# Recently Proposed Amendment to the Federal Sentencing Guidelines Affect Criminal Tax Cases

*By Steven Toscher and Dennis L. Perez*

Steven Toscher and Dennis L. Perez examine the recently proposed amendment to the federal sentencing guidelines.

Since 1987, sentencing for tax crimes has been governed by the Federal Sentencing Guidelines ("Guidelines"). Those Guidelines generally provide that the punishment for tax crimes is determined by the amount of "tax loss" to the Government. For years, sentencing for tax crimes became mechanical, driven by a rigid application of the Guidelines. The rigidity of the Guidelines has been under pressure from their beginning, with the first major change brought by the Supreme Court's decision in *Koon,*[1] when the Court provided District Courts with greater discretion when it recognized that "it has been uniform and constant in federal judicial tradition for the sentencing judge to consider every convicted person as an individual and every case is a unique study in the human failings that, sometimes mitigate, sometime magnify the crime and punishment to ensure."

In 2005, the Supreme Court struck the final blow to the rigidity of the Sentencing Guidelines in *Booker,*[2] when the Court held that, based upon Sixth Amendment jurisprudence, the Guidelines were discretionary and the district courts were to consider the Guidelines, together with other sentencing factors contained in Title 18 U.S.C. Section 3553(a). The sentencing court is free to choose how much or how little reliance to place upon the Guidelines.[3] The "overarching provision instruct[s] district courts to 'impose a sentence sufficient but not greater than necessary' to accomplish the goals of sentencing including 'to reflect the seriousness of the offense,' 'to promote respect for the law,' 'to provide just punishment for the offense,' 'to afford adequate deterrence to criminal conduct'; and 'to protect the public from further crimes of the defendant.'"[4]

Notwithstanding the now-discretionary sentencing authority of the District Courts relating to tax and other crimes, the Sentencing Guidelines still play a central role in the sentencing of all federal offenses. The United States Sentencing Commission still maintains its role in administrating the Guideline system and each year reports to Congress and proposes amendments to the Guidelines, as appropriate.

The Sentencing Commission recently proposed an amendment to the Guidelines which could have a significant impact on the sentencing for federal tax crimes.[5]

## Calculation of Tax Loss and Unclaimed Deductions

As noted above, the primary driver in determining the advisory Guideline sentence for a tax crime is the amount of the "tax loss." For example, a tax loss of more than $200,000 has a base offense level of 18. Assuming no other adjustments, a level 18 provides for an advisory Guideline offense range of 27 to 33 months.

Assume the $200,000 tax loss was based upon omitted gross income, but also assume that in addition to the omission of gross income, the taxpayer omitted legitimate deductions. This happens more often than one would imagine, because deductions related to the fraudulently omitted income somehow seem to get left off the tax return.

**Steven Toscher** and **Dennis L. Perez** are principals of Hochman, Salkin, Rettig, Toscher & Perez, P.C., specializing in civil and criminal tax litigation.

These deductions are legitimate, and with the allowance of the deductions, the tax loss is only $81,000. This would provide a base offense level of 16, which provides for an advisory sentencing range of 21 to 27 months. Thus, the unclaimed deductions can be very significant in terms of the sentence a tax defendant may receive.

Circuit courts have disagreed over whether the tax loss can be reduced by the defendant's legitimate, but unclaimed deductions. The Tenth Circuit recently joined the Second Circuit in holding that sentencing court *may* give the defendant credit for legitimate but unclaimed deductions. *See Hoskins, Martinez-Rios* and *Gordon*.[6] These cases generally reason that where a defendant offers convincing proof, the Guidelines do not prohibit a sentencing court from considering evidence of unclaimed deductions.

Other circuits—the Fourth, Fifth, Seventh, Eighth, Ninth and Eleventh—have reached the opposite conclusion, finding that defendant may *not* present evidence of unclaimed deductions to reduce the tax loss.[7]

The Sentencing Commission recently issued proposals in an effort to resolve this circuit conflict. The Commission lays out three options. First, the tax loss would take into consideration any credit, deduction or exemption to which the defendant was entitled, whether or not originally claimed. Second, the tax loss should *not* account for any unclaimed items, unless originally claimed at the time the offense was committed. The third option is whether the unclaimed deductions will be considered if the defendant demonstrates by *contemporaneous documentation* that the defendant was entitled to the deduction or credit.

The Sentencing Commission has solicited comments on these proposals and options and may adopt the proposed amendment after comment. This would normally happen in May of the amendment cycle. Any amendment that is ultimately adopted and not vetoed by Congress will become effective November 1, 2013.

