National Seminar for Federal Defenders

Baltimore, Maryland
June 2, 2011

Making a Federal Case Out of It –

Innovative Approaches to Working Up Fraud Cases

Panelists:

Larry A. Nathans, Nathans & Biddle, LLP
Robert W. Biddle, Nathans & Biddle, LLP
Caroline D. Ciraolo, Rosenberg | Martin | Greenberg, LLP

Frequently Charged Tax Crimes

Caroline D. Ciraolo
Rosenberg | Martin | Greenberg, LLP
25 S. Charles Street, Suite 2115
Baltimore, Maryland 21201
Ph: 410.547.7852
Fax: 410.727.1115
Email: cciraolo@rosenbergmartin.com

* These materials represent an excerpt of a chapter submitted to Thomson Reuters West for the upcoming publication titled, "White Collar Crimes: Tax Fraud."

Introduction

When does a failure to accurately report income and expense transcend from the civil to the criminal realm? This is a frequent question raised by taxpayers. Put another way, why me and not my neighbor? Well, the Internal Revenue Service's ("the Service" or "IRS") determination that a particular taxpayer's actions rise to the level of a criminal offense is based on a number of factors including whether the government can establish willfulness, an element of most tax crimes.

Concept of Willfulness

In *Cheek v. United States*, 498 U.S. 192 (1991), the Supreme Court set forth the standard for establishing willfulness:

> Willfulness, as construed by our prior decisions in criminal tax cases [i.e., *United States v. Pomponio*, 429 U.S. 10 (1976) and *United States v. Bishop*, 412 U.S. 346 (1973)], requires the Government to prove that the law imposed a duty on the defendant, that the defendant knew of this duty, and that he voluntarily and intentionally violated that duty.

498 U.S. at 201.

The government is not required to prove "bad faith or evil intent" or "evil motive and want of justification," but certainly may introduce such evidence in a tax prosecution. In response, a defendant may attempt to establish a good faith misunderstanding of the law or a good faith belief that he did not violate the law to negate willfulness, even if his belief or misunderstanding is objectively unreasonable. *United States v. Abboud*, 438 F.3d 554, 581 (6th Cir. 2006) ("[b]ecause of the complexity of the tax system, tax law is one of the few areas where the Supreme Court has held that ignorance of the law is a defense.") (citing *Cheek*, 498 at 199-200). On the other hand, a defendant will not be permitted to argue that the Internal Revenue Code ("the Code") is unconstitutional, as that argument simply demonstrates an erroneous conclusion of law and not a good faith belief that the defendant was not willfully violating the law. *See United States v. Beale*, 574 F.3d 512 (8th Cir. 2009); *United States v. Simkanin*, 420 F.3d 397 (5th Cir. 2005).

A related concept in criminal tax prosecutions is "willful blindness." If a defendant challenges willfulness on the grounds that he did not review his return prior to signing and filing, the government may introduce evidence to establish that the defendant acted with a conscious purpose to avoid knowledge of clearly false information reported on the return. In other words, a defendant may not avoid criminal liability by intentionally putting himself in a position where he does not have actual knowledge of the facts. *United States v. Anthony*, 545 F.3d 60, 65-66 (1st Cir. 2008); *United States v. Martin*, 773 F.2d 579, 584 (4th Cir. 1985). Because a refusal to see what is clearly present is inconsistent with a good faith misunderstanding of the law, the government frequently requests willful blindness instructions in criminal tax trials. However, a willful blindness instruction should not be given without evidence that the defendant deliberately ignored relevant facts. *United States v. Miller,* 588 F.3d 897, 905 (5th Cir. 2009); *United States v. Mapelli*, 971 F.2d 284, 285-87 (9th Cir. 1992).

Tax Evasion – 26 U.S.C. § 7201

Under 26 U.S.C. ("IRC") § 7201, a defendant may be charged with the willful attempt to evade or defeat the *assessment* of taxes *or* the *payment* of taxes. The majority of cases under IRC § 7201 fall within the former category, but in recent years, we have seen a growing number of investigations and prosecutions for evasion of payment. A violation of IRC § 7201 is a felony, subjecting defendants to fines of not more than $100,000 ($500,000 in the case of a corporation) and/or imprisonment of not more than 5 years, together with costs of prosecution. To establish evasion of assessment of tax, the government must prove that:

(1) The defendant committed an affirmative act to defeat or evade tax.
(2) There is a material amount of tax due and owing.
(3) The defendant acted willfully.

