

# PROOF OF TAX DEFICIENCY—THE SILENT ELEMENT IN FALSE STATEMENTS CHARGES?

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*Ubi non est condendi auctoritas, ibi non est parendi necessitas—*  
Where there is no authority to enforce, there is no need to obey

## INTRODUCTION

The United States' primary source of revenue is derived from a system of self-assessment and voluntary compliance.<sup>1</sup> Such system, if left unwatched, is highly susceptible to fraud. Therefore, to combat fraud and to ensure the government has a steady income stream, the sanctions imposed for non-compliance must effectively serve their deterrent function. To enforce the provisions of the Internal Revenue Code ("IRC"), the Internal Revenue Service ("IRS") has both civil and criminal sanctions in its toolbox.<sup>2</sup> As this Note asserts, however, the civil sanctions are largely ineffective in many tax evasion and false statements situations, leaving the government to rely on criminal sanctions to deter individuals and corporations from taking advantage of the self-assessment system. Consequently, the government must seek to extract the maximum deterrent value from every criminal tax prosecution.<sup>3</sup>

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1. Criminal Investigation (CI) At-a-Glance, <http://www.irs.gov/irs/article/0,,id=98398,00.html> (last visited Feb. 9, 2008); see also CONGRESSIONAL BUDGET OFFICE, HISTORICAL BUDGET DATA 3 (2006), available at <http://www.cbo.gov/budget/data/historical.pdf>. In 2005, corporate and personal income tax revenues accounted for nearly 56% of the federal government's total revenue. *Id.* If one considers social insurance taxes as part of the self-assessment system, the percentage of total revenues increases to nearly 93%. *Id.*

2. See generally Internal Revenue Code, 26 U.S.C. §§ 1–9833 (2000).

3. The drafters of the sentencing guidelines expressed this sentiment in the introductory comment to section 2T1.1 of the U.S. Sentencing Commission Guidelines Manual that stated:

The criminal tax laws are designed to protect the public interest in preserving the integrity of the nation's tax system. Criminal tax prosecutions serve to punish the violator and promote respect for the tax laws. Because of the limited number of criminal tax prosecutions

Of the criminal sanctions included in the IRC, tax-related criminal offenses are most often charged under the tax evasion (26 U.S.C. § 7201), failure to file a return or pay a tax (26 U.S.C. § 7203), and false statements (26 U.S.C. § 7206) statutes.<sup>4</sup> Less frequently, prosecutors may charge delivery of a fraudulent return.<sup>5</sup> In addition, conspiracy<sup>6</sup> and false statements<sup>7</sup> charges under Title 18 might be filed. In the past, prosecution of tax fraud has been a key goal of the Department of Justice.<sup>8</sup> In 2004, however, the government de-emphasized tax fraud prosecution and turned its attention to other matters.<sup>9</sup> With this shift away from prosecuting tax fraud, the deterrent function of the criminal sanctions is placed at risk. As a result, the deterrent effect of those few cases that are prosecuted has become all the more important. Prosecuting tax offenders under the false statements provision of the IRC has been a significant tool for the government. Given the complexities of many tax frauds and the difficulty in proving the correct tax amount due, a false statements charge simplifies the

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relative to the estimated incidence of such violations, deterring others from violating the tax laws is a primary consideration underlying these guidelines. Recognition that the sentence for a criminal tax case will be commensurate with the gravity of the offense should act as a deterrent to would-be violators.

U.S. SENTENCING GUIDELINES MANUAL § 2T1.1 introductory cmt. (1987).

4. MARVIN J. GARBIS, RONALD B. RUBIN & PATRICIA T. MORGAN, *TAX PROCEDURE AND TAX FRAUD, CASES AND MATERIALS* 537 (3d ed. 1992). In addition to the statutes already noted, other significant criminal tax code provisions include willful failure to collect or pay taxes, 26 U.S.C. § 7202, fraudulent statement or failure to make a statement to employees regarding wages and benefits, 26 U.S.C. § 7204, fraudulent withholding exemption certificate or failure to supply information to an employer, 26 U.S.C. § 7205, and attempts to interfere with administration of Internal Revenue laws, 26 U.S.C. § 7212. For a complete view of all Internal Revenue Code criminal provisions, see 26 U.S.C. §§ 7201–7217, 7231, 7232, 7240, 7261–7261, 7268–7273, and 7275.

5. 26 U.S.C. § 7207.

6. 18 U.S.C. § 371 (2000). In a tax fraud case, conspiracy can be charged where evidence indicates a conspiracy to violate the criminal provisions of the tax code, or a conspiracy to defraud the administration of the federal tax system. *Ingram v. United States*, 360 U.S. 672, 678 (1959).

7. 18 U.S.C. § 1001 (2000 & Supp. IV 2004).

8. DEP'T OF JUSTICE, *FY 2003 PERFORMANCE AND ACCOUNTABILITY REPORT*, at 2.4G (2004), available at <http://www.usdoj.gov/ag/annualreports/ar2003/p2sg2.htm> (including prosecution of tax fraud as one of its strategic goals).

9. See DEP'T OF JUSTICE, *FY 2004 PERFORMANCE AND ACCOUNTABILITY REPORT* (2004), available at <http://www.usdoj.gov/ag/annualreports/pr2004/TableofContents.htm> (omitting prosecution of tax fraud as one of its strategic goals). In contrast to the FY 2004 report that makes no mention of tax fraud prosecution, the DOJ's FY 2003 Performance and Accountability Report stated that a key goal was to achieve a 95% success rate in prosecuting tax fraud. Further, the report stated that the DOJ Tax Department's objective was to "vigorously and consistently enforce the criminal tax laws in order to punish offenders, deter future violations and reassure honest taxpayers that they will not bear an undue share of the federal tax burden." DEP'T OF JUSTICE, *supra* note 8, at 2.4G.

government's task as it does not require proof of a tax deficiency<sup>10</sup> unlike a tax evasion charge.<sup>11</sup>

Without the burden of proving a tax deficiency, to establish a false statements violation under 26 U.S.C. § 7206(1), the Government need only prove: (1) that the defendant made or caused to be made, and subscribed the return in question; (2) that the return contained or was verified by a written declaration that it was made under the penalties of perjury; (3) that the return was not true and correct as to a material matter; and (4) that the defendant acted knowingly and willfully at the time he made and subscribed the return.<sup>12</sup> Because a tax deficiency is not a required element under § 7206, courts traditionally did not allow defendants to introduce evidence that there was no tax due and owing or evidence of unclaimed expense deductions that would offset any incremental tax due as a result of the false statements.<sup>13</sup> Such evidence was generally held to be irrelevant, serving only to confuse the jury.<sup>14</sup> However, after the United States Supreme Court held in 1999 that questions of materiality in § 7206 cases should be determined by the jury,<sup>15</sup> several circuit courts noted that evidence of a tax deficiency is relevant to a jury's determination of materiality.<sup>16</sup> Accordingly, courts admitted such evidence.<sup>17</sup> This view has been adopted in circuits defining materiality as any item that is necessary for a correct computation of tax owed.<sup>18</sup> Other courts have adopted an alternative definition and have continued to exclude such evidence.<sup>19</sup> Those courts have defined a material item as any item having a natural tendency to

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10. United States v. Pree, 408 F.3d 855, 867 (7th Cir. 2005).

11. See 26 U.S.C. § 7201 (2000). To sustain a charge of tax evasion under § 7201, the government must prove 1) the existence of a tax deficiency, 2) an affirmative or attempted act of evasion of tax imposed under the IRC, and 3) willfulness. *Id.*

12. 26 U.S.C. § 7206(1); see also United States v. Bishop, 412 U.S. 346, 350 (1973).

13. *E.g.*, United States v. Marashi, 913 F.2d 724, 735 (9th Cir. 1990) (holding defendant's argument that conviction under § 7206 should be reversed because available deductions would have left him with no tax deficiency lacks merit as it is irrelevant whether there was an actual tax deficiency); United States v. Olgin, 745 F.2d 263, 272 (3d Cir. 1984) (holding the effect of underreported expenses is not relevant to the charge of willful filing of inaccurate tax reports); United States v. Garcia, 553 F.2d 432, 432 (5th Cir. 1977) (holding refusal to permit defendant to introduce evidence as to what tax, if any, would be owing on the unreported income was not error); Schepps v. United States, 395 F.2d 749, 749 (5th Cir. 1968) (holding proof showing that the falsity resulted in no tax deficiency was not relevant to the issue raised by the indictment and it was not error to reject it).

14. See *Marashi*, 913 F.2d at 735; *Olgin*, 745 F.2d at 272; *Schepps*, 395 F.2d at 749.

15. *Neder v. United States*, 527 U.S. 1, 4 (1999).

16. See *United States v. Scholl*, 166 F.3d 964, 980 (9th Cir. 1999); *United States v. Clifton*, 127 F.3d 969, 970 (10th Cir. 1997); *United States v. Uchimura*, 125 F.3d 1282, 1285 (9th Cir. 1997).

17. See *Scholl*, 166 F.3d at 980; *Clifton*, 127 F.3d at 970; *Uchimura*, 125 F.3d at 1285-86.

18. See *Clifton*, 127 F.3d at 970; *Uchimura*, 125 F.3d at 1285; *United States v. Aramony*, 88 F.3d 1369, 1384 (4th Cir. 1996).

19. *E.g.*, *United States v. DiRico*, 78 F.3d 732, 736 (1st Cir. 1996).

influence or impede the IRS in ascertaining the correctness of the tax reported or in verifying or auditing the returns of the taxpayer.<sup>20</sup>

Today, there is a circuit split over the definition of materiality and the admissibility of evidence of unclaimed expenses as an offset to unreported gross income in § 7206 cases. Although the majority of circuits that have considered this issue have found in favor of admissibility,<sup>21</sup> such holdings effectively establish a tax deficiency as a *de facto* fifth element not intended when Congress enacted the IRC. Thus, this Note argues that the better course is to exclude such evidence because the purpose of § 7206 is to prevent false statements. Section 7206 is more akin to a perjury or obstruction statute than an evasion statute. To allow a tax deficiency to become an element of a false statements claim weakens the government's prosecution power by making the false statements statute redundant to the tax evasion statute, and effectively sends the message to all would-be tax offenders that submitting false information that substantially inhibits the IRS's administrative function is acceptable, provided that no tax deficiency results. As sentencing guidelines already take into consideration the tax liability evaded or unpaid in determining the severity of the punishment, there is no need to cloud the guilt phase of a false statements case with such irrelevant and prejudicial evidence. Lastly, this Note recommends that the Supreme Court address the split and adopt the view that a tax deficiency is not an element of a false statements charge, and that evidence of a lack of tax due and owing should not be admitted as such evidence is irrelevant.