The courts have been struggling with the issue of allowing these unclaimed deductions and other unclaimed offsets. A very strong argument can be made that if we are going to punish tax offenders based upon the harm or tax loss, we should look to the *actual tax harm or loss* to the Government. If a restaurant owner decides to omit income, but also omits legitimate food costs that would otherwise be deductible, isn't the actual harm to the government the lesser amount?

Allowing the deduction would of be consistent with the current structure of the Guidelines, which sets forth that "tax loss" is 28 percent of the amount of unreported gross income for an individual "unless a more accurate determination of tax loss can be made." Legal arguments can and have been made supporting both sides of the argument, and this is something that the Sentencing Commission should resolve.

There is also a practical issue that has likely contributed to the disagreement among the circuit courts. At the point when the District Court is considering the amount of tax loss determined by the Government, the tax defendants' last-minute effort to offset that loss with unclaimed deductions (which have not been part of the investigation in the case), presents administrative problems and problems of proof. Sentencing courts do not want to become embroiled in mini tax loss trials, especially when the offsetting deductions have little or nothing to do with the investigation.

Nevertheless, because the Sentencing Guidelines rely upon tax loss as the primary driver for determining the advisory guideline range, it is important to have an accurate determination of that loss. If the taxpayer is able to demonstrate through credible proof that there are offsetting deductions or credits, those amounts should be allowed in determining the amount of harm. Such an interpretation is consistent with the doctrine of lenity[8] in the criminal sentencing process and would seem to be the better view where an individual's freedom is at stake. The courts are very capable of dealing with speculative and/or frivolous claims of offsetting deductions and credits.



## Endnotes

1 *Koon,* SCt, 518 US 81, 113 (1996).

2 *Booker,* SCt, 514 US 220 (2005).

3 *Rita,* SCt, 551 US 338, 351 (2007); *Gall*, SCt, 552 US 38 (2007).

4 *Kimbrough,* SCt, 552 US 85 (2007).

5 Proposed Amendments to Sentencing Guidelines, Jan. 18, 2013.

6 *See J. Hoskins*, CA-10, 2011-2 USTC ¶50,580, 654 F3d 1086, 1094 ("But where defendant offers convincing proof—where the court's exercise is neither nebulous nor complex—nothing in the Guidelines prohibits a sentencing court from considering evidence of unclaimed deductions in analyzing a defendant's estimate of the tax loss suffered by the government."); *A.L. Martinez-Rios,* CA-2, 143 F3d 662, 671 (1998) ("the sentencing court need not base its tax loss calculation on gross unreported income if it can make a more accurate determination of the intended loss and that determination of the tax loss involves giving the defendant the benefit of legitimate but unclaimed deductions"); *B.W. Gordon*, CA-2, 291 F3d 181, 187 (2002) (applying *Martinez-Rios,* the court held that the district erred when it refused to consider potential unclaimed deductions in its sentencing analysis).

7 *See J.D. Delfino,* CA-4, 2008-1 USTC ¶50,114, 510 F3d 468, 473 ("The law

## Endnotes

simply does not require the district court to engage in [speculation as to what deductions would have been allowed], not does it entitle the Delfinos to the benefit of deductions they might have claimed now that they stand convicted of tax evasion."); *C. Phelps, Jr.*, CA-5, 2007-1 USTC ¶50,377, 478 F3d 680, 682 (holding that the defendant could not reduce tax loss by taking a social security tax deduction that he did not claim on the false return); *L. Chavin*, CA-7, 316 F3d 666, 679 (2002) (holding that the definition of tax loss "excludes consideration of unclaimed deductions"); *J. Psihos*, CA-7, 2012-1 USTC ¶50,403, 683 F3d 777, 781–82 (following *Chavin* in disallowing consideration of unclaimed deductions); *Sherman*, CA-9, 2010-1 USTC ¶50,336, 372 FedAppx 668, 676–77; *L.T. Blevins*, CA-9, 2008-2 USTC ¶50,556, 542 F3d 1200, 1203 (declining to decide "whether an unclaimed tax benefit may ever offset tax loss," but finding the district court properly declined to reduce tax loss based on taxpayers' unclaimed deductions); *Yip*, CA-9, 592 F3d 1035, 1041 (2010) ("We hold that § 2T1.1 does not entitle a defendant to reduce the tax loss charged to him by the amount of potentially legitimate, but unclaimed, deductions even if those deductions are related to the offense."); *G.L. Clarke*, CA-11, 2009-1 USTC ¶50,295, 562 F3d 1158, 1164 (holding that the defendant was not entitled to a tax loss calculation based on a filing status other than the one he actually used; "[t]he district court did not err in computing the tax loss based on the fraudulent return Clarke actually filed, and not on the tax return Clarke could have filed but did not.").

[8] *McBoyle*, SCt, 283 US 25, 27 (1931) (the principle of fundamental fairness motivates the lenity rule) (Holmes, J.).