See United States v. Barker, 556 F.3d 682, 687 (8th Cir. 2009) (citations omitted).

Affirmative Conduct

The courts have viewed the requirement of affirmative conduct broadly. In the seminal case of *Spies v. United States*, 317 U.S. 492 (1943), the Supreme Court provided a nonexclusive list of acts that constitute such affirmative conduct: "keeping a double set of books, making false entries of alterations, or false invoices or documents, destruction of books or records, concealment of assets or covering up sources of income, handling of one's affairs to avoid making the records usual in transactions of the kind, and any conduct, the likely effect of which would be to mislead or to conceal." *Id.* at 499.

A failure to act or omission is not sufficient to establish affirmative conduct. *United States v. McKee,* 506 F.3d 225, 234 (3rd Cir. 2007); *United States v. Meek*, 998 F.2d 776, 779 (10th Cir. 1993) ("An affirmative act requires more than the passive failure to file a tax return; rather, it requires a positive act of commission designed to mislead or conceal."); *United States v. Romano,* 938 F.2d 1569, 1573 (2d Cir. 1991) ("[a taxpayer] cannot be convicted of tax evasion based merely on a willful omission."). However, the failure to file a return coupled with other affirmative conduct to evade tax can be considered as evidence of evasion under IRC § 7201. *United States v. Copeland*, 786 F.2d 768, 770 (7th Cir. 1985).

Additional Tax Due and Owing

The existence of a tax deficiency is a required element of evasion of assessment under IRC § 7201. Even if a defendant intentionally failed to report income and took affirmative steps toward this goal, the defendant must be acquitted of tax evasion if the government is unable to prove that additional tax was owed. Defendants are entitled to introduce evidence that no tax is due, which often results in a criminal prosecution looking a lot like the civil tax case. For example, an owner of a corporation who takes cash out of the register for his own personal use and fails to report that cash as income will not be guilty of tax evasion if the corporation has no earnings and profits and therefore, the funds taken are viewed as a return of the owner's capital, assuming the owner has sufficient basis in the corporation. *United States v. Boulware*, 552 U.S. 421 (2008); *see also Peterson v. United States*, 344 F.2d 419, 427 (5th Cir. 1965).

On the other hand, the government is not required to prove the exact amount of tax due. *United States v. Kaatz*, 705 F.2d 1237, 1246 (10th Cir. 1983); *United States v. Jacob*, 242 F.3d 391 (Table), 2000 WL 1694300 (10th Cir. (N.M.)) (Nov. 13, 2000). Instead, most courts have held that the element of additional tax due and owing is satisfied by proof that the amount due is "substantial." *United States v. Koskerides*, 877 F.2d 1129, 1137 (2d Cir. 1989); *but see United States v. Heath*, 525 F.3d 431 (6th Cir. 2008); *United States v. Daniels*, 387 F.3d 636, 641 (7th Cir. 2004) ("We take this opportunity to clarify the law in this Circuit: the government need not charge a substantial tax deficiency to indict or convict under 26 U.S.C. § 7201.") And of the courts that require proof that the tax due is "substantial," the threshold is fairly low. *See, e.g., United States v. Cunningham,* 723 F.2d 217, 231 (2d Cir. 1983) (tax deficiency of $2,617 deemed substantial); *United States v. Siragusa*, 450 F.2d 592 (2d Cir. 1971) ($3,956, $900 and $2,209 for three successive years found substantial); *United States v. Gross*, 286 F.2d 59 (2d Cir. 1961) ($2,500 in *unreported income* found substantial).

Nor must there have been an actual assessment or even a civil examination conducted by the Internal Revenue Service prior to the commencement of a criminal case. *See United States v. Gustafson*, 528 F.3d 587, 592-93 (8th Cir. 2008); *United States v. Ellet*, 527 F.3d 38 (2d Cir. 2008); *United States v. Daniel*, 956 F.2d 540, 542 (6th Cir. 1992); *United States v. Hogan,* 861 F.2d 312, 315-16 (1st Cir. 1988); *United States v. Dack,* 747 F.2d 1172, 1174-75 (7th Cir. 1984). Defendants often complain that if the Service had simply examined their returns and proposed an additional assessment, they would have paid the amount due. But the government's failure to offer a taxpayer a chance to make things right does not provide the taxpayer with a defense.