Part I of this Note identifies and discusses the elements of a false statements charge. Part II addresses the historical definitions of materiality and answers the question of whether materiality is a question of law or fact. Part III examines whether there are viable alternatives to a false statements charge under the criminal provisions of the IRC. Part IV discusses civil sanction under Title 26 as a possible substitute to criminal sanctions. Finally, Part V explores available options under the criminal provisions of Title 18.

## I. ELEMENTS OF A FALSE STATEMENTS CHARGE

As previously mentioned, to obtain a false statements conviction under 26 U.S.C. § 7206(1) the government must prove that: (1) the defendant made or caused to be made, and subscribed the return in question; (2) the return contained or was verified by a written declaration that it was made under the penalties of perjury; (3) the return was not true and correct as to a material matter; and (4) the defendant acted knowingly and willfully at the time he made and subscribed the return.<sup>22</sup> An examination of these elements quickly reveals that the materiality of

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20. *E.g., id.*

21. The Fourth, Ninth, and Tenth Circuits have allowed evidence of a tax deficiency. *See Aramony*, 88 F.3d at 1384; *Clifton*, 127 F.3d at 970; *Uchimura*, 125 F.3d at 1285. The First Circuit has not admitted evidence of a tax deficiency. *DiRico*, 78 F.3d at 736.

22. 26 U.S.C. § 7206(1) (2000); *see also* *United States v. Bishop*, 412 U.S. 346, 350 (1973).

an alleged false statement or omission, unlike the other elements, is subject to confusion arising out of the inconsistent definitions of materiality.

In addition to individuals and corporations who file a false return, tax return preparers who willfully make or subscribe a false return on behalf of a taxpayer can be charged under § 7206(1).<sup>23</sup> Although an unsigned return may support a tax evasion charge, to sustain a false statements charge, the return or document must be signed or subscribed as authorized by the taxpayer.<sup>24</sup>

Under a strict reading of the statute, there is no requirement that a return or document containing a false statement be filed with the IRS to result in prosecution.<sup>25</sup> Some courts, however, have read a filing requirement into the statute,<sup>26</sup> while others have held that the criminal offense is complete when the document is submitted to the entity responsible for transmitting the information to the IRS.<sup>27</sup> Further, a false statement charge does not require an actual affirmative statement; rather, an omission of a material fact renders the return just as untrue and incorrect within the meaning of § 7206(1) as the inclusion of a materially false fact.<sup>28</sup> For example, a return that includes correct amounts for wages but fails to disclose separate business income on a schedule filed along with the return is a false return under § 7206(1).<sup>29</sup>

A defendant acts willfully when the defendant voluntarily or intentionally violates a known legal duty.<sup>30</sup> Proof of willfulness does not require evidence of evil motive.<sup>31</sup> Unlike most criminal matters, in which ignorance of the law is no excuse, in a criminal tax case the government must prove that the defendant knew the act was illegal and purposefully violated the law.<sup>32</sup> Accordingly, an honest

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23. *United States v. Shortt Accountancy Corp.*, 785 F.2d 1448, 1454 (9th Cir. 1986) (holding that perjury committed in connection with the preparation of a false return can be charged under either § 7206(1) or § 7206(2)).

24. *See United States v. Robinson*, 974 F.2d 575, 577–78 (5th Cir. 1992); *United States v. Ponder*, 444 F.2d 816, 822 (5th Cir. 1971).

25. 26 U.S.C. § 7206(1). As the Second Circuit aptly stated:

The purpose of § 7206(1) is not simply to ensure that the taxpayer pay the proper amount of taxes—though this is surely one its goals. Rather, that section is intended to ensure also that the taxpayer not make misstatements that could hinder the Internal Revenue Service . . . in carrying out such functions as the verification of the accuracy of that return or a related tax return.

*United States v. Greenberg*, 735 F.2d 29, 31 (2d Cir. 1984) (citations omitted).

26. *See, e.g., United States v. Gilkey*, 362 F. Supp. 1069, 1071 (E.D. Pa. 1973) (holding offense is not complete until the filing of the return with the Internal Revenue Service).

27. *See United States v. Cutler*, 948 F.2d 691, 695 (10th Cir. 1991); *United States v. Monteiro*, 871 F.2d 204, 210–11 (1st Cir. 1989).

28. *See United States v. Cohen*, 544 F.2d 781, 783 (5th Cir. 1977); *United States v. Siravo*, 377 F.2d 469, 472 (1st Cir. 1967).

29. *Siravo*, 377 F.2d at 472.

30. *United States v. Bishop*, 412 U.S. 346, 360 (1973).

31. *United States v. Pomponio*, 429 U.S. 10, 12–13 (1976).

32. *Cheek v. United States*, 498 U.S. 192, 201–02 (1991) (holding the government must prove the “defendant was aware of the duty at issue, which cannot be true

misunderstanding of the law, even if unreasonable, is a complete defense to a false statements charge.<sup>33</sup> In addition, a defendant can defeat the second prong of the willfulness test by proving that at the time of the false statement there was an uncertainty in the law and that the defendant made a good faith attempt to interpret and comply with the law.<sup>34</sup> Similarly, if a defendant relied in good faith on advice sought from a qualified attorney or accountant, and such advice formed the basis for the false statements included in the return or document, then the defendant is entitled to a reliance instruction to the jury.<sup>35</sup> The reliance defense is unavailable, however, if the defendant failed to disclose relevant information that would have impacted the advice provided.<sup>36</sup>

As this discussion shows, most of the central elements of false statements are relatively straightforward and contain several protections for taxpayers. However, the definition and treatment of materiality is less clear, and its continued evolution has failed to provide the requisite clarity. A detailed discussion of this evolution follows below.

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if the jury credits a good-faith misunderstanding and belief submission, whether or not the claimed belief or misunderstanding is objectively reasonable”).

33. *Id.*

34. *See* United States v. Regan, 937 F.2d 823, 826–27 (2d Cir. 1991).

35. *See* United States v. Bishop, 291 F.3d 1100, 1106–07 (9th Cir. 2002); United States v. Claiborne, 765 F.2d 784, 798 (9th Cir. 1985), *abrogated on other grounds by* United States v. Alexander, 48 F.3d 1477 (9th Cir. 1995). A reliance instruction would likely instruct the jury that:

The defendant would not be acting [willfully] if, before [completing or subscribing the false return, the defendant] consulted in good faith an attorney [or tax accountant] whom [the defendant] considered competent, . . . made a full and accurate report to that attorney [or tax accountant] of all material facts of which [the defendant] had the means of knowledge, and then acted strictly in accordance with the advice given to [the defendant] by that attorney [or tax accountant].

Whether the defendant acted in good faith for the purpose of seeking advice concerning questions about which [the defendant] was in doubt, and whether [the defendant] made a full and complete report to that attorney [or tax accountant], and whether [the defendant] acted strictly in accordance with the advice [the defendant] received, are all questions for [the jury] to determine.

JUDICIAL COMM. ON MODEL JURY INSTRUCTIONS FOR THE EIGHTH CIRCUIT, MANUAL OF MODEL CRIMINAL JURY INSTRUCTIONS FOR THE DISTRICT COURTS OF THE EIGHTH CIRCUIT 484 (2008), *available at* [http://www.juryinstructions.ca8.uscourts.gov/crim\\_manual\\_2008\\_expanded.pdf](http://www.juryinstructions.ca8.uscourts.gov/crim_manual_2008_expanded.pdf) [hereinafter EIGHTH CIRCUIT MODEL CRIMINAL JURY INSTRUCTIONS].

36. *See* Bishop, 291 F.3d at 1106–07 (holding reliance defense unavailable to defendants because they did not make full disclosure to their accountants); United States v. Becker, 965 F.2d 383, 387 (7th Cir. 1992) (holding reliance instruction unwarranted where defendant did not present evidence that he told his lawyer everything about his situation, that his lawyer provided specific advice, and that he followed the specific advice of his lawyer); United States v. Masat, 948 F.2d 923, 930–31 (5th Cir. 1991) (holding defendant not entitled to reliance instruction as no evidence offered that proved he disclosed all facts related to his exempt status to his attorney, or that he relied on advice from such attorney).

## II. MATERIALITY—A QUESTION OF LAW OR FACT?

As previously noted, in order to convict a person under § 7206(1), the government must prove that the false statement charged is material.<sup>37</sup> The issue of whether materiality is a question of law or fact, or perhaps a blended question of law and fact, is one that has evolved and changed.<sup>38</sup> Today, it is well settled that materiality, in the context of § 7206(1), is a question for the jury to decide. Consequently, the definition of materiality becomes ever more important as judges must provide written instructions to jurors faced with determining whether a false statement is material.

### A. Materiality—the Historical Approach

Prior to the 1990s, courts generally treated materiality in false statements cases as a question of law to be decided by the court.<sup>39</sup> The rationale for treating materiality as a question of law was that the finding of materiality required an interpretation of substantive law, which necessarily fell within the responsibilities of the court.<sup>40</sup> Therefore, such issues were left to the trial judge to determine.<sup>41</sup>

In *United States v. Gaudin*, however, the Supreme Court held that in prosecutions under 18 U.S.C. § 1001 (Fraud and False Statements), materiality was a question for the jury.<sup>42</sup> In *Gaudin* the defendant was found guilty of making false statements on United States Department of Housing and Urban Development loan documents in violation of 18 U.S.C. § 1001.<sup>43</sup> At trial, the District Court instructed the jury that the government was required to prove that the alleged false statements were material to the activities and decisions of the Department of Housing and Urban Development, but that the determination of whether the defendant's statements were material was a question for the court, not the jury.<sup>44</sup> The court then instructed the jury that in the matter at hand, the defendant's statements were material.<sup>45</sup> On appeal, the Court of Appeals for the Ninth Circuit reversed the defendant's conviction, holding that failure to submit the issue of materiality to the jury violated the defendant's Fifth and Sixth Amendment rights.<sup>46</sup> In affirming the Ninth Circuit's decision, the United States Supreme Court noted that the Constitution grants a criminal defendant the right to have a jury

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37. 26 U.S.C. § 7206(1) (2000).

38. See *infra* notes 42–69 and accompanying text.

39. See *United States v. Tandon*, 111 F.3d 482, 488 (6th Cir. 1997) (noting that prior to *Gaudin*, materiality had always been a question of law for the judge to determine); *United States v. Fawaz*, 881 F.2d 259, 261–62 (6th Cir. 1989); *United States v. Rogers*, 853 F.2d 249, 251 (4th Cir. 1988); *United States v. Greenberg*, 735 F.2d 29, 31 (2d Cir. 1984); *United States v. Strand*, 617 F.2d 571, 574 (10th Cir. 1980); *United States v. Romanow*, 509 F.2d 26, 28–29 (1st Cir. 1975).

40. *Fawaz*, 881 F.2d at 261–62.

