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Update on the Department Of Justice's and Internal Revenue Service's Criminal And Civil International Enforcement Program: Don't Let the Statistics on Sentencing Fool You

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INTRODUCTION

Approximately three years ago I presented a paper to the Tax Management Advisory Board titled ''Civil and Criminal Tax Enforcement Implications of the UBS Enforcement Initiative and the Future of Voluntary Disclosure.'' In that presentation I concluded that the international enforcement effort by the Department of Justice (DOJ) and the Internal Revenue Service (IRS) was a ''*game changer*'' that would have a lasting impact on international tax enforcement and the IRS's long-standing voluntary disclosure policy. It has — but that is not the topic of this presentation.

Much has occurred over the last three years, both on the voluntary disclosure front and the civil and criminal enforcement initiatives. In this presentation I will mention the most significant developments in the civil and criminal areas, but the focus will be on the criminal enforcement effort in the ''offshore cases'' and how it has manifested itself in the sentencing of criminal tax cases.

What the sentencing statistics for the offshore cases since 2009 show is that the defendants who have been prosecuted and have pled guilty have received *substantially lower* sentences than we might have expected under the now advisory Federal Sentencing Guidelines (''Guidelines''). These cases are ''outliers.'' While I have not undertaken an empirical study to support my views, I will provide my thinking as to why these cases are outliers in criminal tax sentencing, why they are not reflective of sentencing for tax crimes in general and, importantly, why these sentences may not be a good indicator of sentences in offshore criminal tax cases in the future.

While the lighter sentences received so far in the offshore cases could provide a criminal tax defendant some light at the end of the long dark tunnel of criminal tax investigations, any client convicted in an offshore criminal tax case — or any criminal tax case for that matter — should be *very* concerned that at the end of the journey, they will be incarcerated in a federal prison.

Three years ago we did not know how long the government initiatives would continue. While the IRS is struggling with budget and manpower issues, given the vigor in which the DOJ has embraced combatting offshore tax evasion and the continued globalization of our economy, it appears a robust effort will continue.

OFFSHORE VOLUNTARY DISCLOSURE INITIATIVES — THE CARROT

In October of 2010, when I last presented to the Advisory Board, the IRS's Offshore Voluntary Disclosure Initiative, announced in March of 2009 (''2009 OVDI''), had been in full swing, but with little data available as to how it was operating and its success or failure in bringing U.S. taxpayers back into compliance and revenue into the federal treasury. The watershed event was UBS's decision to enter into a Deferred Prosecution Agreement (DPA) with the United States in February of 2009 and, importantly, the turnover of ''secret'' account information on what is believed to be approximately 240 U.S. account holders. That was promptly followed by the announcement of 2009 OVDI which, for the first time, set forth a fixed formula for civil penalties. Although 2009 OVDI terminated, it was reborn as the 2011 OVDI and later made permanent as the 2012 OVDI, which has no set termination date. The word on the street is that because of the amount of resources required to administer the OVDI programs, the IRS is revamping the program, but it will no doubt work very much like the 2012 program, which looked very much like the 2009 and 2011 programs, but with possible increased penalties.

While there have been criticisms of the OVDI programs, both in the terms of the way they were administered and the ''one size fits all'' penalty approach, it is fair to say that from a tax enforcement and compliance perspective, it has been a *great success*. The OVDI programs have brought more than 43,000 U.S. taxpayers back into U.S. tax compliance and are credited with the collection of tax, interest and penalties in excess of $5 billion.[1] The level of voluntary disclosures and increased offshore tax compliance is unprecedented.

OVDI FOR SWISS BANKS

The efforts continue. On August 29, 2013, the DOJ announced what is in effect an OVDI program for Swiss banks (''Bank Program''). These banks, if not already under criminal investigation, must have applied to the program by the end of 2013 and, if qualified, pay a substantial penalty based upon a percentage of the unreported U.S. accounts and receive a ''non-prosecution agreement.'' While many of the Swiss banks will start reporting U.S. account holders in 2014 under the new FATCA regime, the disclosure under the Bank Program will go back to older years and require disclosure of the so-called ''leavers'' — those who fled the larger Swiss banks when the U.S. investigative machinery started its rumblings.[2]

CRIMINAL INVESTIGATION AND PROSECUTION — THE STICK

While encouraging taxpayers to enter into the OVDI programs, the IRS and the DOJ have also been vigorously pursuing those who did not voluntarily disclose or who were not eligible to enter into the OVDI programs. Of the approximately 240 names which were turned over to the DOJ pursuant to the UBS DPA, there have been approximately 100 criminal filings, with UBS account holders constituting the vast majority. Interestingly, of the 100 filings, approximately 30 relate to bankers, lawyers and other advisors — most of them foreign nationals.