Similarly, the filing of an amended return correcting past errors does not eliminate the existence of a deficiency. *United States v. Radtke,* 415 F.3d 829, 840-41 (8th Cir. 2005) ("there is no doubt that self-serving exculpatory acts performed substantially after a defendant's wrongdoing is discovered are of minimal probative value as to his state of mind at the time of the alleged crime."); *Norwitt v. United States*, 195 F.2d 127 (9th Cir. 1952). On the other hand, an amended return will be viewed as an admission of the existence of additional tax due and owing, as required under IRC § 7201.

Defenses

Defendants often labor under a misconception that since most individuals have no love lost for the IRS, juries are likely to acquit a defendant of tax charges barring some outrageous conduct such a drug trafficking or theft from innocent victims. To the contrary, the government enjoys a better than ninety percent conviction rate in federal tax prosecutions. *See* IRS Criminal Investigation Management Information System, http://www.irs.gov/compliance/enforcement/article/0,,id=107484,00.html One reason for this impressive statistic is that while taxpayers may not like the IRS, the idea that another person is getting away with not paying their fair share overrides such animosity. As a result, a defendant proceeding to trial needs to do more than just point out that the IRS is on the other side of the courtroom. They must raise sufficient and credible defenses.

Lack of Willfulness

Unlike most criminal offenses, ignorance or a good faith misunderstanding of the law constitutes a defense to a criminal tax offense. *See United States v. Abboud*, 438 F.3d 554, 581 (6th Cir. 2006) ("[b]ecause of the complexity of the tax system, tax law is one of the few areas where the Supreme Court has held that ignorance of the law is a defense.") (citing *Cheek v. United States,* 498 U.S. 192, 199-200 (1991)).

In *United States v. Simkanin,* 420 F.3d 397 (5th Cir. 2005), Simkanin was convicted of, *inter alia*, failing to collect and pay over employment taxes in violation of IRC § 7202 and failing to file federal income tax returns in violation of IRC § 7203. At trial, Simkanin raised classic, time-worn tax protestor arguments regarding the constitutionality of the internal revenue laws. He contended that the Internal Revenue Code was over 7,000 pages long, contained an extensive list of industries and activities subject to withholding, and since his company did not operate in any of the listed industries or perform any of the listed activities, his workers were not subject to withholding. *Id.* at 405. During deliberations, the jury sent the following note to the judge:

> Since no proof has been made that the defendant and his employees are in an occupation listed in those 7,000 [pages], are we to conclude that they are, in fact, not in that 7,000, or do we need to read all 7,000 to see what the defendant was referring to, and in fact, wasn't listed in the 7,000[?]

Id. The court instructed the jury that Simkanin's company was required to withhold and deposit taxes from its employee's wages and, therefore, they should disregard whether there are certain employers excused from this obligation. *Id.* at 405-06.

Because the judge did not characterize Simkanin's belief of the law when it instructed the jury, the Fifth Circuit found the instruction proper. The court noted that while a defendant may present evidence of what he believed the law to be at the time of his alleged illegal conduct, a court must prevent the defendant's interpretation of the law from confusing the jury as to the actual state of the law. *Simkanin*, 438 F.3d at 404 (*citing United States v. Barnett*, 945 F.2d 1296, 1300 (5th Cir. 1991) ("The jury must know the law as it actually is respecting a taxpayer's duty to file before it can actually determine the guilt or innocence of the accused for failing to file as required.")).

In *United States v. Loglia*, 2007 WL 81925, 99 A.F.T.R.2d 2007-434 (D. Nev.) (January 5, 2007), and *United States v. Kahre*, 2007 WL 119147, 99 A.F.T.R.2d 2007-600 (D. Nev.) (January 5, 2007), Loglia and Kahre were accused of conducting business using gold and silver coins for the purpose of boycotting the Federal Reserve System and evading the assessment and payment of income tax. Rather than report the true value of the coins they received, they only reported the face value of the coins. They were charged with evasion in violation of IRC § 7201, conspiring to attempt to evade or defeat tax in violation of 18 U.S.C. § 371, filing false returns in violation of IRC § 7206(1), and wire fraud in violation of 18 U.S.C. § 1343.