41. See *id.*; *Rogers*, 853 F.2d at 251; *Greenberg*, 735 F.2d at 31; *Strand*, 617 F.2d at 574; *Romanow*, 509 F.2d at 28–29.

42. 515 U.S. 506, 522–23 (1995).

43. *Id.* at 508–09.

44. *Id.* at 508.

45. *Id.*

46. *Id.* at 509.

determine every element of the crime charged, including materiality that requires application of the law to the facts.<sup>47</sup>

In the years immediately after this ruling, a split arose in the circuits as to whether *Gaudin* applied to false statements prosecutions under Title 26.<sup>48</sup> In 1999, the Supreme Court resolved the split, holding that the jury should determine questions of materiality in § 7206 cases.<sup>49</sup> In *Neder v. United States*, the defendant engaged in a property flip scheme whereby he purchased properties in Florida using shell corporations and then resold such properties at inflated prices to limited partnerships that the defendant also controlled.<sup>50</sup> To facilitate the resale of the properties to the partnerships, Neder used inflated appraisals to secure financing from banks.<sup>51</sup> At no point did Neder disclose to the banks that he controlled both the shell corporations and the limited partnerships, that he had purchased the properties at substantially lower prices than he resold the properties, or that the limited partnerships had not actually made the down payments on the properties as represented to the banks.<sup>52</sup> Further, the defendant never reported on his income tax returns the portion of the loan proceeds that he retained for himself.<sup>53</sup> The defendant also engaged in a number of land development fraud schemes. Ultimately, Neder was charged with numerous counts of mail fraud, wire fraud, bank fraud, and filing a false income tax return.<sup>54</sup> At trial, the District Court, in accordance with then-existing precedent, instructed the jury that it did not need to consider, in relation to the tax charges, whether the false statements in the defendant's income tax returns were material.<sup>55</sup> Instead, the District Court instructed that materiality was a question for the court to decide.<sup>56</sup> Neder was found guilty of the fraud and tax offenses. On appeal, the Eleventh Circuit affirmed the conviction; however, it held that the District Court erred by not submitting the question of materiality to the jury.<sup>57</sup> The Eleventh Circuit further held that such error was subject to the harmless-error doctrine, and that the failure to submit materiality to the jury on the false statements charges was harmless

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47. *Id.* at 511.

48. *Compare* *United States v. Clifton*, 127 F.3d 969, 970 (10th Cir. 1997) (materiality must be submitted to jury), *United States v. Uchimura*, 125 F.3d 1282, 1286 (9th Cir. 1997) (materiality is a mixed question of law and fact for the jury), *United States v. McGuire*, 99 F.3d 671, 671 (5th Cir. 1996) (materiality a question for the jury), *and* *United States v. DiRico*, 78 F.3d 732, 736 (1st Cir. 1996) (materiality is a mixed question of law and fact for the jury), *with* *United States v. Klausner*, 80 F.3d 55, 61 (2d Cir. 1996) (materiality purely a legal question to be determined by the court).

49. *Neder v. United States*, 527 U.S. 1, 4 (1999).

50. *Id.* at 4–5.

51. *Id.* at 5.

52. *Id.*

53. *Id.*

54. *Id.*

55. *Id.* at 6.

56. *Id.*

57. *Id.* at 6–7. The Court noted that the Eleventh Circuit also held that “materiality is not an element of the mail fraud, wire fraud, and bank fraud statutes, and thus the District Court did not err in failing to submit the question of materiality to the jury.” *Id.* at 7 (citations omitted). The Supreme Court, however, disagreed holding that materiality is an element of such offenses. *Id.* at 25.



because “materiality was not in dispute” and, therefore, did not impact the jury’s verdict.<sup>58</sup>

On certiorari, the United States Supreme Court affirmed the Eleventh Circuit’s holding that materiality is an issue of fact for the jury to determine, that failure to submit materiality to the jury is subject to harmless error analysis, and in the instant case, the failure was harmless. Consequently, post-*Neder* judges should instruct juries to consider the materiality of false statements under Title 26.

### ***B. Defining Materiality Post-Gaudin and Neder***

Although the circuits agree that post-*Gaudin* and *Neder* materiality is a question for the jury, the circuits do not agree on the definition of a material item. Courts have generally defined a material item as either (1) any item that is necessary for a correct computation of tax owed (the *Warden* definition),<sup>59</sup> or (2) any item having a natural tendency to influence or impede the IRS in ascertaining the correctness of the tax reported or in verifying or auditing the returns of the taxpayer (the *DiVarco* definition).<sup>60</sup> The *DiVarco* definition is consistent with the definition of materiality applied to other false statement statutes, including 18 U.S.C. § 1001 (False Statements)<sup>61</sup> and 18 U.S.C. § 1623 (False Declarations Before Grand Jury or Court).<sup>62</sup>

In recent years, several circuits started utilizing a third definition that blends the two into an either/or test. For example, the First Circuit in its pattern

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58. *Id.* at 7.

59. *United States v. Warden*, 545 F.2d 32, 37 (7th Cir. 1976). The Fourth, Eighth, Ninth, and Tenth Circuits have followed the *Warden* definition. *United States v. Aramony*, 88 F.3d 1369, 1384 (4th Cir. 1996); *United States v. Uchimura*, 125 F.3d 1282, 1285 (9th Cir. 1997); *United States v. Clifton*, 127 F.3d 969, 970 (10th Cir. 1997); EIGHTH CIRCUIT MODEL CRIMINAL JURY INSTRUCTIONS, *supra* note 35, at 449.

60. *United States v. DiVarco*, 484 F.2d 670, 673 (7th Cir. 1973). The First, Second, and Sixth Circuits have followed the *DiVarco* definition. *See United States v. DiRico*, 78 F.3d 732, 736 (1st Cir. 1996); *United States v. Bok*, 156 F.3d 157, 165 (2d Cir. 1998); *United States v. Tarwater*, 308 F.3d 494, 505 (6th Cir. 2002). The Fifth and Seventh Circuits have recognized both tests. *See United States v. Taylor*, 574 F.2d 232, 235 (5th Cir. 1978); *United States v. Pree*, 408 F.3d 855, 873 (7th Cir. 2005); COMM. ON FED. CRIMINAL JURY INSTRUCTIONS FOR THE SEVENTH CIRCUIT, PATTERN CRIMINAL FEDERAL JURY INSTRUCTION FOR THE SEVENTH CIRCUIT 358 (1998), *available at* <http://www.ca7.uscourts.gov/pjury.pdf> (noting the two definitions and declining to take a position as to which definition is required). Although case law in the Fifth Circuit indicates acceptance of both definitions, the circuit’s pattern criminal jury instructions favor the *DiVarco* definition. *See FIFTH CIRCUIT DIST. JUDGES ASS’N, FIFTH CIRCUIT DISTRICT JUDGES ASSOCIATION PATTERN JURY INSTRUCTIONS (CRIMINAL CASES) 91* (2001), *available at* <http://www.lb5.uscourts.gov/juryinstructions/crim2001.pdf>.

61. *See Chad B. Pimental, False Statements*, 38 AM. CRIM. L. REV. 709, 716 (2001). Similar to the definition in *Di Varco*, courts in matters involving false statements under 18 U.S.C. § 1001 define materiality as a statement that influences or has the tendency or capacity to influence a decision or function of a federal agency. *Id.* at 716–17.

62. *United States v. Fawaz*, 881 F.2d 259, 263 (6th Cir. 1989) (noting rule for assessing materiality of a false statement made to a grand jury is a “like rule” to materiality under 26 U.S.C. § 7206).

jury instructions defines a material false statement as “one that is likely to affect the calculation of tax due and payable, or to affect or influence the IRS in carrying out the functions committed to it by law, such as monitoring and verifying tax liability.”<sup>63</sup> Further, the Tenth Circuit has created a definition of materiality that requires satisfaction of both tests.<sup>64</sup> The Eleventh Circuit rejects both the *Warden* and *DiVarco* definitions, and instead states that a statement “is ‘material’ if it relates to a matter of significance or importance as distinguished from a minor or insignificant or trivial detail.”<sup>65</sup> Clearly, there is no one dominant definition of materiality.

At first blush, the differences between the *Warden* and *DiVarco* definitions may not appear significant; however, in determining whether evidence submitted at trial is sufficient to prove that a false statement is material, the definition of materiality provided to the jury is crucial as some false statements that satisfy one definition will not satisfy the other. Thus, the criminality of a false statement turns on the definition the judge provides the jury.

### C. Implications of Adopting the Warden Definition

In jurisdictions following the *Warden* definition—that materiality is any item necessary for a correct computation of tax owed—there is a risk that the definition might create a presumption that a false statement is not material if the impact of the statement does not result in additional tax due and owing. In a jurisdiction that focuses on the tax computation, a false statement can have one of three effects: (1) it can increase tax due; (2) it can decrease tax due; or (3) it can have no impact on tax due. Although a prosecutor can argue that a tax deficiency is not a required element, in the last two scenarios it is quite possible that a jury may hesitate to find a defendant guilty based on the prosecution’s inability to satisfy the “so-what factor.”

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63. PATTERN CRIMINAL JURY INSTRUCTIONS DRAFTING COMM., PATTERN CRIMINAL JURY INSTRUCTIONS FOR THE DISTRICT COURTS OF THE FIRST CIRCUIT 108 (1997), available at <http://www.med.uscourts.gov/practices/crpji.97nov.pdf>. In 2003, the First Circuit defined materiality using an either/or test that encompassed both the *Warden* and *DiVarco* definitions. See *United States v. Boulerice*, 325 F.3d 75, 82 n.3 (1st Cir. 2003). Similarly, in a recent unpublished Ninth Circuit opinion, the court used a blended instruction applying both tests. *United States v. Parker*, 173 F. App’x 582, 586 (9th Cir. 2006). It is unclear whether this signifies a conscious shift in the circuit to adopt a blended test. The use of the blended test appears to conflict with both the precedent set in *Uchimura* and the 2003 Edition of the Ninth Circuit Manual of Model Criminal Jury Instructions which favored the use of the *DiVarco* definition.

64. See CRIMINAL PATTERN JURY INSTRUCTION COMM. OF THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT, CRIMINAL PATTERN JURY INSTRUCTIONS 323–24 (2005), available at <http://www.ck10.uscourts.gov/downloads/pji10-cir-crim.pdf>. According to the Tenth Circuit’s instructions, “a statement is material under [26 U.S.C. § 7206] if it concerned a matter necessary to the correct computation of taxes owed and was capable of influencing the decision of the Internal Revenue Service.” *Id.* (emphasis added).

65. JUDICIAL COUNCIL OF THE ELEVENTH CIRCUIT, ELEVENTH CIRCUIT PATTERN JURY INSTRUCTIONS (CRIMINAL CASES) 562 (2003), available at <http://www.ca11.uscourts.gov/documents/jury/crimjury.pdf>.