Some of the UBS account holders actually tried to make voluntary disclosures after word of the turnover of information became public in February of 2009. The government's position was that it was *too late* if the DOJ had information before the account holder attempted to enter into the voluntary disclosure.

SENTENCING FOR OFFSHORE TAX CRIMES

Of the approximate 100 criminal filings in the offshore cases, there have been approximately 60 plea dispositions and sentences.

Trials

Of the six cases which have gone to trial and verdict, the government has won five[3] and one ended in a complete acquittal of the taxpayer.[4]

Plea Dispositions

The sentences in the plea dispositions are of most interest. The high number of plea dispositions is not surprising. A very high percentage of criminal tax cases end up in a plea disposition. That is a function of primarily two factors. The first is that the DOJ rarely files a case unless it has met high standards of proof — ''a likelihood of conviction beyond a reasonable doubt.'' Second, ever since the introduction of the Guidelines in 1987, the risk of incarceration of a criminal tax defendant who is convicted has tipped the scales of justice in favor of plea dispositions. Many clients, even if they have a good case — cannot afford the downside of a trial and conviction.

This leads to the main topic of this paper — an examination of the sentences received in the offshore cases and why they are ''outliers'' of criminal tax prosecutions when compared to other criminal tax cases as reflected in the sentencing statistics maintained by the IRS and the United States Sentencing Commission.

The current fiscal year's statistics published by the IRS for the first quarter of the 2014 fiscal year (October 2013–December 2013), reflects 861 sentences and that 78.5% of offenders went to prison, with an average of 43 months to serve.[5] The IRS statistics for the prior three fiscal years reflect a similar percentage of tax offenders sentenced to prison.[6]

For fiscal year 2012, the United States Sentencing Commission statistics reflect that the average (mean) length of imprisonment for tax offenders was 23 months and the median time to serve was 18 months.[7]

The sentences received in the offshore cases since 2009 appear to be *substantially below* these averages.

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[1] See IR-2012-64 (6/26/12), available at http://www.irs.gov/uac/IRS-Says-Offshore-Effort-Tops-$5-Billion,-Announces-New-Details-on-the-Voluntary-Disclosure-Program-and-Closing-of-Offshore-Loophole, as modified by comments from a high ranking IRS official at American Bar Association National Institute on Criminal Tax Fraud, Dec. 13, 2013.

[2] The scope and implications of the new Bank Program is beyond the scope of this paper but for an excellent discussion see Michel and Matthews, ''The Justice Department and Swiss Banks: Understanding The Special Program,'' 101 *BNA Banking Rpt.* 489 (9/24/13). It was announced on Dec. 17, 2013, that as of that date, 10 Swiss banks have entered the Bank Program.

[3] *See United States v. Kerr et al.*, No. 11-cr-02385 (D. Ariz. 9/25/13) (each of the two defendants sentenced to 10 months in prison; government asked for six years); *United States v. Ahuha*, No. 11-cr-135 (E.D. Wisc.) (three years of probation); *United States v. Desai*, No. 11-cr-846 (N.D. Cal.) (sentencing pending); *United States v. Hough*, Case No. 2:13-cr-00072-JES-USM (M.D. Fla.) (motions for new trial and judgment of acquittal pending). *See also United States v. Simon*, 727 F.3d 682 (7th Cir. 2013) (affirming conviction and the sentence following trial).

[4] *See United States v. Pflueger*, No. 10-00631 LEK (order of acquittal Mar. 10, 2013).

[5] *See* http://www.irs.gov/uac/Current-Fiscal-Year-Statistics.

[6] *See* http://www.irs.gov/uac/Statistical-Data-for-Three-Fiscal Years-Criminal-Investigations-(CI).

