

FEDERAL SENTENCING GUIDELINES FOR TAX CRIMES

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INTRODUCTION

While most taxpayers convicted of criminal tax violations have, historically, received probationary sentences, the advent of the Federal Sentencing Guidelines ("Guidelines") in 1987 has increased the likelihood of incarceration or some form of community confinement upon conviction of a tax crime. Recent amendments to the Guidelines, effective for tax crimes committed after November 1, 1993 ("1993 Amendments"), substantially increased the likelihood that a convicted tax defendant will receive some term of imprisonment. While Congress has not statutorily increased the criminal sanctions for tax crimes, one effect of the Federal Sentencing Guidelines has been to substantially increase the severity of the criminal sanction. Practitioners representing potential criminal tax defendants need to be aware of the impact of the Guidelines early in the investigation so that critical defense opportunities are not overlooked.

APPLICATION OF THE SENTENCING GUIDELINES

The application of the Guidelines to a tax crime requires a number of steps, ultimately resulting in a "Guideline Range" which reflects the minimum and maximum number of months to which a defendant may be sentenced. The sentencing judge has discretion to sentence the defendant within the minimum and maximum range, subject to special circumstances which might warrant a "departure" below or above that range.

In determining the appropriate Guideline Range, the first step is determining the applicable Guideline Section. Tax crimes are covered by Section 2T of the Guidelines. The second step is to determine the "base offense level" for the crime and whether the crime has any "specific offense characteristics." For tax crimes, the computation of "tax loss" is central to this determination. Once the base offense level is determined, adjustments, focusing on the defendant's conduct, including whether the defendant has "accepted responsibility" for the offense, are applied. The adjusted offense level is then considered with the defendant's "criminal history" to determine the Guideline Range. Based upon the Guideline Range, the sentencing judge has specified sentencing options which may include probation, imprisonment, community confinement and monetary fines. Finally, a determination must be made concerning whether there are grounds for the sentencing judge to "depart" from the Guideline Range and give the defendant a lesser sentence (a "downward departure") or a greater sentence (an "upward departure").

"TAX LOSS" IN SENTENCING FOR TAX CRIMES

The critical factor in determining the sentence of a tax defendant is the amount of "tax loss" involved. Prior to the 1993 Amendments, there were a number of different definitions of "tax loss" depending upon whether the crime charged was tax evasion (Guideline Section 2T1.1), filing a false tax return (Guideline Section 2T1.3) or some other tax offense. In tax evasion or false tax return cases, the tax loss was generally determined to be 28% of the amount of the omitted gross income, 28% of the amount of any false deductions and 100% of the amount of any false credits. If the taxpayer was a corporation, a 34% figure was used in lieu of 28%.¹

"Tax Loss" focuses on the "criminal deficiency." Not all potential adjustments to an income tax return are "criminal items"; many items may be civil in nature. Both the Commentary to the Guidelines and recent decisions of the Courts of Appeal indicate that items which are civil in nature should not be considered when determining the "tax loss" for sentencing purposes.²

The 1993 Amendments consolidate the various "tax loss" definitions for the major tax crimes. Under the 1993 Amendments, a uniform definition of tax loss is now contained in Section 2T1.1. If the offense involves the underreporting of gross income, the tax loss is treated as 28% of the unreported gross income "unless a more accurate determination of tax loss can be made." If the offense involves erroneous deductions, the tax loss is 28% of the amount of the improperly claimed deductions "unless a more accurate determination of tax loss can be made."³ The Commentary to the Amendments suggests that the 28% figure is to be used where the tax loss is not otherwise reasonably ascertainable.

Under the 1993 Amendments, technical tax issues and actual determinations of criminal tax deficiencies will take on greater importance. While under the prior Guidelines the actual tax deficiency was not the focus of sentencing, under the 1993 Amendments, the defense (or prosecution) is free to introduce evidence of a "more accurate determination of the tax loss." This could have significant consequences on the ultimate sentencing range.

POSSIBLE ADJUSTMENTS TO BASE OFFENSE LEVEL

After the determination of "tax loss" is made, it must be determined whether there are any adjustments to the base offense level. If the income involved was derived from an illegal source and is greater than \$10,000, the base offense level is increased by two. If the taxpayer used "sophisticated means" to engage in the tax crime, the offense level is increased by two. Generally, in order for the "sophisticated means" adjustment to apply, the crime must be "more complex" than "routine tax evasion"⁴ For example, in *United States v. Hammes*, 3 F.3d 1081 (7th Cir. 1993), the Seventh Circuit affirmed the District Court's adjustment for "sophisticated means" where the defendant used aliases, moved his wire rooms from place to place, destroyed records and had foreign bank accounts. On the other hand, in *United States v. Stokes*, 998 F2d

279 (5th Cir. 1993), the Court held that the "sophisticated means" adjustment did not apply since there was nothing sophisticated about not disclosing income to your accountant.