Loglia and Kahre indicated their intent to raise a good faith defense based on their belief that the law permitted them to report their income in this fashion. The government responded with a motion *in limine*, asking the court to preclude the defendants from raising this defense or introducing any evidence in support of their incorrect legal position.

The district court held that Loglia and Kahre could present a good faith defense that they believed they could report the income as they did for the *limited* purpose of negating willfulness. However, the court precluded them from arguing or presenting evidence that their belief was legally correct or that they had a legal right to exclude the value of the coins from income.

Reliance of Accountant

A frequent defense in criminal tax cases is good faith reliance on an accountant or professional tax advisor. This defense requires that the defendant provide his advisors with all necessary information and follow the advice received. *See United States v. Bishop*, 291 F.3d 1100, 1107-1008 (9th Cir. 2002); *United States v. Butler*, 211 F.3d 826, 833 (4th Cir. 2000); *United States v. Custer Channel Wing Corp.*, 376 F.2d 675, 683 n.15 (4th Cir. 1967).

In *United States v. Moran*, 493 F.3d 1002 (9th Cir. 2007), Pamela and James Moran were "Executive Education Officers" who trained the sales force of Anderson's Ark and Associates ("AAA"), a firm well known for promoting fraudulent "tax reduction plans" to clients who paid and successfully completed an application process. The Morans were charged along with 8 other defendants with numerous counts of conspiring to defraud the United States in violation of 18 U.S.C. § 371, wire and mail fraud, aiding and assisting in the preparation of false returns and other substantive offenses. At trial, the government successfully objected to the testimony of Mrs. Moran's accountant as to what he told her regarding filing statement in place of returns, and to Mrs. Moran's testimony regarding legal opinions she received regarding the AAA program. After a 37-day jury trial, the Morans were convicted on 36 counts each.

On appeal, Mrs. Moran argued that the court committed reversible error by excluding her testimony regarding opinions she received from an accountant and other experts, upon which she based her good faith belief that the AAA programs were legal.

The Ninth Circuit acknowledged that a "defendant is entitled to testify about the tax advice he received – subject, of course, to cross-examination – and exclusion of this testimony is error." *Id.* at 1013 (*citing Bishop, supra* at 1111). "Not only is testimony about the reliance on qualified experts relevant to establishing this defense, but the defendant '[has] the right to tell the court his own version of the tax advice on which he claims[s] to have relied." *Id.* Finally, the court noted that such testimony would not be hearsay, since it is not offered for the truth of the matter asserted. *Id.* Therefore, the court agreed that Mrs. Moran was permitted to testify and that the district court erred in sustaining the government's objections. The court further held that the error was not harmless, noting the government's failure to provide "fair assurance that the verdict was not substantially swayed by the error." *Id.* at 1014 (*quoting United States v. Seschillie*, 310 F.3d 1208, 1214 (9th Cir. 2002)).

Mr. Moran likewise argued that, since he also asserted a good faith defense, he is entitled to any relief stemming from the court's error in excluding his wife's testimony. The court agreed, noting that the Morans were coconspirators and any evidence of professional opinions about the AA programs obtained by Mrs. Moran would be relevant as circumstantial evidence of Mr. Moran's state of mind. *Id.* at 1014-1015. Based on the foregoing, the Ninth Circuit vacated the convictions and remanded for a new trial.

Due Process Argument

A defendant can also challenge willfulness where the statute at issue is vague or ambiguous. Such a defense raises due process arguments under the Fifth Amendment. *United States v. Kay*, 513 F.3d 432, 445-46 (5th Cir. 2007); *United States v. Batchelder*, 442 U.S. 114, 123 (1979). One of the most well known cases involving the uncertainty of the law and its impact on willfulness is *James v. United States*, 366 U.S. 213 (1961), where the Court held that although embezzled funds constituted taxable income, a conviction for failure to report such funds must be vacated on the grounds that the element of willfulness could not be proven beyond a reasonable doubt where the Court had previously ruled that embezzled funds were *not* taxable income in *Commissioner v. Wilcox*, 327 U.S. 404 (1946), and as of the year at issue had not specifically overruled that decision. *See also, Kahr v. Commissioner*, 414 F.2d 621 (2d Cir. 1969).