[7] *See* United States Sentencing Commission 2012 Sourcebook,

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The sentences have ranged from approximately one minute of probation[8] to 19 months in prison.[9] *Most defendants have received probation with home detention*. The highest sentence to date — oddly — appears to have gone to the whistleblower who brought the whole UBS matter to the government's attention. In addition to his over $100 million dollar whistleblower award, he was awarded 40 months in prison.[10]

Many criminal tax defense counsel have been asking themselves the question why these foreign account cases appear to have a more lenient sentencing outcome than the run-of-the-mill criminal tax cases. The answer lies in no single factor; there are a number of reasons.

THE REASONS FOR THE OUTLIER SENTENCES

Two core principles of sentencing in federal criminal cases, while not answering the question here, do place the question in context. The first is the statement from *Koon v. United States*, where Justice Breyer, one of the architects of the Guidelines (as an aide to Senator Kennedy) stated:

> [I]t has been uniform and constant in the federal judicial tradition for the sentencing judge to consider every convicted person as an individual in every case as a unique study in human failings that sometimes mitigate, sometimes magnify the crime and punishment to ensue.[11]

And the second is Justice Stevens's statement in *Gall v. United States*, where the Supreme Court reminded us that a probationary term does have consequences:

> We recognize that custodial sentences are qualitatively more severe than probationary sentences of equivalent terms. Offenders on probation are nonetheless subject to several standard conditions that substantially restrict their liberty. . . . Probationers may not leave the judicial district, move, or change jobs without notifying, and in some cases, receiving permission from, their probation officer or the court. They must report regularly to their probation officer, permit unannounced visits to their homes, and refrain from associating with any person convicted of a felony, [etc.]. Most probationers are also subject to individual ''special conditions'' imposed by the Court.[12]

The reasons which will be discussed include, and there are others: the new discretion granted the sentencing judges following the decision of *United States v. Booker*[13] rendering the Guidelines advisory; the substantial number of the pleading defendants who have been ''cooperators'' and have received credit under the Guidelines and closely related to the cooperation is the government's focus on what is referred to as the enablers, the foreign bankers but for whom this type of tax evasion cannot stand; the low tax loss numbers; case selection and the demographics (''history and characteristics'') of the defendants; the draconian amount of the FBAR penalty imposed; and perhaps the impact of the more than 43,000 taxpayers who were allowed to make a voluntary disclosure without a criminal prosecution.

Discretion Under the Guidelines

Prior to 1987, when the Guidelines came into effect, sentencing judges had great discretion. Each crime had a statutory maximum term of imprisonment. Tax evasion[14] had a five-year maximum and a false tax return had a three-year maximum.[15] The sentencing judge had almost unfettered discretion in sentencing the convicted defendant to probation or up to the statutory maximum.

Sentencing for tax offenses was caught up with the general concern with the broad discretion given to the federal district judges in sentencing. One client sentenced in Alabama guilty of a tax crime could receive years in prison and another client sentenced in New York who committed a similar tax crime could receive probation. Congress wanted more uniformity among sentences. The result was the promulgation of the Guidelines, which not only were designed to create uniformity but, with respect to tax cases, were designed to place more convicted tax offenders in prison. A key determinant under the Guidelines was the amount of the tax loss, and for most tax cases prosecuted, defendants were facing the likelihood of incarceration.

The application of the Guidelines took some twists and turns, a major one being the Supreme Court's decision in *Koon v. United States*,[16] where the Court held that there was in fact substantial discretion reserved within the Guidelines for federal district judges to consider ''departures.'' This was followed in 2003 with the enactment of the Protect Act,[17] which not only increased the severity of the Guidelines for tax

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Table 14, and Figure E, available at http://www.ussc.gov/Research_and_Statistics/annual_Reports_and_Sourcebooks/2012/Table14.pdf.

[8] *United States v. Curran*, No. 12-cr-80206 (S.D. Fla. 1/8/13).

[9] *See United States v. Gupta*, No. 13-cr-145 (D.N.J. 2/26/13).

[10] *United States v. Birkenfeld*, No. 08-cr-60099 (S.D. Fla. 6/19/08).

[11] 518 U.S. 81 (1996).

[12] *Gall v. United States*, 552 U.S. 38 (2007).