If the tax crime involves five or more persons or was otherwise extensive, the base offense level can be adjusted upward based upon the defendant's role in the offense. Leaders and managers of an extensive criminal activity may receive higher sentences and minimal participants may receive lower sentences.⁵ If a taxpayer willfully obstructs or impedes an investigation, the Court may also increase the base offense by two levels.⁶

Perhaps the most important adjustment a tax defendant must consider is "acceptance of responsibility." When the Court believes the defendant has accepted responsibility for the offense, there is a two level reduction in the base offense level. In cases where the base offense level is 16 or greater, a three level reduction is available in some circumstances.⁷ Acceptance of responsibility can shorten the period of incarceration by six months and in many cases could mean the difference between incarceration in a prison type facility and a lesser punishment, such as confinement in a community treatment facility, home detention or straight probation.

Tax defendants going to trial will generally find it difficult to obtain an acceptance of responsibility adjustment where there is a factual dispute and the Court finds that the Government's version of the facts is the correct version. On the other hand, if the defendant goes to trial on a technical or constitutional issue and has otherwise accepted responsibility for his conduct, the two level reduction for acceptance of responsibility should be available.

1993 AMENDMENTS INCREASE THE SENTENCING OFFENSE LEVELS

A major change to the Guidelines contained in the 1993 Amendments is an increase in the sentencing offense levels and applicable Guideline Ranges. Under the 1993 Amendments, persons who have committed tax crimes are generally faced with a base offense level which is two levels higher than the base offense level under the prior Guidelines. Set forth in the following two tables are the offense levels and Guideline Ranges under the prior Guidelines and under the 1993 Amendments:

PRIOR GUIDELINES

Offense Guideline/⁸

Tax Loss Level Range (Months)

- (A) \$2,000 or less 6 0-6
- (B) More than \$2,000 7 0-6
- (C) More than \$5,000 8 0-6
- (D) More than \$10,000 9 4-10
- (E) More than \$20,000 10 6-12
- (F) More than \$40,000 11 8-14
- (G) More than \$70,000 12 10-16
- (H) More than \$120,000 13 12-18
- (I) More than \$200,000 14 15-21
- (J) More than \$350,000 15 18-24
- (K) More than \$500,000 16 21-27
- (L) More than \$800,000 17 24-30
- (M) More than \$1,500,000 18 27-33
- (N) More than \$2,500,000 19 30-37
- (O) More than \$5,000,000 20 33-41
- (P) More than \$10,000,000 21 37-46
- (Q) More than \$20,000,000 22 41-51
- (R) More than \$40,000,000 23 46-57
- (S) More than \$80,000,000 24 51-63

1993 AMENDMENTS

Offense Guideline/9

Tax Loss Level Range (Months)

- (A) \$1,700 or less 6 0-6
- (B) More than \$1,700 7 0-6
- (C) More than \$3,000 8 0-6
- (D) More than \$5,000 9 4-10
- (E) More than \$8,000 10 6-12
- (F) More than \$13,500 11 8-14
- (G) More than \$23,500 12 10-16
- (H) More than \$40,000 13 12-18
- (I) More than \$70,000 14 15-21
- (J) More than \$120,000 15 18-24
- (K) More than \$200,000 16 21-27
- (L) More than \$325,000 17 24-30
- (M) More than \$550,000 18 27-33
- (N) More than \$950,000 19 30-37
- (O) More than \$1,500,000 20 33-41
- (P) More than \$2,500,000 21 37-46
- (Q) More than \$5,000,000 22 41-51
- (R) More than \$10,000,000 23 46-57
- (S) More than \$20,000,000 24 51-63
- (T) More than \$40,000,000 25 57-71
- (U) More than \$80,000,000 26 63-78

Under the prior Guidelines, a tax loss of more than \$120,000 would carry an offense level of 13. Under the 1993 Amendments, the same tax loss would carry an offense level of 15. The offense level of 13 carries a sentencing range of 12 to 18 months. On the other hand, an offense level of 15 carries a sentencing range of 18 to 24 months.