Based on the reasoning in *James*, the Fourth Circuit reversed a conviction under IRC § 7201 for failure to report rental income earned on land held by the government in trust for the Eastern Cherokee Indians within a Cherokee reservation. *United States v. Critzer*, 498 F.2d 1160 (4th Cir. 1974). In *Critzer*, the defendant testified that she believed the rent was not taxable income based on advice from the Bureau of Indian Affairs. The Service disagreed. The Fourth Circuit held:

> We hold that defendant must be exonerated from the charges lodged against her. As a matter of law, defendant cannot be guilty of willfully evading and defeating income taxes on income, the taxability of which is so uncertain that even co-ordinate branches of the United States Government plausibly reach directly opposing conclusions. As a matter of

> law, the requisite intent to evade and defeat income taxes is missing. The obligation to pay is so problematical that defendant's actual intent is irrelevant. Even if she had consulted the law and sought to guide herself accordingly, she could have had no certainty as to what the law required.
>
> It is settled that when the law is vague or highly debatable, a defendant- actually or imputedly - lacks the requisite intent to violate it.

Id. at 1162; *see also United States v. Mallas*, 762 F.2d 361, 363 (4th Cir. 1985) ("Criminal prosecution for the violation of an unclear duty itself violates the clear constitutional duty of the government to warn citizens whether particular conduct is legal or illegal.").

Prior to the Service's increased enforcement efforts in the area of tax shelters, and recent convictions of those involved in such transactions, defendants successfully argued that the legality of using certain tax shelters was so unsettled that they had not received fair notice that their conduct was illegal. *United States v. Dahlstrom*, 713 F.2d 1423 (9th Cir. 1983) (use of foreign trusts); *Mallas*, *supra* (shelters involving the deduction of coal-mining royalties).

No Tax Due

A defendant can challenge the existence of a deficiency by offering evidence that the funds at issue do not constitute taxable income. For example, evidence that funds represent a nontaxable return of capital, as opposed to a taxable dividend, is relevant and admissible to challenge the existence of a deficiency. *See United States v. Boulware*, 552 U.S. 421 (2008) (overruling *United States v. Miller*, 545 F.2d 1204, 1210-12 (9th Cir. 1976)). Similarly, a defendant could establish that funds constitute nontaxable loan repayments, gifts or payments received for the benefit of third parties. *See United States v. Harris*, 942 F.2d 1125, 1136 (7th Cir. 1991) (unreported gifts do not constitute taxable income); *Peterson v. United States*, 344 F.2d 419, 427 (5th Cir. 1965) (receipts constitute return of principal, not interest income); and *United States v. Hawryluk*, 658 F. Supp. 112, 114 (E.D. Pa. 1987).

A deficiency can also be challenged with previously unclaimed deductions. In *United States v. Kayser*, 488 F.3d 1070 (9th Cir. 2007), the defendant incorporated Aspen Ventures, Inc. to receive his consulting income and take related business deductions. He filed his 1998 through 2000 returns in August, 2001, and was indicted on two counts of evasion in violation of IRC § 7201 for tax years 1999 and 2000. The government alleged that Kayser evaded the tax due by reporting his 1999 consulting income on his corporate return rather than his individual return and by not reporting his 2000 consulting income at all. Kayser deducted business expenses on his 2000 corporate return and carried back the net operating loss to offset the tax due for 1999.

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

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

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

Other defendants have not been as fortunate when it comes to taking unclaimed deductions into account for purposes of calculating tax loss at sentencing. *See United States v. Delfino*, 510 F.3d 468, 473 (4th Cir. 2007) (tax loss is intended loss, or unpaid tax on gross unreported income, not actual loss after unclaimed deductions); *United States v. Chavin*, 316 F.3d 666, 677 (7th Cir. 2002); *but see United States v. Gordon*, 291 F.3d 181, 187 (2d Cir. 2002); *United States v. Maali*, 2005 WL 2204982 (M.D. Fla.), 96 A.F.T.R.2d 2005-6358 (September 8, 2005) (flat percentage of gross unreported income not required if more accurate determination of intended loss is available, including consideration of legitimate but unclaimed deductions).

Another defense to a deficiency is an unclaimed loss carry forward that eliminates the tax due in the year of prosecution. Note, however, that the existence of a carry back loss will not eliminate a deficiency in an earlier year for purposes of IRC § 7201 because the illegal conduct occurs when the return for the year at issue was filed. *Willingham v. United States*, 289 F.2d 283, 287-88 (5th Cir. 1961).