Even when a prosecutor is initially able to clear the “so-what” hurdle by showing the false statement had the effect of increasing tax due, this victory may be negated by a defendant’s argument that evidence of unclaimed corporate or business expenses or other unclaimed deductions should be admitted, as those unclaimed items would offset any potential increase in tax deficiency.<sup>66</sup> Such arguments have enjoyed some success, although limited.<sup>67</sup> In *United States v. Uchimura*, the Ninth Circuit held that the lack of a tax deficiency is relevant to a jury’s determination of materiality and should be admitted.<sup>68</sup> Similarly, in *United States v. Clifton*, the Tenth Circuit held that where a taxpayer failed to report all his income, but had no tax due because his allowable deductions exceeded his taxable income for the year, the taxpayer’s failure to report all taxable income “might very well affect the jury’s deliberations on the element of materiality.”<sup>69</sup>

The admission of such evidence increases the risk that proof of a tax deficiency becomes a *de facto* fifth element.<sup>70</sup> If this occurs, § 7206 would become redundant to § 7201, as the only remaining difference between the two statutes would be the requirement that the government prove an affirmative act of attempted evasion under § 7201.<sup>71</sup> It is arguable, however, that evidence that proves the “willfulness” element under § 7206 could also be used to satisfy the “affirmative act” requirement under § 7201. Were such an argument to succeed, § 7206(1) would be effectively removed from the government’s enforcement toolbox. That result would greatly diminish the propriety and effectiveness of the self-assessment system. As the Seventh Circuit noted, for the tax system to “function properly, there must be not just truthful reporting, but also the ability to assure truthful reporting.”<sup>72</sup> The court further noted, “[t]he ability to assure honest returns is lodged in the right of the Government to prosecute for knowing falsification on individual tax returns.”<sup>73</sup>

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66. See *United States v. Clifton*, 127 F.3d 969, 970 (10th Cir. 1997); *United States v. Uchimura*, 125 F.3d 1282, 1285 (9th Cir. 1997).

67. See *Clifton*, 127 F.3d at 970; *Uchimura*, 125 F.3d at 1285.

68. 125 F.3d at 1285.

69. 127 F.3d at 971.

70. In a pre-*Gaudin* case, the Fifth Circuit raised such concern. *United States v. Taylor*, 574 F.2d 232, 233–34 (5th Cir. 1978). In *United States v. Taylor*, Taylor was charged with filing false tax returns that failed to report gross receipts from the sale of livestock. *Id.* Taylor argued as his defense that his unreported losses offset his unreported income. *Id.* at 234. He further testified that he was unaware he was required to report such losses. *Id.* The Fifth Circuit rejected Taylor’s argument that his failure to report receipts was not material because of offsetting expenses, noting “[t]he existence of such offsets . . . did not go to the materiality of the omitted receipts, but to the lack of mens rea in their omission.” *Id.* at 237. In holding that failure to report “gross receipts” was material, the Fifth Circuit explained that “[r]equiring the government to prove the omission of gross income comes near to requiring proof of additional tax liability. Such definition of ‘material’ would seriously jeopardize the effectiveness of section 7206(1) as a perjury statute and would imperil the self-assessment nature of our tax system.” *Id.* at 236.

71. See 26 U.S.C. § 7201 (2000).

72. *United States v. Paepke*, 550 F.2d 385, 391 (7th Cir. 1977).

73. *Id.*

In addition to the potential to create a *de facto* fifth element, focusing solely on whether the false statement affects the tax computation ignores the significant and real impact on the ability of the IRS to perform its verification and audit functions that arise when non-additive information is incorrectly stated or omitted from a return. Although such statements do not result in additional tax due, they do result in a real tax loss to the IRS in terms of the incremental time spent in verifying the accuracy of the return, and its impact, if any, on other returns.

Further, the use of the *Warden* definition deprives the government of the use of established law that a false statement does not need to be substantial to support a conviction under § 7206(1). As the Second Circuit stated in *United States v. Helmsley*, “[f]alse statements about income do not have to involve substantial amounts in order to violate [18 U.S.C. § 7206(1)].”<sup>74</sup> Additionally, as the Ninth Circuit stated, “[a]ny concern that trivial mistakes will be prosecuted is obviated by the stringent requirement of specific intent to violate the law.”<sup>75</sup>

#### ***D. Implications of Adopting the DiVarco Definition***

Adopting the *DiVarco* definition—that materiality is any item having a natural tendency to influence or impede the IRS in ascertaining the correctness of the tax reported or in verifying or auditing the returns of the taxpayer—provides prosecutors the flexibility to hold defendants criminally accountable for making false statements or omissions that mischaracterize or hide the sources of income or fail to disclose required information in a non-additive schedule, but do not actually result in a tax loss to the government. This definition is true to the initial purpose of the statute—it seeks to punish those who complete and file a false return.<sup>76</sup> At its core, the statute is as much a perjury statute as it is a tax fraud statute.<sup>77</sup> As the First Circuit aptly recognized as far back as 1950,

[i]t seems to us clear that the latter subsection makes it a felony merely to make and subscribe a tax return without believing it to be true and correct as to every material matter, whether or not the purpose in so doing was to evade or defeat the payment of taxes. That is to say, it seems to us that the subsection’s purpose is to impose the penalties for perjury upon those who wilfully falsify their returns regardless of the tax consequences of the falsehood.<sup>78</sup>

Just over a quarter of a century later, the Fifth Circuit specifically considered whether to adopt the *DiVarco* or *Warden* definition. Opting for the *DiVarco*

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74. 941 F.2d 71, 92 (2d Cir. 1991) (citations omitted).

75. *United States v. Holland*, 880 F.2d 1091, 1096 (9th Cir. 1989) (citations omitted).

76. 26 U.S.C. § 7206 (2000).

77. *See United States v. Scholl*, 166 F.3d 964, 980 (9th Cir. 1999) (describing § 7206(1) as a perjury statute); *United States v. Marashi*, 913 F.2d 724, 736 (9th Cir. 1990) (same).

78. *Gaunt v. United States*, 184 F.2d 284, 288 (1st Cir. 1950). At the time the First Circuit decided *Gaunt*, the false statements offense was codified as § 145(c) of the Internal Revenue Code.

definition, the court noted that requiring the government to prove additional tax liability would “seriously jeopardize the effectiveness of section 7206(1) as a perjury statute and would imperil the self-assessment nature of our tax system.”<sup>79</sup>

Further, the *DiVarco* definition of materiality is broad enough to encompass any statement that would be material under the *Warden* definition. For example, a return that significantly underreports income would likely have the impact of impeding the IRS in determining the correctness of the tax reported or in verifying or auditing the returns of the taxpayer.

### ***E. Implications of Adopting a Blended Definition***

A third alternative is a blended definition that results in an either/or test, which finds that a statement is material if it is necessary for a correct computation of tax owed or it has a natural tendency to influence or impede the IRS in ascertaining the correctness of the tax reported or in verifying or auditing the returns of the taxpayer. The adoption of such definition allows the same flexibility of the *DiVarco* definition, and while it does not add to the government’s enforcement toolbox, it also does not raise the same risks as the *Warden* definition.

In contrast to the either/or test, a second type of blended definition requires that both the *DiVarco* and *Warden* definitions be satisfied. This test carries the same risks and drawbacks of the stand-alone *Warden* definition. Similar to *Warden*, this definition would limit the government’s ability to prosecute those who impede the IRS by supplying false information because such falsity did not impact the computation of tax owed.

Ultimately, neither of the blended definitions are preferable to *DiVarco*; however, an either/or test is the least burdensome of the two and provides prosecutors with necessary flexibility.

## **III. OTHER OPTIONS UNDER THE CRIMINAL PROVISIONS OF THE INTERNAL REVENUE CODE**

As previously noted, the IRC provides a number of criminal sanctions for violating the Code,<sup>80</sup> and it is useful to examine these alternatives and their consequences in order to determine whether there are other statutes that can achieve the same result as the false statements statute. Decisions about how to prosecute a person arguably are made by taking into consideration the elements of the offense, as well as the likely penalty. Where a taxpayer purposefully provides false information on a return or report filed with the IRS, criminal prosecution could be pursued under any number of statutes depending on the nature of the false information and the impact on tax due and owing. As each of the statutes carries its own penalties, the severity of the punishment will vary according to the statute under which the taxpayer is prosecuted.

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79. United States v. Taylor, 574 F.2d 232, 236 (5th Cir. 1978).

80. See *supra* note 4 and accompanying text.

In a false statements matter, a likely starting point for deciding how to charge a taxpayer is the maximum penalty prescribed under 26 U.S.C. § 7206.<sup>81</sup> An individual taxpayer convicted of filing a false return under § 7206(1) is guilty of a felony, and faces a potential fine of up to \$100,000, and/or imprisonment of no more than three years, and may be responsible for the costs of prosecution.<sup>82</sup> A corporation found guilty may be fined up to \$500,000.<sup>83</sup>

The base offense level under the federal sentencing guidelines is determined first by the tax loss resulting from the offense. Where a false statement does not result in a tax loss, the base offense level defaults to a level six.<sup>84</sup> If a defendant “failed to report or to correctly identify the source of income exceeding \$10,000 in any year from criminal activity,” the level increases by two.<sup>85</sup> Because this will only result in base offense level of eight, and the sentencing guidelines require a minimum offense level of twelve when a person fails to report or correctly identify the source of income exceeding \$10,000, the offense level is automatically increased to level twelve.<sup>86</sup> The sentencing guidelines permit a further increase of two levels if the offense involved sophisticated means.<sup>87</sup> This enhancement is independent of the source of income enhancement. An offense level of twelve under federal sentencing guidelines results in a sentence of ten to sixteen months for a violation of § 7206 that results in no tax loss to the government.<sup>88</sup> In order to obtain a sentence equivalent to the maximum under the statute, the government must prove a tax loss of more than \$400,000.<sup>89</sup>

#### *A. Section 7201 as an Alternative for Prosecution*

Because a false statements charge can be a lesser-included offense to tax evasion under 26 U.S.C. § 7201, prosecution under § 7201 necessarily requires proof of additional elements.<sup>90</sup> Specifically, § 7201 requires proof that the taxpayer

81. In criminal tax matters, decisions as to whether to prosecute require approval of both the Department of Justice Tax Division and the United States Attorney. U.S. Dep’t of Justice Tax Div., About Us, [http://www.usdoj.gov/tax/about\\_us.htm#ces](http://www.usdoj.gov/tax/about_us.htm#ces) (last visited Jan. 26, 2008); see also 28 C.F.R. § 0.70 (2007).

82. 26 U.S.C. § 7206 (2000).

