, and failed to show that prejudice caused by the government’s delay, since the official’s name was always illegible on the Release and the government was not responsible for the missing records.

(jury instructions) In *United States v. Rayborn*, 491 F.3d 513 (6th Cir. 2007) (July 2, 2007), Rayborn was a pastor for a church in Tennessee. In 2002, Rayborn and his wife applied for a mortgage with Wells Fargo and provided tax returns reflecting sufficient income to qualify for the loan. These returns were not the returns filed with the IRS. The loan was approved. When the Rayborns tried to refinance, Wells Fargo denied the loan due to Rayborn’s debt and insufficient income, prompting Rayborn to submit a false lease showing additional monthly income of \$1,300. Rayborn was convicted of conspiring to commit mail fraud, wire fraud and money laundering in violation of 18 U.S.C. § 371, aiding and abetting mail fraud in violation of 18 U.S.C. §§ 1341 and 2, and money laundering in violation of 18 U.S.C. § 1957.

On appeal, Rayborn argued that the district court erred in giving a jury instruction based on IRC § 6064: “If you find beyond a reasonable doubt that the defendant signed the tax return, that is evidence from which you may but are not required to find or infer that the defendant had knowledge of the contents of the return.” Rayborn argued that § 6064 provides only that a taxpayer’s signature on a return is *prima facie* evidence that the taxpayer actually signed the return, not knowledge of its contents. Since his defense was that he signed the return, but did not have knowledge of its contents, Rayborn argued that this instruction impermissibly allowed the jury to infer his knowledge and eviscerated his good faith defense. 491 F.3d at 519.

The district court agreed, referring to *United States v. Trevino*, 419 F.3d 896, 902 (9th Cir. 2005), but found the instruction to be harmless error since it simply informed the jury that it *may* find that Rayborn had knowledge of the contents of the return. *Id.*

(supervised release) In *United States v. Theyerl*, 2007 WL 2303395 (E.D. Wis.) (Aug. 7, 2007), Theyerl pled guilty to filing a false IRS Form 8300 in violation of 26 U.S.C. § 7212(a), and a false sight draft purportedly issued under the authority of the Department of Treasury in violation of 18 U.S.C. § 514(a). He was sentenced to 10 months and 5 years of supervised release. The following conditions were imposed:

3. The defendant is to provide access to all financial information requested by the supervising probation officer including, but not limited to, copies of all federal and state tax returns. All tax returns shall be filed in a timely manner. The defendant shall also submit monthly financial reports to the supervising probation officer.

4. The defendant is to cooperate with the IRS and submit all delinquent tax returns and pay all back taxes and interest under the guidance and supervision of the supervising probation officer.

Theyerl, at *1. When Theyerl failed to produce documents relating to his tax liabilities and to cooperate with the IRS, his probation officer petitioned for revocation. Theyerl later produced the tax returns, but refused to cooperate with the IRS after it became clear that he was under audit and under suspicion for hiding income and/or filing false returns.

The court acknowledged that, notwithstanding his status on supervised release, Theyerl is entitled to the protections of the Fifth Amendment. He can not be compelled to answer questions regarding his tax filing and can not be threatened with revocation for asserting his rights under the Fifth Amendment. *Theyerl*, at *3. The district court held, however, that he could be ordered to meet with the IRS and respond to questions raised, even if it is to assert his Fifth Amendment rights. *Id.* at *4 (citing *United States v. Monia*, 317 U.S. 424, 433 (1943) (“[T]he Constitution does not protect a refusal to obey a process.”)). The court further held that Theyerl had no Fifth Amendment right to withhold certain documents, including business records voluntarily prepared or records are from a third party. *Id.* (citations omitted).

Theyerl argued that he should not be required to cooperate with the IRS beyond how an ordinary citizen is required to respond to an IRS summons issued pursuant to 26 U.S.C. § 7602. He asserted that the government should not be allowed to circumvent the protections through his supervised release, and that cooperation with the IRS is not reasonably related to his offenses.

The court these arguments, noting that Theyerl was not an ordinary citizen, but a felon convicted of tax-related offenses, under the supervision of the court, who allegedly failed to pay tax on income received. In sum, the court found that Theyerl violated conditions of his supervised release, but gave Theyerl an opportunity to redeem himself by directing him to meet with the IRS and produce the requested information. The court held that Theyerl could assert his Fifth Amendment privilege to questions posed, but could not withhold the requested documents.