[13] 543 U.S. 220 (2005).

[14] §7201.

[15] §7206(1).

[16] 518 U.S. 81 (1996).

[17] Prosecutorial Remedies and Tools Against Exploitation of Children Today Act of 2003 (P.L. 108-21).

ISSN 0148-8295

and other crimes, but also attempted to circumscribe the discretion of federal district judges in applying them.

When things seemed to be not going so well for judicial discretion in sentencing, the Supreme Court in *United States v. Booker* held that because the Guidelines allow a judge to make factual finding which impacts punishment, the Guidelines infringed upon the Sixth Amendment to the Constitution. Rather than invalidating the Guidelines, the Supreme Court determined that it could excise the mandatory nature of the Guidelines and make them discretionary. That would pass constitutional muster.

For the year or two after *Booker*, there was much talk about legislation which would restore the mandatory nature of the Guidelines consistent with the constitutional concerns. That, however, never happened, and since 2005, for over eight years now, we have been living with the advisory guidelines which provide the district courts great discretion. While there are criticisms to the present system and the Sentencing Commission continues to refine and change the Guidelines, most practitioners agree the advisory system is working well.

It is not surprising that, once judicial discretion was restored for the sentencing of tax offenders, there would be more sentences below the Guidelines. This can explain in part why we have seen very low sentences in the offshore criminal tax cases. But discretion applies to all tax cases and the discretionary nature of the Guidelines alone does explain why the offshore sentences are *much lower* than those of the average criminal tax case. That is likely explained by other factors which are present in the offshore cases, although the discretionary nature of the sentencing determination allows consideration of these factors.

Cooperators and Enablers

Under the Guidelines, if an individual cooperates with the government in connection with the investigation or the prosecution of others, that individual is eligible for the government filing a motion for ''downward departure'' from the Guidelines, under what is referred to as §5K.[18] This section of the Guidelines incorporated the longstanding prosecutorial practice that gives the cooperator a reduction or even elimination of his or her sentence.

Aside from the formal motion for downward departure under §5K, both the prosecutors and the judicial system recognize the value of cooperators and while the measure of cooperation is quantified in terms of downward levels of departure under the Guidelines, the cooperator has now joined the prosecutorial team and is viewed in a better light, by both the prosecutors and the courts. Cooperators receive lower sentences.

Many of the cases reflect that these criminal tax defendants are cooperating. While the plea agreements do not specifically state whom they are cooperating against or the nature of the cooperation — and often motions for downward departure under §5K are filed under seal in order to maintain confidentiality — the public plea agreements suggest there is a substantial level of cooperation that has gone on in these initial offshore cases. Why? The DOJ and the IRS recognize that this type of offshore tax evasion could not occur without the formal institutional involvement of the foreign banks. Just like the enablers of the large tax shelters in the late '90s and 2000s, foreign bankers are the enablers. By going after the enablers, the prosecution not only gets cooperation from the enablers against other taxpayers, they bring the practice of secret offshore accounts to an end.

As noted above, there have been a number of cases filed against the so-called foreign enablers — most of whom remain outside the United States and who have not been brought to trial. The U.S. Government views the jurisdiction to charge a foreign person very broadly — but the ability to physically bring that person to trial is much more limited. Extradition for tax crimes is rare if legally available at all and there have been no instances at least publicly reported of efforts to extradite these foreign enablers. Nevertheless, many of the foreign persons who are under U.S. indictment cannot feel comfortable living in their own country, much less trying to cross an international border and potentially being detained. This may well account in large part why the Swiss government and the United States continue to negotiate and try to come to a final resolution of the investigations and prosecutions.[19]

The Low Tax Loss Numbers

As noted above, the Guidelines for tax crimes are driven in large part by the amount of the tax loss involved. Because of the difficulty of obtaining foreign records — even to this day — and very low earnings on most of the foreign accounts, the tax loss has generally been lower than the normal criminal tax case loss. Some have said that UBS and other Swiss banks were not selling yield, they were selling secrecy.

The lower tax loss under the Guidelines have the effect of driving lower sentences. The DOJ has been so concerned regarding the level of sentencing in offshore cases, that they have asked the Sentencing Commission to provide a policy statement or a commentary which would direct a district court judge to consider an ''upward departure'' from the Guidelines where an offshore account was involved.[20] The stated basis for the request is that in many cases, informa-

[18] United States Sentencing Guidelines (USSG), §5K.