83. *Id.*

84. 18 U.S.C.S. app. § 2T1.1(a)(2) (LexisNexis 2007).

85. *Id.* § 2T1.1(b)(1)

86. *Id.*

87. *Id.* § 2T1.1(b)(2). A sophisticated means enhancement is appropriate where the execution or concealment of the offense is “especially intricate” or “complex.” *Id.* § 2T1.1 cmt. n.4. Conduct such as hiding assets or transactions, use of fictitious entities, or use of offshore accounts usually indicates sophisticated means. *Id.*

88. 18 U.S.C.S. app. § 5A (LexisNexis 2007). A sentence of ten to sixteen months assumes an offense level of twelve and a criminal history category of I. *Id.* A sentence that also includes a sophisticated means enhancement, resulting in an offense level of fourteen, would increase to fifteen to twenty-one months. *Id.*

89. 18 U.S.C.S. app. § 2T4.1 (LexisNexis 2007); 18 U.S.C.S. app § 5A.

90. Compare 26 U.S.C. § 7206(1) (2000), with 26 U.S.C. § 7201, and *United States v. Kaiser*, 893 F.2d 1300, 1307 (11th Cir. 1990). Although the Eleventh Circuit held that § 7206(1) is a lesser-included offense of § 7201, this view is not consistent with that of the Department of Justice. In a Tax Division memorandum, the Acting Assistant Attorney

had the specific intent to evade or defeat taxes.<sup>91</sup> With respect to the penalty, a taxpayer found guilty of tax evasion is subject to a fine of up to \$100,000 and/or imprisonment of up to five years, as well as the costs of prosecution.<sup>92</sup> Similar to the sentencing range under a § 7206 prosecution, the amount of the tax loss to the government is the primary driver of the sentencing range for tax evasion.<sup>93</sup> Consequently, like false statements sentences, the smaller the tax loss, the smaller the sentence and ultimately, the less meaningful the prison sentence becomes.<sup>94</sup>

In addition, the requirement that the government prove intent to evade taxes makes § 7201 an unlikely alternative to § 7206(1) where: (1) the false statement does not result in additional tax due and owing; and (2) the government is unable to prove the amount of tax due and owing. Where the government seeks an alternative to § 7206(1) because it is unable to prove that a false statement is material under the *Warden* definition, it is unlikely the government will be able to prove intent to evade taxes because the impact would be minimal, if any, on the amount of tax due and owing. Further, to the extent that the material false statement impacts a non-additive aspect of a tax return, prosecution would not be possible under § 7201.

### ***B. Section 7203 as an Alternative for Prosecution***

Prosecution under 26 U.S.C. § 7203 requires proof that a person required by law to do so willfully failed to: (1) file a return; (2) keep records; (3) supply information; or (4) pay any estimated tax or tax due.<sup>95</sup> A person found guilty of violating § 7203 may be fined up to \$25,000 and/or imprisoned for up to one year, and assessed the costs of prosecution.<sup>96</sup> In the case of a corporation, the maximum fine increases to \$100,000.<sup>97</sup> Unlike tax evasion under § 7201 and false statements under § 7206, violation of § 7203 is a misdemeanor offense.<sup>98</sup> Similar to § 7206, proof of a tax deficiency is not a required element.<sup>99</sup> Although § 7203 provides a mechanism for prosecuting failure to keep records or supply information, most

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General stated that “it is now the Tax Division’s policy that a lesser included offense instruction is not permissible, since evasion may be established without proof of the filing of a false return.” Memorandum from James A. Bruton, Acting Assistant Attorney Gen. Tax Div., Lesser Included Offenses in Tax Cases (Feb. 12, 1993) (citing *Schmuck v. United States*, 489 U.S. 705 (1989)), available at <http://www.usdoj.gov/tax/readingroom/2001ctm/03ctax.htm#policy%20change>. In *Schmuck*, the United States Supreme Court adopted the elements test to lesser-included offenses, holding that one offense is not a lesser-included offense unless the elements of the lesser offense are a subset of the required elements of the charged offense. 489 U.S. at 716.

91. 26 U.S.C. § 7201.

92. *Id.*

93. See 18 U.S.C.S. app. §§ 2T1.1(a)(1), 2T4.1.

94. *See id.*

95. 26 U.S.C. § 7203 (2000).

96. *Id.*

97. *Id.*

98. *Id.*

99. *Spies v. United States*, 317 U.S. 492, 496 (1943) (“[T]he willful failure to make a return, keep records, or supply information when required, is made a misdemeanor, without regard to existence of a tax liability.” (citation omitted)).

prosecutions under this statute arise out of a failure to file a return or failure to pay taxes.<sup>100</sup>

Because the act of submitting a false statement necessarily requires either the filing of, or delivery of, a return to an intermediary responsible for filing the return, it would only be possible to charge such an act under § 7203 as willful failure to supply information or pay taxes. In the case of a willful failure to supply information, only an omission, as opposed to a misrepresentation, could be prosecuted under § 7203. Arguably, a false statement that results in a tax deficiency could also be prosecuted under this section as a willful failure to pay tax. In such situation, however, prosecution under § 7201 would also be possible.<sup>101</sup> Generally where a tax return is filed, but the taxpayer fails to pay the tax legally due, prosecution under § 7201 or § 7203 may be possible, depending on whether the government is able to prove an affirmative act of tax avoidance.<sup>102</sup> Because the penalty ascribed to § 7201 is significantly greater than § 7203, and a false statement made to reduce a taxpayer's tax obligation is necessarily an affirmative act of tax avoidance, it is unlikely the government would opt to prosecute under § 7203.

### *C. Section 7212(a) as an Alternative for Prosecution*

Prosecution under 26 U.S.C. § 7212(a) is perhaps the most viable option as its goal is to penalize those who obstruct or impede government agents, rather than to merely evade taxes. For this reason, a more in-depth analysis of the statute and its potential applicability is warranted.

Section 7212(a) prohibits: (1) threats or forcible endeavors designed to interfere with United States agents acting under the authority of Title 26; and (2) any act that either corruptly obstructs or impedes, or endeavors to obstruct the due administration of the IRC.<sup>103</sup> It is the second provision, referred to as the "omnibus" clause or provision, that appears to be the most likely alternative for prosecution of false statements. In interpreting this clause as a broad enforcement tool, the Eleventh Circuit stated:

In a system of taxation such as ours which relies principally upon self-reporting, it is necessary to have in place a comprehensive statute in order to prevent taxpayers and their helpers from gaining unlawful benefits by employing that "variety of corrupt methods" that is "limited only by the imagination of the criminally inclined."<sup>104</sup>

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100. U.S. DEP'T OF JUSTICE CRIMINAL TAX MANUAL § 10.02 (2001), available at <http://www.usdoj.gov/tax/readingroom/2001ctm/titlepg.htm> [hereinafter CRIMINAL TAX MANUAL].

101. Compare 26 U.S.C. § 7201, with 26 U.S.C. § 7203.

102. CRIMINAL TAX MANUAL, *supra* note 100, § 10.05[2].

103. See *id.* § 17.02.

104. *United States v. Popkin*, 943 F.2d 1535, 1540 (11th Cir. 1991) (quoting *United States v. Martin*, 747 F.2d 1404, 1409 (11th Cir. 1984)).



In prosecuting a matter under the omnibus clause of § 7212(a), the government must establish that the defendant (1) corruptly (2) endeavored (3) to obstruct or impede the due administration of the IRC.<sup>105</sup>

### 1. Defining “Corruptly”

In *United States v. Reeves*, the Fifth Circuit defined “corruptly” as an act done with the intent to secure an unlawful advantage or benefit for one’s self or for another.<sup>106</sup> The court in *Reeves* went on to state that “[s]ection 7212(a) is directed at efforts to bring about a particular advantage such as impeding collection of one’s taxes, the taxes of another, or the auditing of one’s or another’s tax records.”<sup>107</sup> Courts have since expanded the definition of corruptly to include efforts to bring about financial gain.<sup>108</sup>

### 2. Defining “Endeavor”

Courts interpreting “endeavor” under § 7212(a) have generally looked to cases interpreting endeavor in the context of 18 U.S.C. § 1503.<sup>109</sup> Specifically, the Eleventh Circuit defined endeavor as any effort undertaken to accomplish the “evil purpose that section was intended to prevent.”<sup>110</sup> The court in *Reeves* validated this definition while considering the meaning of “corruptly.”<sup>111</sup> The court noted that to define corruptly as “‘intentionally’ or ‘with improper motive, or bad or evil purpose,’” would result in corruptly being “absorbed into the meaning of ‘endeavor.’”<sup>112</sup> This is just the sort of reading a common canon of statutory interpretation, the rule against surplusage, seeks to avoid; courts strive to give independent meaning to each word in a statute, so “corruptly” and “endeavor” merit separate interpretations.<sup>113</sup> Although most instances of endeavoring to impede or obstruct the administration of the tax code commonly involve direct action against government officials, courts have also allowed prosecution of persons engaged in conduct not specifically targeting officials, including preparation and filing of false tax forms.<sup>114</sup> Courts have also held that a defendant

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105. *United States v. Williams*, 644 F.2d 696, 699 (8th Cir. 1981).

106. *United States v. Reeves*, 752 F.2d 995, 1001 (5th Cir. 1985); *see also United States v. Kelly*, 147 F.3d 172, 177 (2d Cir. 1998); *United States v. Wilson*, 118 F.3d 228, 234 (4th Cir. 1997); *United States v. Hanson*, 2 F.3d 942, 946 (9th Cir. 1993); *Popkin*, 943 F.2d at 1540.

107. *Reeves*, 752 F.2d at 998.

108. *E.g.*, *United States v. Dykstra*, 991 F.2d 450, 453 (8th Cir. 1993).

109. *United States v. Martin*, 747 F.2d 1404, 1409 (11th Cir. 1984).

110. *Id.* (quoting *Osborn v. United States*, 385 U.S. 323, 333 (1966)).

111. *Reeves*, 752 F.2d at 998.

112. *Id.*

113. WILLIAM N. ESKRIDGE ET AL., *CASES AND MATERIALS ON LEGISLATION: STATUTES AND THE CREATION OF PUBLIC POLICY* 833 (3d ed. 2002).