Evasion of Payment of Tax

The elements of the offense of evading the payment of tax are: (1) an assessment of tax due and owing; (2) an affirmative attempt to evade the payment to the tax; and (3) willfulness. The assessment requirement is satisfied by the defendant filing a tax return resulting in a self-assessment, or the Internal Revenue Service making an assessment based on the results of an examination, a jeopardy assessment, or a substitute-for-return pursuant to IRC § 6020(b).

Evasion of payment cases typically arise where a taxpayer conceals income or assets in an effort to prevent or impede collection efforts by the Service. The affirmative conduct includes the filing of a false Collection Information Statement (Form 433-A, 433-B or 433-F) in support of a collection alternative such as a proposed installment plan, an Offer in Compromise, or a request that the accounts be placed in Currently Not Collectible status pursuant to Internal Revenue Manual (I.R.M.) § 15.16.1. *See United States v. Brimberry*, 961 F.2d 1286 (7th Cir. 1992); *United States v. Miller*, 520 F.3d 504, 509-10 (5th Cir. 2008). Other affirmative acts that can support a charge of evasion of payment include: having income paid to third parties; placing accounts in the names of others; transferring real estate to a non-debtor spouse or unrelated third party for less than fair market value; and hiding funds offshore. The government must establish not just that the defendant was aware of the tax liability and committed affirmative acts, but that the defendant knew in committing such acts that he or she was violating a known legal duty. *United States v. Van Meter*, 2006 WL 2323191 (E.D. Tex. Aug. 9, 2006) (defendants permitted to testify as to their beliefs about the federal income tax in response to charges for evasion of payment).

Willful Failure to Collect or Pay Over Tax - 26 U.S.C. § 7202

IRC § 7202 provides that, "[a]ny person required under this title to collect, account for, and pay over any tax imposed by this title who willfully fails to collect or truthfully account for and pay over such tax shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution." There has been an increase in such prosecutions in recent years, a trend that is expected to continue as the Internal Revenue Service invests significant resources on employment tax examinations and investigations.

A common defense to a charge under IRC § 7202 is lack of willfulness based on an inability to pay. *See United States v. Poll*, 521 F.2d 329, 333 (9th Cir. 1975). In *Poll*, the trial court gave the following instruction to the jury:

> The word "willfully" means a voluntary, intentional violation of a known legal duty. In other words, the defendant must have acted voluntarily and intentionally, not through ignorance, mistake, or accident and with the

> specific intent to do something he knew the law prohibited; that is to say, with the intent either to disobey or disregard the law.
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> In the context of this case, in order for the government to establish willfulness beyond a reasonable doubt, it must prove that on the date the taxes were due, the taxpayer possessed sufficient funds to be able to meet his legal obligations to the government, or that the lack of sufficient funds on such date was created by or was the result of a voluntary and intentional act, and the taxpayer voluntarily and intentionally, without justification in light of all the financial circumstances of the taxpayer, did not pay such taxes.

Id. at 333; *but see United States v. Easterday*, 2007 WL 2023500 (N.D. Cal. July 12, 2007) (rejecting notion that willfulness requires evil motive or improper purpose) (*citing United States v. Pomponio*, 429 U.S. 10, 12 (1976)). While the defendant can introduce evidence regarding ability to pay, the government can satisfy its burden of establishing willfulness with evidence that the defendant chose to pay other creditors, such as vendors or utility companies, instead of the IRS. *See Easterday*, *supra* at * 3.

As with other tax offenses, the government may prove willfulness through circumstantial evidence. In *United States v. Radtke*, 415 F.3d 829 (8th Cir. 2005), Radtke was found guilty of failing to collect, account for and pay over taxes in violation of IRC § 7202 as a result of his participation in a scheme to pay employees using "cash checks" from which no taxes or union benefit payments were withheld. On appeal, Radtke argued that the evidence was insufficient to support his conviction, since it only showed that he instigated and permitted the use of cash checks, not that he did so with criminal intent. Of the 600 cash checks introduced, Radtke only signed four, and those were to workers not subject to withholding or union benefit payments.