[19] Recently, Raoul Weil, one of the first UBS bankers to be indicted, surrendered to U.S. authorities in Fort Lauderdale, Florida after being arrested in Italy and was freed on $10.5 million bail. There is speculation whether this alleged enabler will now become a cooperator. *See* www.swissinfo.ch/eng/business/Ex-banker_granted_$10.5_million_bail.html?cid=3755474.

[20] *See* Letter dated July 11, 2013 from U.S. Department of Justice to the United States Sentencing Commission re: upward departures for failing to report foreign bank accounts.

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tion regarding the true amount of the tax loss cannot be ascertained or is so old that it will not be within the scope of the Guidelines, and therefore, the tax loss amount, the primary driver of the Guidelines, does not accurately reflect the nature and circumstances of the offense.

Case Selection — Starting with the UBS Deferred Prosecution Agreement Was Unusual

It also appears that the offshore cases which have been selected for prosecution have had an impact on the more lenient sentences. Most criminal tax prosecutions start with either a referral from the IRS Examination Division, a grand jury investigation or an administrative criminal tax investigation. The cases begin with some core allegations — one might say ''firm indications of fraud'' — and the case is then methodically built by IRS Special Agents and DOJ prosecutors. The investigation usually takes well over a year and they are about as thorough as one could imagine.

The offshore cases which have been prosecuted have in large part started out much differently. When UBS turned over the approximately 240 names to the DOJ, the DOJ, together with the IRS Special Agents, went through the information and selected 100 or more for criminal prosecution. These cases started, in effect, from the top, not from the bottom.

While the government culled out those cases which were not worthy of prosecution, many of the cases which were prosecuted might not have seen the light of day if the government started from the bottom and worked its way up through the system. The normal selection process in criminal tax investigations would have weeded out many of these cases — in the author's judgment. On the other hand, the cases started from the top with the prosecutor asking the question of whether ''there is a reasonable probability of conviction.'' If the answer is yes, the DOJ, absent unique circumstances, would likely insist on prosecuting the case. It is rare in criminal tax history that there is such a large group of individuals which have, in effect, been almost preselected for prosecution — but that is the case.

The Nature and Circumstances of the Offense

Under the Guidelines, the court is required to consider the ''nature and circumstances of the offense'' — is there something so different that the Guidelines, perhaps, do not capture or over-punish the offense involved? This is truly a two-edged sword and in large part would seem to argue that engaging in tax evasion through the use of foreign accounts is a more pernicious type of tax evasion. Indeed, many defense lawyers feel that with the element of engaging in financial transactions beyond the borders present, a ''stench'' is created in the courtroom. How many jurors have foreign bank accounts?

The Guidelines themselves punish foreign offshore cases more severely by in most cases imposing a two-level ''sophisticated means'' increase in the applicable Guideline range. Under §2T.1.1 of the Guidelines, if sophisticated means is involved, there is an increase of two levels and the minimum level under the Guidelines is a 12. Thus, even if there is little or no tax loss, placing the case at the low end of the Guidelines, if sophisticated means is involved, the level will be 12 and the sentencing range will be 10–16 months.

Ever since the early promulgation of the Guidelines, the commentary has indicated that the use of foreign bank accounts or corporations was sufficiently beyond routine tax evasion and would subject the defendant to the sophisticated means enhancement.

So all of this would suggest that the sentences in the offshore cases should be higher, not lower than the average criminal tax case — but they are not. Perhaps, the analogy here is that U.S. individuals who have engaged in this type of activity are not terribly different than the many high-net-worth individuals who engaged in structured tax shelter transactions in the 2000s that were promoted by large law firms and accounting firms. Many lawyers and accountants were criminally prosecuted for their conduct.

Many of us who defended the individual taxpayers were concerned with potential criminal liability of the taxpayers themselves even though they were following the lead of the lawyers and the accountants. The government, however, never prosecuted any of the individual taxpayers, at least that I am aware of, but instead used the taxpayers as witnesses in the prosecution against the accountants and lawyers — so-called enablers.