114. *United States v. Williams*, 644 F.2d 696, 701 (8th Cir. 1981) (holding that assisting in the preparation and filing of false W-4 forms “constitutes an endeavor to impede or obstruct the due administration of the Internal Revenue Code”).

need not be successful in his efforts; the mere act of undertaking to obstruct or impede the due administration of tax laws is sufficient.<sup>115</sup>

3. *Existence of a Pending, Known Action—a de facto Element Under § 7212(a)*

Although the text of § 7212(a) does not explicitly state that there must be a pending IRS action of which the defendant is aware, the Sixth Circuit, applying the reasoning of *United States v. Aguilar*,<sup>116</sup> adopted such requirement.<sup>117</sup> In *Aguilar*, the Supreme Court held that under 18 U.S.C. § 1503 there must be both a known judicial proceeding and a nexus between the act of obstruction and the judicial proceeding.<sup>118</sup> The Sixth Circuit in *Kassouf* did not disavow or overrule holdings reached prior to *Aguilar*, nor did the court explicitly require knowledge of a pending action as a prerequisite going forward.<sup>119</sup> Instead, concerned with the speculative nature of the obstructive conduct, the court held that under the facts of that case, “permitting the IRS to impose liability for conduct [that] was legal (such as a failure to maintain records) and occurred long before an IRS audit, or even a tax return was filed . . . would open [individuals] up to a host of potential liability [for] conduct that is not specifically proscribed.”<sup>120</sup> Accordingly, the Sixth Circuit dismissed the single count of obstruction under § 7212(a), which alleged that *Kassouf* failed to keep appropriate records detailing the use of his partnerships and corporate partners to conduct transactions for his personal benefit.<sup>121</sup> The count also alleged that *Kassouf* took specific actions to make it more difficult to discover and trace his activities by transferring funds between accounts prior to making expenditures, and purposefully misleading the IRS by filing returns that did not disclose such transactions, bank accounts and other assets, or the interest earned on those accounts.<sup>122</sup> The court, however, was unwilling to find constructive or actual knowledge in these actions.

4. *United States v. Bowman: A Reprieve From Kassouf?*

If this holding represented the majority rule, prosecution of false statements in a tax return under § 7212(a) would effectively be prohibited because few taxpayers are aware of a pending investigation or action until an indictment is obtained. Further, the requisite proof that the defendant had actual knowledge of a pending action at the time the alleged conduct occurred often sits solely within the mind of the defendant. Fortunately, neither a majority of circuits, nor the Sixth Circuit, which decided *Kassouf*, fully accept the requirement that there be a

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115. *United States v. Rosnow*, 977 F.2d 399, 410 (8th Cir. 1992) (holding defendant's actions committed with intent to impede was sufficient to sustain charge under § 7212(a)); *see also United States v. Wells*, 163 F.3d 889, 897 (4th Cir. 1998).

116. 515 U.S. 593 (1995).

117. *United States v. Kassouf*, 144 F.3d 952, 957 (6th Cir. 1998).

118. *Aguilar*, 515 U.S. at 599.

119. *Kassouf*, 144 F.3d at 957.

120. *Id.*

121. *Id.* at 953.

122. *Id.*

pending proceeding of which the defendant is aware.<sup>123</sup> In 1999, one year after *Kassouf*, the Sixth Circuit expressly limited its holding in *Kassouf* to the particular facts of the case.<sup>124</sup> In *United States v. Bowman*, the defendant was found guilty of “corruptly endeavoring to obstruct or impede the due administration of the Internal Revenue laws in violation of 26 U.S.C. § 7212(a),” in addition to violation of 26 U.S.C. § 7206(1) and 27 § U.S.C. 7203.<sup>125</sup> On appeal, Bowman argued that the District Court wrongly decided his motion for dismissal, as the government did not prove that there was a pending IRS action against him of which he was aware at the time of the alleged conduct.<sup>126</sup> The court rejected this argument, noting that failure to limit the applicability of *Kassouf* would prevent the government from prosecuting actions whose sole purpose was to obstruct or impede the IRS in the administration of its duties, as such acts of obstruction only trigger or attempt to trigger investigations by the IRS.<sup>127</sup> In arriving at its opinion, the court identified three factors for determining whether to apply the holding in *Kassouf*.<sup>128</sup> Specifically, the court considered: (1) whether the act is legal when undertaken; (2) the speculative nature of the obstructive conduct; and (3) whether the response or action the obstructive conduct is designed to cause is of a routine nature.<sup>129</sup> In applying these factors, the court held that the act of filing false forms with the IRS for the purpose of causing the IRS to initiate an action against a taxpayer would not be subject to the holding in *Kassouf*.<sup>130</sup> The court noted that the filing of a false tax form is not legal when undertaken, the conduct was not speculative as it was specifically designed to cause a particular action by the IRS, and the action it was designed to cause—the audit of victimized taxpayers—is not routine.<sup>131</sup>

Applying these factors to a false statements matter that does not misstate the amount of tax due and owing of the taxpayer filing the return, however, is likely to prove problematic for the government. Take, for example, a taxpayer who submits a return that shows the correct amount due, yet conceals the illegal source of income. As concealing the source of income from the government is itself illegal, the first factor is easily satisfied.

With respect to the speculative nature of the defendant’s conduct, the court in *Kassouf* noted:

[T]here is no guarantee that a particular tax return will be audited. Therefore, it would be highly speculative to find conduct such as the destruction of records, which might or might not be needed, in an

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123. See *United States v. Bowman*, 173 F.3d 595, 600 (6th Cir. 1999); *United States v. Kuball*, 976 F.2d 529, 531 (9th Cir. 1992); *United States v. Molesworth*, 383 F. Supp. 2d 1251, 1253–54 (D. Idaho 2005).

124. *Bowman*, 173 F.3d at 600.

125. *Id.* at 596.

126. *Id.* at 599.

127. *Id.*

128. *Id.*

129. *Id.*

130. *Id.*

131. *Id.*

audit which might or might not ever occur, is sufficient to make out an omnibus clause violation.<sup>132</sup>

Consequently, an allegation under § 7212(a) that includes lawful and routine conduct as a foundation for the obstruction charge because such conduct makes the IRS's job more difficult in the event of an audit would likely fail the second factor. The deliberate concealment of the nature and source of income, however, is not lawful conduct, nor is it routine conduct. Further, unlike conduct solely designed to make an audit more difficult, the act of concealing the source of income also seeks to obstruct other law enforcement agencies. Although the concealment of the nature and source of income does not have the same clear cause and effect as that in *Bowman*,<sup>133</sup> the deliberate, illegal, and non-routine nature of the conduct likely satisfies the second factor.

Unlike the first two factors, application of the third factor is likely to be problematic. In *Bowman*, the defendant's conduct was intended to cause a non-routine action on the part of the IRS (an audit of a third party taxpayer). In contrast, the taxpayer who deliberately conceals the nature and source of his own income intends to impede the IRS should an audit of his tax returns occur. While *Kassouf* did not identify what actions were routine under Title 26, the court in *Bowman* held that an audit of a third-party victim was not a routine action, suggesting that perhaps an audit of the person in question or his corporation might be considered routine.<sup>134</sup>

##### 5. *An Alternative View—Kassouf Misinterprets and Misapplies Aguilar*

Given the unclear answer that results from applying the factors set forth in *Bowman*, the better argument for the government would be that the *Kassouf* opinion was founded upon faulty reliance on and application of *Aguilar*, in which the Supreme Court imposed a nexus requirement under 18 U.S.C. § 1503.<sup>135</sup> Although both § 1503 and § 7212 are obstruction statutes, the language used in § 7212 is broader than that used in § 1503.<sup>136</sup> As alluded to in *United States v. Popkin*, § 7212 was drafted using broad language to address the varied ways in which a person might seek to impede or obstruct the administration of internal revenue laws.<sup>137</sup> Further, § 7212 was enacted after § 1503; if Congress wanted §

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132. *United States v. Kassouf*, 144 F.3d 952, 958 (6th Cir. 1998).

133. In *Bowman*, the defendant instituted civil suits against certain creditors alleging violation of his civil rights. 173 F.3d at 597. He would then file a W-9 request for the creditor's tax identification numbers. *Id.* Subsequently, he would send a bill to the parties for the fines *Bowman* believed were due as a result of his lawsuits against the parties. *Id.* When the bills were not paid, *Bowman* then submitted a bill of forgiveness to each of the parties, forgiving the debt due and claiming such forgiveness constituted income to the parties. *Id.* *Bowman* then prepared 1099 form and filed them with the Internal Revenue Service. *Id.*

134. *Id.* at 600.

135. *United States v. Aguilar*, 515 U.S. 593, 599 (1995).

136. Compare 18 U.S.C. § 1503(a) (2000) with 26 U.S.C. § 7212(a) (2000).

137. 943 F.2d 1535, 1540 (11th Cir. 1991). In *Popkin* the defendant was convicted of violating 26 U.S.C. § 7212(a) for preparing false income tax returns on behalf of a client, and for assisting the same client in establishing a corporation to disguise the

7212 to be interpreted in the same way as § 1503, Congress would have used identical language.<sup>138</sup> In addition, precedent exists that rejects the application of interpretations under § 1503 to the terms and phrases in § 7212.<sup>139</sup> In *Reeves*, the Fifth Circuit rejected the government's argument that the definition of "corruptly" under § 1503 should be used to define "corruptly" under § 7212.<sup>140</sup>

Furthermore, there does not appear to be broad support for the holding in *Kassouf*, as evidenced by the limitations imposed in *Bowman*, as well as the fact that no other circuit has adopted the holding in *Kassouf*. In fact, prior to *Kassouf* several circuits allowed prosecution under § 7212 where there was no pending investigation or proceeding at the time of the defendant's conduct.<sup>141</sup> In addition, since *Kassouf* was decided, the Ninth Circuit and the District Court in Idaho have decided cases under § 7212 in which there was no pending investigation or proceeding. In both cases, the courts allowed prosecution to go forward.<sup>142</sup>

Although prosecution under the omnibus clause of § 7212(a) might be possible, such prosecution would be an uphill battle. Thus, absent the ability to prosecute a taxpayer for false statements that do not result in incremental tax due and owing under § 7206, the government is left solely with civil sanctions or prosecution under Title 18.

#### IV. CIVIL SANCTIONS AS AN ALTERNATIVE TO CRIMINAL PROSECUTION OF FALSE STATEMENTS

In addition to the criminal sanctions provided by the IRC, a taxpayer can also be subject to civil sanctions.<sup>143</sup> Civil tax penalties include failure to file a tax

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character of his client's drug related income and to repatriate such income from a foreign bank account. *Id.* at 1536–37. On appeal, the defendant argued that the conduct alleged by the government did not constitute a crime under § 7212(a) as he neither made threats nor used force against the Internal Revenue Service. *Id.* at 1537–38. The Eleventh Circuit rejected the defendant's argument holding that the use of threats or force was not a required element under § 7212(a), and further that Congress intended the statute to encompass a broad range of activities. *Id.* at 1539–40.

138. The Whole Act Rule—a tool of statutory interpretation—bolsters this conclusion: the rule (or presumption of consistent usage) assumes that when Congress uses the same words, it intends a consistent meaning, and when Congress chooses a different phrasing, it encourages courts to interpret those phrases in dissimilar ways. *See* ESKRIDGE, *supra* note 113, at 833–35.