The court disagreed, noting that intent to defraud need not be proved by direct evidence, but can be inferred from conduct. The court referred to testimony that Radtke recognized that the use of cash checks was illegal and expressed concern about the legal consequences, including incarceration. The court also observed that Radtke was the president and chief executive officer, was involved in the daily operations, and personally profited from the use of cash checks. The court held that this evidence gave rise to a sufficiently strong inference of intent to defraud to sustain the jury's verdict.

If the government is unable to establish the requisite willfulness, it may bring a charge under IRC § 7215, which proscribes the failure to deposit withheld taxes in a separate trust account payable to the United States after notice of such requirement from the Internal Revenue Service under IRC § 7512. This statute is a misdemeanor and subjects offenders to fines up to $5,000 and/or up to one year imprisonment. The statute will not apply if the defendant establishes reasonable doubt as to whether the law required the collection of tax, reasonable doubt as to who was required to collect the tax, or that the failure to comply was due to circumstances beyond his control. IRC § 7215(b).

Not having sufficient funds does not constitute "circumstances beyond his control." *United States v. Dreske*, 536 F.2d 188, 195 (7th Cir. 1976).

Failure to File Returns – 26 U.S.C. § 7203

Willful failure to pay a tax, make a return, keep records or supply information required by the Internal Revenue Code constitutes a violation of IRC § 7203 and one of the few misdemeanor tax offenses.[1] Those convicted of this offense are subject to fines of not more than $25,000 ($100,000 in the case of a corporation) and/or imprisonment up to one year, with costs of prosecution. The elements of this offense are:

(1) The defendant had an obligation under the Internal Revenue Code to pay a tax, file a return, keep records or supply information.
(2) The defendant failed to perform such obligation.
(3) The defendant acted willfully.

The government generally requires a pattern of behavior - three or more years of failure to file - before bringing charges under IRC § 7203. This avoids the risk of a defendant establishing that he filed the return but it was lost *en route* to the IRS; that he signed the return and believed that a third party (such as a spouse or return preparer) mailed or e-filed the return; or that he was unable to file the return due to medical issues. This is not to say that a willful failure to file will never be charged as the sole count. Defendants often attempt to negotiate a plea to this misdemeanor charge when facing more serious offenses. The government may also add a single count of failure to file to a multiple-count indictment involving other offenses.

Another defense to willful failure to file is that the defendant was not, or at least believed in good faith that she was not, legally required to file a return for the years at issue. This defense may be raised by U.S. citizens who have left the United States and are living as ex-patriots abroad, by U.S. residents who claim a treaty exemption, or by spouses who do not earn an income. Such was the case in *United States v. McKee*, 506 F.3d 225 (3d Cir. 2007), where McKee and his co-defendants, Joseph and Inge Donato, were "members of the Reformed Israel of Yaweh ("RIY"), a small religious sect founded by Leo Volpe that opposes payment of taxes based upon the members' religious opposition to war and the taxes that fund it." *Id.* at 228. McKee and Joseph were partners in a construction company and Inge assisted with the bookkeeping.

Inge was convicted of willful failure to file for 1997 and 1999. During the trial, the district court instructed the jury that, "[i]f the married couple files no returns, the law presumes that the tax status of the husband and wife is married filing separately." *Id.* at 244. The government conceded that Inge did not earn a paycheck for services rendered.

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[1] Unless the violation involves the failure of a trade or business to report cash received in excess of $10,000 or more in cash, as required by IRC § 6050I. In that case, the willful violation of IRC § 7203 is a felony and those convicted face terms of imprisonment up to five years. *See, infra.*

Instead, it claimed that Inge was compensated because company checks were used to paint her residence and to purchase two vehicles titled in her name. The government argued that 50% of these payments constituted taxable income to Inge.

The Third Circuit found that the government failed to prove that the payments were intended as compensation to Inge or, if they were so intended, that Inge knew of that intention and therefore, knew she "had a duty to file returns for those years." *Id*. at 245. The court specifically noted her history of providing services without compensation and the lack of connection between the payments and any specific amount of time she worked. It further noted that the payments could simply represent a gift from Joseph or household support. The Court held that "benefit alone can not establish income," *Id*. at 247. The court vacated the convictions and directed an order of acquittal.