The increase in offense levels may also increase the minimum period of incarceration for a tax defendant. For example, under the prior Guidelines, if the tax loss was \$200,001, the offense level was 14. Assuming the tax defendant was granted a two level reduction for acceptance of responsibility, the adjusted offense level would be 12. This provides a sentencing range of 10 to 16 months which would allow the Court to impose a "split sentence," requiring the tax defendant to serve 5 months in a prison type facility and the remaining 5 months (of the mandatory 10 month minimum) in an alternative treatment facility (i.e., half-way house or home detention).

Under the Amendments, the same tax loss of \$200,001 provides an offense level of 16 and an adjusted offense level of 14 (assuming a 2 level reduction for acceptance of responsibility). An adjusted offense level of 14 provides for a sentencing range of 15 to 21 months. Under this circumstance, the tax defendant would be required to serve a minimum of 15 months in a prison type facility. The 1993 Amendments have effectively tripled the mandatory minimum amount of time this tax defendant must serve in prison.

APPLICATION OF 1993 AMENDMENTS

As a general matter, a tax defendant will be sentenced under the Guidelines in effect at the time of sentencing,¹⁰ rather than those in effect on the date the offense was committed. However, when amendments occur after the offense, but before sentencing, the Constitutional prohibition on ex post facto laws generally precludes a Court from applying an amendment which creates a harsher punishment.¹¹ Because of the Constitutional ex post facto limitation, tax defendants currently under investigation for tax years 1992 and prior generally need not fear the increased offense levels contained in the 1993 Amendments.

DEPARTURES

While the Guidelines have curtailed the discretion of the Federal District Court in fashioning a sentence that fits the crime and a particular tax defendant, in some circumstances the Court may depart from the Guidelines and impose a lesser sentence ("downward departure") or a greater sentence ("upward departure"). Departures require either an express basis for departure in the Guidelines, or a type of situation which the Sentencing Commission failed to adequately consider in formulating the Guidelines.¹²

Since the introduction of the Guidelines in 1987, departures have been in a constant state of evolution and development by the courts. When the sentence under the Guidelines seems excessively harsh given the particular crime or the particular defendant, defense counsel should request that the District Court grant a downward departure.

The Guidelines specifically provide that where there is a "voluntary disclosure" of a tax offense, the District Court may depart downward.¹³ Other departures potentially applicable to tax crimes include "one time aberrant behavior" (U.S. v. Morales, 977 F.2d 1330 (9th Cir. 1992)); "youthful lack of guidance" (U.S. v. Floyd, 945 F.2d 1096 (9th Cir. 1991)); "unique combination of factors" (U.S. v. Berlier, 948 F.2d 1093, 1097 (9th Cir. 1991)); and "extraordinary acceptance of responsibility" (U.S. v. Crumb, 902 F.2d 1337, 1339-1340 (9th Cir. 1990)).

CONCLUSION

Sentencing under the Guidelines has become more mechanical than in the past and in many cases tax defendants will face a harsher punishment. While the District Court does still retain discretion in sentencing, the Guidelines have significantly altered the landscape for the tax practitioner and the tax defendant. As with any change, there are pitfalls for the unwary and opportunities for the well-informed.

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1. Tax loss does not include interest or penalties. Guideline Section 2T1.1.
 2. Guideline Section 2T1.1, Commentary; *United States v. Harvey*, 996 F.2d 919 (7th Cir. 1993); *United States v. Meek*, 998 F.2d 776 (10th Cir. 1993); *United States v. Daniel*, 956 F.2d 540 (6th Cir. 1992).
 3. If the taxpayer is a corporation, the 34% rate is used as under the prior Guidelines. Also, if there are false credits involved, 100% of the false credits will be used in determining tax loss. The Amendments provide that in the case of a failure to file a tax return, the tax loss is "the amount of the tax the taxpayer owed and did not pay." Generally, the tax loss shall be treated as equal to 20% of the gross income (25% if the taxpayer is a corporation), less any tax withheld or otherwise paid, unless a more accurate determination of the tax loss can be made.
 4. *United States v. Ford*, 989 F.2d 347 (9th Cir. 1993.)
 5. Guideline Sections 3B1.1 and 3B1.2.

6. Guideline Section 3C1.1.

7. Guideline Section 3E1.1.

8. The Guideline Range set forth in the table is applicable to a tax defendant in the lowest criminal history category.

9. See footnote 9, *supra*.

10. 18 U.S.C. Section 3553(a)(4); *U.S. v. Restrepo*, 903 F.2d 468 (9th Cir. 1990).

11. Guideline Section 1B1.11; *U.S. v. Warren*, 980 F.2d 1300, 1304 (9th Cir. 1992).

12. *U. S. v. Takai*, 941 F.2d 738 (9th Cir. 1991).

13. Guideline Section 5K2.16.