139. *United States v. Reeves*, 752 F.2d 995, 999–1000 (5th Cir. 1985).

140. *Id.*

141. *See* *United States v. Hanson*, 2 F.3d 942, 946–47 (9th Cir. 1993); *United States v. Mitchell*, 985 F.2d 1275, 1276–79 (4th Cir. 1993); *United States v. Kuball*, 976 F.2d 529, 531 (9th Cir. 1992); *Popkin*, 943 F.2d at 1540–41; *United States v. Williams*, 644 F.2d 696, 697–701 (8th Cir. 1981).

142. *United States v. Massey*, 419 F.3d 1008, 1010 (9th Cir. 2005) (holding government not required to prove that the defendant was aware of a pending investigation, it was sufficient that the defendant hoped to benefit financially from the conduct); *United States v. Molesworth*, 383 F. Supp. 2d 1251, 1253–54 (D. Idaho 2005) (holding *Kassouf* is limited to its particular facts, as such the filing of false forms with the Internal Revenue Service is a proper allegation under 26 U.S.C. § 7212).

143. 26 U.S.C. §§ 6651–6658, 6662–6664 (2000).

return or to pay tax, imposition of accuracy-related penalty on underpayments, and imposition of fraud penalty.<sup>144</sup> There are two significant drawbacks to the use of civil sanctions as an alternative to criminal prosecution: (1) the definition of fraud is driven by case law and is dependent on finding objective manifestations of a specific intent to evade taxes,<sup>145</sup> and (2) unlike criminal tax sanctions that may result in imprisonment and/or fines, civil sanctions result solely in fines.<sup>146</sup>

### *A. Defining Fraud in a Civil Context*

The definition of fraud is case law driven because the IRC does not specifically define the term fraud. Case law defines fraud as “‘actual, intentional wrong-doing, and the intent required is specific purpose to evade a tax believed to be owing.’”<sup>147</sup> Further, the IRS instructs that fraud penalties should only be applied in instances where there is evidence of “misrepresentation of material facts,” “silence when good faith requires expression,” false or altered documents, evasion, or conspiracy.<sup>148</sup> Such evidence must rise to a clear and convincing standard.<sup>149</sup> Thus, underpayment of taxes due to negligence is not sufficient to impose a civil fraud penalty.<sup>150</sup>

### *B. Civil Fraud Penalties—an Effective Deterrent?*

The Tax Reform Act of 1986 substantially changed the civil fraud penalties the government could levy against taxpayers.<sup>151</sup> Prior to the 1986 Act, the civil fraud penalty was 50% percent of the entire underpayment of tax, plus 50% of the interest on the portion of underpayment resulting from fraud.<sup>152</sup> Under that penalty scheme, no allowance was made for nonfraudulent items.<sup>153</sup> Therefore, even if the fraudulent aspect of the underpayment was only a very small fraction of

144. 26 U.S.C. §§ 6651, 6662–6663. For a complete view of all Internal Revenue Code civil provisions, see 26 U.S.C. §§ 6651–6658, 6662–6664.

145. IAN M. COMISKY, LAWRENCE S. FELD & STEVEN M. HARRIS, *TAX FRAUD AND EVASION* ¶ 8.02[3] (2007). Such objective manifestations are often referred to as badges or indicia. *Id.* Although there is no standard definition of fraud, the Internal Revenue Service distinguishes fraud from “inadvertence, reliance on incorrect technical advice, honest difference of opinion, negligence or carelessness.” INTERNAL REVENUE SERV., *FRAUD HANDBOOK* 25.1.6.1(3) (2003), available at <http://www.irs.gov/irm/part25/index.html>.

146. 26 U.S.C. §§ 6651–6658, 6662–6664.

147. *Zell v. Comm’r*, 763 F.2d 1139, 1142–43 (10th Cir. 1985) (quoting *Mitchell v. Comm’r*, 118 F.2d 308, 310 (5th Cir. 1941)).

148. INTERNAL REVENUE SERV., *supra* note 145, at 25.1.1.2, 25.1.2.2, 25.1.6.1.

149. *Id.* at 25.1.6.1(3).

150. *Williams v. Comm’r*, 13 T.C.M. (CCH) 1053, 1056 (1954). Although civil fraud penalties do not apply, a negligence penalty of 20% of the underpayment may. COMISKY, *supra* note 145, ¶ 8.02[7].

151. Tax Reform Act of 1986, Pub. L. No. 99-514, § 1503(a), 100 Stat. 2085, 2742–43.

152. COMISKY, *supra* note 145, ¶ 8.02[2]. Such penalty applied to tax returns due between September 3, 1982 and January 1, 1987. *Id.* Prior to September 3, 1982, the civil fraud penalty was 50% of the amount of the entire tax underpayment; no interest penalty was available. *Id.*

153. *Id.*

the total underpayment, the entire amount was subject to the 50% penalty.<sup>154</sup> Only the interest portion of the penalty was tied to the specific amounts arising from the fraud.<sup>155</sup>

Today, the penalty associated with filing a fraudulent return under 26 U.S.C. § 6663 is “75 percent of the portion of the underpayment which is attributable to fraud.”<sup>156</sup> Accuracy-related penalties under 26 U.S.C. § 6662 are calculated as 20% of the amount of the underpayment attributable to the conduct penalized.<sup>157</sup> A taxpayer that fails to pay tax when due is subject to a penalty under 26 U.S.C. § 6651 of 0.5% per month up to 25% of the tax due and owing as shown on the return.<sup>158</sup>

Where a false statement results in an overpayment of tax or is tax neutral, no civil sanction is imposed, as the amount of tax due to the government provides the basis for calculating civil sanctions. Consequently, there is no civil deterrent to submitting a tax return containing false statements that impede the ability of the IRS to perform its functions, such as false statements aimed at concealing the nature or source of income.

## V. OTHER OPTIONS UNDER THE CRIMINAL PROVISIONS OF TITLE 18

In addition to the sanctions available under the IRC, the government arguably could prosecute a taxpayer for false statements made in a return under the Criminal Code. In particular, the government could pursue charges under the federal false statements statute (18 U.S.C. § 1001),<sup>159</sup> mail fraud statute (18 U.S.C. § 1341),<sup>160</sup> wire fraud statute (18 U.S.C. § 1343),<sup>161</sup> and/or conspiracy statute (18 U.S.C. § 371).<sup>162</sup>

### A. 18 U.S.C. § 1001 as an Alternative

Pursuit of a false statements charge under 18 U.S.C. § 1001 is perhaps the most viable option, as § 1001 is the most flexible of the alternatives, covering a

154. *Id.*

155. *Id.*

156. 26 U.S.C. § 6663(a) (2000). The changes in civil penalties under the Tax Reform Act of 1986 occurred in two phases. The first phase, for returns due after December 31, 1986 and before January 1, 1989, resulted in penalties calculated as 75% of the underpayment due to fraud, plus 50% of the interest payable on the portion of the underpayment due to fraud. COMISKY, *supra* note 145, ¶ 8.02[2]. It was only for returns due after December 31, 1988, that the second and final phase of the changes in penalties applied. *Id.*

157. 26 U.S.C. § 6662(a) (2000).

158. 26 U.S.C. § 6651(a)(2) (2000).

159. *See United States v. Gordon*, 548 F.2d 743, 744–45 (8th Cir. 1977) (noting that “courts have consistently held that prosecution under section 1001 is permissible even in view of other overlapping and more specific false statements statutes”).

160. *See United States v. Miller*, 545 F.2d 1204, 1216 n.17 (9th Cir. 1976) (mailing of false returns is a violation of 18 U.S.C. § 1341).

161. *See infra* Part V.B.

162. *United States v. Klein*, 247 F.2d 908 (2d Cir. 1957).

wide range of criminal activity including fraud, perjury, obstruction of justice, and false statements. In the context of false statements made in a tax return, § 1001 provides the government with the ability to pursue a claim without having to prove that the statement was made to defraud the government out of money or property. Consequently, the lack of a tax deficiency loses importance and makes prosecution for a false statement that does not result in a tax loss to the government permissible.

To sustain a fraud or false statements charge under § 1001, the government must prove:

- (a) the defendant either made or used a false or fraudulent statement, representation or writing; or falsified, or affirmatively concealed or covered up by trick, scheme, or device, a fact that the defendant had a legal duty to disclose;
- (b) the false statement or information concealed was “material”;
- (c) the subject-matter involved was within “jurisdiction”;
- (d) of the executive, legislative, or judicial branch of the Government of the United States (as those terms are qualified in § 1001(b), (c); and
- (e) in so doing, the defendant acted “knowingly and willfully.”<sup>163</sup>

Unlike the definition of materiality under 26 U.S.C. § 7206, there is no controversy in defining materiality under 18 U.S.C. § 1001. As previously noted, the United States Supreme Court defines materiality in the context of § 1001 as any statement having “‘a natural tendency to influence, or [be] capable of influencing, the decision of the decisionmaking body to which it was addressed.’”<sup>164</sup> Thus, in a false statements case, the government must prove that the taxpayer had the specific intent to mislead the IRS, but it need not prove that the taxpayer did so in order to deprive the government of money or property.<sup>165</sup> Where a taxpayer is accused of concealing the source of income or providing a false social security number, § 1001 provides the requisite flexibility to pursue false statement charges.

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163. JULIE R. O’SULLIVAN, *FEDERAL WHITE COLLAR CRIME CASES AND MATERIALS* 212 (1st ed. 2001); see also *United States v. Puente*, 982 F.2d 156, 158 (5th Cir. 1993) (holding government must prove: “‘(1) a statement, that is (2) false (3) and material, (4) made with the requisite specific intent, [and] (5) within the purview of the government agency jurisdiction’” (quoting *United States v. Lichenstein*, 610 F.2d 1272, 1276 (5th Cir. 1980))).

164. *United States v. Gaudin*, 515 U.S. 506, 509 (1995) (quoting *Kungys v. United States*, 485 U.S. 759, 770 (1988)).

165. In *Friedman v. United States*, the Eighth Circuit specifically held that 18 U.S.C. § 1001 is violated by making false statements that frustrate lawful regulation. 374 F.2d 363, 368 (8th Cir. 1967) (citing *United States v. Gilliland*, 312 U.S. 86 (1941); *Brethauer v. United States*, 333 F.2d 302 (8th Cir. 1964); *Gonzales v. United States*, 286 F.2d 118 (10th Cir. 1960); *Rolland v. United States*, 200 F.2d 678 (5th Cir. 1953); *United States v. Moore*, 185 F.2d 92 (5th Cir. 1950); *Terry v. United States*, 131 F.2d 40 (8th Cir. 1942)).