While the government has in fact prosecuted many U.S. taxpayers who had offshore accounts, how different is the U.S. taxpayer who has an offshore account and who followed a foreign banker's recommendation that having a secret foreign account was legal. After all, if UBS or HSBC told you it was legal, may be it was.

I am not saying these cases are just like the tax shelters, but there are sufficient similarities in them which would give one pause as to whether this has had an impact in terms of the sentences involved.

The Draconian FBAR Penalty

Substantially every one of the plea dispositions in the offshore cases has required the defendant to pay an FBAR penalty equal to 50% of the highest balance of the offshore accounts for the years under investigation. These penalties have been enormous with the largest appearing to be the recent plea agreement in *United States v. H. Ty Warner*, where the defendant has agreed to pay a penalty of $55,552,248.[21] In most cases, the amount of the FBAR penalty — because it is based on the value of the account, exceeded the tax

[21] *United States v. H. Ty Warner*, No. 13-cr-731 (N.D. Ill.; plea agreement filed Oct. 2, 2013) (highest value of account in 2008 was $107,104,968).

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loss amount by more than 10 fold. These amounts — designed to punish — far exceed the amount of fines under the Guidelines and even the maximum statutory fines. In pre-Guideline practice, many judges who decided not to incarcerate a tax offender would make it hurt by imposing the maximum statutory fine — maybe $250,000. Making it hurt is part of the sentencing process. Imposing a penalty of $55,552,248 for a tax offense is significant punishment.

Mr. Warner was sentenced on January 14, 2014, and, to the surprise of many, received a sentence of two years probation and 500 hours of community service.[22] He faced 46–57 months of prison under the advisory Guidelines and the prosecutors were pushing for prison time. Although Mr. Warner did not cooperate against others and admitted to evading over $5 million in taxes, he was paying a penalty of over $50 million dollars and the court cited Mr. Warner's charitable works as a reason for his probationary sentence.

More Than 43,000 Voluntary Disclosures

As noted above, the government's Voluntary Disclosure Program for offshore cases has been very successful, having brought more than 43,000 taxpayers into compliance and collected over $5 billion. One does not know how many of those U.S. taxpayers who engaged in voluntary disclosures actually committed tax crimes and were potentially subject to criminal prosecution. However, many criminal tax practitioners will tell you that one of the main reasons for making a voluntary disclosure is because there is potential criminal exposure. It is also said, tongue-in-cheek, that it is the ''truly guilty'' that really benefit from the voluntary disclosure policy. Thus, how does a judge sentence an individual for an offshore bank account case when more than 43,000 possibly similarly situated taxpayers were not prosecuted, did not have the stigma of a felony conviction and certainly are not going to jail? This raises an issue of disparity of treatment among similarly situated taxpayers and may have had an influence on many of the sentences which have been handed down.

The fact that this has had an influence for more lenient sentences is not a bad thing. The voluntary disclosure policy is critical to effective tax administration and we have made a policy choice to allow people to come into the system and avoid criminal prosecution.

CONCLUSION — A NON-PREDICTION

Sentencing by its very nature in the post-*Booker* world is discretionary and individualized. The overarching policy of the Guidelines is to hand down a sentence which is ''sufficient but not greater than necessary'' to achieve the goals of sentencing. While the offshore tax crimes are very serious, the history and characteristics of these defendants seem to be playing a role in the sentences we have seen to date.

The best example of this, and it is just an example, was the prosecution of Ms. Curran. She was an extremely wealthy and charitable socialite who, while technically guilty of the crime, did not fit your normal paradigm of a tax cheat. The reaction of the court says it all. Ms. Curran was sentenced to a term of probation, typical for these offshore cases, and then at the sentencing, the court terminated the probation after about a minute. The judge called the prosecution misguided and suggested the government support a request for a pardon on behalf of Ms. Curran.

Curran is an extreme case, but one has to think that the demographics of these individuals selected for prosecution is having an effect on the sentences that are being handed down. After all, Mr. Warner engaged in a much more extensive tax evasion scheme than Ms. Curran, and while he did not get the judicial endorsement for a pardon — his charitable works helped him avoid prison. Perhaps making Beanie Babies, which have brought smiles to millions of children, including those who could not afford them — helped as well.

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[22] *Id.*

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