A person convicted under § 1001 is subject to fine and/or imprisonment for no more than five years.<sup>166</sup> The actual term of imprisonment is calculated by applying the factors set forth in the federal sentencing guidelines. Similar to 26 U.S.C. § 7206(1), the sentence imposed is determined in part based on the amount of the loss. In addition, the base level offense may increase due to the number of victims, the use of sophisticated means, or a number of other reasons.<sup>167</sup> For illustrative purposes, assume that a taxpayer's use of false statements does not result in a tax loss, but that such statements are made using sophisticated means. In such situation, the offense level that results is a twelve.<sup>168</sup> Further, assuming a criminal history of I, the resulting sentence is a range of 10–16 months;<sup>169</sup> a sentencing range just below that available under 26 U.S.C. § 7206(1) assuming a similar set of facts.

### ***B. 18 U.S.C. § 1341 or § 1343 as an Alternative***

In 2004, the Tax Division of the Department of Justice quietly signaled a significant change in the Department's willingness to charge wire and mail fraud under Title 18 in tax-related prosecutions. This shift came in the form of Tax Directive No. 128, which replaced Tax Directive No. 99. Under the new directive, the Tax Division

may approve mail fraud, wire fraud or bank fraud charges in tax-related cases involving schemes to defraud the government or other persons if there was a large fraud loss *or a substantial pattern of conduct* and there is *a significant benefit to bringing the charges instead of or in addition to Title 26 violations*. Absent unusual circumstances, however, the Tax Division will not approve mail or wire fraud charges in cases involving only one person's tax liability, or when all submissions to the IRS were truthful.<sup>170</sup>

Tax Directive No. 99 largely prohibited prosecutors from charging defendants under Title 18 fraud statutes where use of the mails or wires was not central to the underlying tax violation.<sup>171</sup>

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166. 18 U.S.C. § 1001(a) (Supp. IV 2004).

167. See 18 U.S.C.S. app. § 2B1.1(b) (LexisNexis 2007).

168. See *id.* § 2B1.1(b)(9).

169. See 18 U.S.C.S. app. § 5A (LexisNexis 2007). According to the sentencing guidelines, a person who received less than two criminal history points qualifies for a criminal history of I. In effect this means that person has committed no more than one offense for which a conviction was obtained but the sentence received was less than 60 days. *Id.* § 4A1.1.

170. U.S. DEP'T OF JUSTICE TAX DIVISION, DIRECTIVE NO. 128 CHARGING MAIL FRAUD, WIRE FRAUD OR BANK FRAUD ALONE OR AS PREDICATE OFFENSES IN CASES INVOLVING TAX ADMINISTRATION (2004), available at [http://www.usdoj.gov/usao/eousa/foia\\_reading\\_room/usam/title6/tax00014.htm](http://www.usdoj.gov/usao/eousa/foia_reading_room/usam/title6/tax00014.htm) (citations omitted) (emphasis added).

171. Ian M. Comisky & Matthew D. Lee, *New Policy Encourages More Aggressive Prosecution of Tax Cases*, WHITE COLLAR LITIGATION, available at <http://www.blankrome.com/siteFiles/Publications/1C488C13FB25B7142B28B37CB7B6FA53.pdf> (last visited Jan. 26, 2008).

Consequently, it is likely prosecutors will look to charge violations of Title 18 in conjunction with, or instead of, violations under the IRC.<sup>172</sup> Section 1343 of Title 18 of the United States Code, generally referred to as the Federal Wire Fraud statute, provides, in part, that:

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate . . . commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined under this title or imprisoned not more than 20 years, or both.<sup>173</sup>

Thus, to sustain a charge of wire or mail fraud, the government need only prove that the defendant: (1) knowingly and willfully devised or participated in a scheme to defraud; (2) participated in such scheme with the specific intent to defraud; and (3) used the interstate wires or mail for purposes of executing the scheme.<sup>174</sup> Therefore, in the context of the filing of a tax return that includes false statements, the government must establish that the defendant: (1) knowingly and willfully devised or participated in a scheme to defraud the IRS, through the use of material false statements;<sup>175</sup> (2) made such false statements with the specific intent to defraud the IRS; and (3) filed the tax return online thereby using interstate wires or filed the tax return by use of the mail.

Where a false statement in a tax return is made with the specific intent to defraud the government of tax revenue, then clearly the intent and defraud aspects of the statute are met. Where the intent is not to obtain or secure a monetary benefit, the intent and defraud aspects are less apparent as the vast majority of wire and mail fraud cases likely involve a scheme to defraud persons or the government of money or property. Case law exists, however, that supports the assertion that

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172. Significantly, use of wire or mail fraud statutes presents prosecutors with another tool—RICO and money laundering sanctions. Although offenses under Title 26 are not predicates for RICO or money laundering enforcement actions, wire and mail fraud are. A RICO violation allows prosecutors to seek forfeiture of any proceeds resulting from the fraud scheme even if the scheme did not impact the amount of tax due and payable. *Id.*

173. 18 U.S.C. § 1343 (Supp. II 2002). The elements required in the offenses of mail and wire fraud are essentially the same; the variation between the two statutes being the use of the mail versus the use of wires (i.e., internet or e-mail). *United States v. Lemire*, 720 F.2d 1327, 1334 n.6 (D.C. Cir. 1983). To avoid repetition, the use of 18 U.S.C. § 1341 and § 1343 to prosecute false statement charges are addressed together.

174. *Miller v. Yokohama Tire Corp.*, 358 F.3d 616, 620 (9th Cir. 2004); *United States v. Sawyer*, 85 F.3d 713, 723 (1st Cir. 1996).

175. *United States v. Reid*, 533 F.2d 1255, 1265 (D.C. Cir. 1976) (holding a “material false statement contained in a document sent through the mails clearly constitutes a fraudulent misrepresentation and violation of [18 U.S.C. § 1341]”). In the context of wire and mail fraud, the United States Supreme Court in *Neder v. United States* adopted the *Gaudin* definition of materiality. 527 U.S. 1, 16 (1999) (stating “a false statement is material if it has ‘a natural tendency to influence, or [is] capable of influencing, the decision of the decisionmaking body to which it was addressed’” (quoting *United States v. Gaudin*, 515 U.S. 506, 509 (1995))).

under the wire and mail fraud statutes, the government is not required to prove the defendant intended to defraud the victim of money or property;<sup>176</sup> instead the government need only prove a generic intent to defraud.<sup>177</sup> Borrowing from such case law, it appears that prosecution of taxpayers who make tax-neutral material false statements, with the specific intent to deceive the IRS, is permissible.

Under the statutes, a person convicted of wire or mail fraud is generally subject to fine and/or imprisonment for up to twenty years.<sup>178</sup> A conviction under either 18 U.S.C. § 1341 or § 1343 applies the same sentencing guidelines as a conviction under 18 U.S.C. § 1001.<sup>179</sup> Thus, assuming that a taxpayer's use of false statements does not result in a tax loss, but that such statements are made using sophisticated means, a conviction under either the mail or wire fraud statutes results in an offense level of twelve.<sup>180</sup> Again, assuming a criminal history of I, the resulting sentence is a range of 10–16 months.<sup>181</sup>

Prosecution under the federal wire and mail fraud statutes requires proof of additional elements that are not required under the federal false statements statute (18 U.S.C. § 1001), including: (1) proof of a scheme or artifice to defraud, and (2) use of the interstate wires or mail.<sup>182</sup> Based on such additional proof requirements and the fact that the sentence resulting from a conviction under the mail or wire fraud statutes is the same as that under the false statements statute, there is no strategic advantage to pursuing a charge under the mail or wire fraud statutes.

### *C. 18 U.S.C. § 371 as an Alternative, or Supplemental Charge*

Title 18, Section 371 of the United States Code provides, in part, that: “[i]f two or more persons conspire . . . to commit any offense against the United States, . . . and one or more of such persons do any act to effect the object of the conspiracy, . . .” an offense against the United States has been committed.<sup>183</sup> To establish a criminal conspiracy under § 371, the government must prove, beyond a reasonable doubt, that:

- (1) two or more persons formed an agreement either to commit an offense against or defraud the United States;
- (2) the defendant knowingly participated in the conspiracy with the intent to commit at least one of the offenses charged or to defraud the United States;

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176. United States v. States, 488 F.2d 761, 764 (8th Cir. 1973) (holding mail fraud statute “on its face does not preclude a finding that a ‘scheme or artifice to defraud’ need not concern money or property”).

177. See *id.* at 764–65.

178. 18 U.S.C. §§ 1341, 1343 (Supp. II 2002).

179. 18 U.S.C.S. app. § 2B1.1 (LexisNexis 2007).

180. See 18 U.S.C.S. App. § 2B1.1(a)(2), (b)(9).

181. See 18 U.S.C.S. App. § 5A (LexisNexis 2007).

182. Compare 18 U.S.C. §§ 1341, 1343 (2000), with 18 U.S.C. § 1001.

183. 18 U.S.C. § 371.

and (3) at least one overt act was committed in furtherance of the common scheme.<sup>184</sup>

Thus, to use § 371, the government must prove that two or more persons engaged in the scheme to defraud the IRS through filing a tax return that includes false statements. Such requirement adds an additional burden on the government, one that may not be applicable in a great number of cases, especially those in which a taxpayer does not engage the services of, and collude with a tax return professional. Accordingly, the utility of a conspiracy charge as an alternative or supplement to a Title 26 charge is limited.

### CONCLUSION

Given the lack of clarity surrounding the definition of materiality in a prosecution under 26 U.S.C. § 7206(1), and the potential for inconsistent verdicts created by the current circuit split, the Supreme Court should address the split. The current lack of authoritative guidance leaves both prosecutors and defendants in a state of limbo, unsure of how to assess their chances at trial.

Further, the Supreme Court should adopt a definition that at a minimum includes as a component the *DiVarco* definition—that materiality is any item having a natural tendency to influence or impede the IRS in ascertaining the correctness of the tax reported or in verifying or auditing the returns of the taxpayer. Such definition would provide courts with the clear guidance and authority to refuse to admit evidence of offsetting deductions, thereby closing the judicially created loophole that allows taxpayers to argue a lack of tax deficiency in a false statements matter.

Adoption of a definition similar to *Warden* that focuses on the impact of the false statements on tax due and owing unnecessarily allows a tax deficiency to become a *de facto* element of a false statements claim. Such result would significantly weaken the government's prosecution power by making the false statements statute redundant to the tax evasion statute, and effectively send the message to all would-be tax offenders that submitting false information that substantially inhibits the IRS's administrative function is acceptable, provided that no tax loss to the government results. In essence, adopting such definition effectively decriminalizes tax-neutral false statements.

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184. United States v. Treadwell, 760 F.2d 327, 333 (D.C. Cir. 1985); see also United States v. Klein, 247 F.2d 908, 918–19 (2nd Cir. 1957).