An issue that has divided the courts is whether willful failure to file is a "lesser included" offense of tax evasion under IRC § 7201. In *United States v. Cryer*, 2007 WL 1805031 (W.D. La. June 20, 2007), Cryer was charged with two counts of evasion in violation of IRC § 7201 (counts 1 and 2) and two counts of willful failure to file a return in violation of IRC § 7203 (counts 3 and 4). Cryer moved to dismiss counts 3 and 4 on the grounds that they represent lesser included offenses. The district court acknowledged that, under the statutory elements approach set forth in *Schmuck v. United States*, 489 U.S. 705 (1989), the Sixth, Seventh and Ninth Circuits have held that that IRC § 7203 is <u>not</u> a lesser included charge of IRC § 7201. However, since the district court was bound by the Fifth Circuit's decision in *United States v. Doyle,* 956 F.2d 73, 74-75 (5th Cir. 1992), it held that a IRC § 7203 violation *was* a lesser included charge requiring counts 3 and 4 to be dismissed for multiplicity. *Cryer, supra* at * 4.

On the other hand, a defendant's claim that he could not file due to a pending audit or investigation will not succeed. In *United States v. Josephberg*, 562 F.3d 478, 492-93 (2d Cir. 2009), the defendant was convicted of, *inter alia,* failure to file returns for 1999 through 2002 in violation of IRC § 7203. Josephberg appealed the district court's refusal to dismiss those charges, arguing that the Fifth Amendment bars prosecution for willful failure to file when the taxpayer is the subject of an ongoing audit or investigation. The Third Circuit disagreed, holding that Josephberg's "privilege against self-incrimination is protected by his right to refuse, with a *Sullivan* citation, to answer the questions that implicate that privilege." *Id.* at 494 (*citing United States v. Sullivan*, 274 U.S. 259, 263-64 (1927) (holding taxpayer may invoke Fifth Amendment privilege selectively on a return as to any particular item of information solicited)).

With regarding to willful failure to pay, defendants can raise the *Poll* defense addressed herein, but again, the government may introduce evidence that the defendant chose to spend his funds on something other than his tax obligations.

False or Fraudulent Returns or Statements – 26 U.S.C. § 7206(1)

Under IRC § 7206(1), any person who willfully signs and files any return, statement, or other documents containing a declaration that it is under the penalties of perjury, and that he does not believe to be true and correct as to every material matter, is guilty of a felony and subject to a fine of not more than $100,000 (not more than $500,000 for corporations) and/or imprisonment of up to three years, along with costs of prosecution. This statute is sometimes referred to as the tax perjury or fraud statute. Comisky, Feld and Harris, *Tax Fraud and Evasion,* § 2.04 (WG&L, 6th Ed.). The elements of this offense are:

(1) The return, statement or other document contained false information with respect to a material matter.
(2) The defendant made and signed a return, statement or other document that contained a written declaration that it was being signed subject to the penalties of perjury.
(3) The defendant did not believe that the material matter was true and correct; and
(4) The defendant acted willfully.

Id.; United States v. Hendrickson, 664 F.Supp.2d 793, 810-11 (E.D. Mich. Oct. 7, 2009).

Although not in the express language of the statute, the courts are in agreement that to charge a violation of IRC § 7206(1), the actual *filing* of the false return, statement or other document is required. *See United States v. Swanson*, 112 F.3d 512 (Table), at ** 1-2 (4th Cir. 1997) (rejecting contention that limitations begin to run when the return is signed) (citing *United States v. Marashi,* 913 F2d 724, 736 (9th Cir. 1990); *see also United States v. Gilkey,* 362 F. Supp. 1069, 1071 (E.D. Pa. 1973); *United States v. Horwitz*, 247 F. Supp. 412, 413-14 (N.D. Ill. 1965)). As the *Horwitz* court noted, "[w]ere it otherwise, the individual making the return could substantially shorten the length of the statutory period by subscribing the return months before it was filed and then retain it so that the statute of limitations would be running long before the government had any notice of the offense." 247 F. Supp. at 414-15. Moreover, if filing were not required and signing alone was sufficient, "a person [could] be prosecuted for (1) signing a return he never intends to file, or (2) signing a false return but then changing his mind about breaking the law and sending in a correct return instead." *Gilkey*, 362 F. Supp. at 1071. A recent unpublished decision from the Western District of New York further noted that the "filing" requirement need not be satisfied by the defendant – someone else can file the return on the defendant's behalf. *United States v. Benacquista,* 2009 WL 1651458, at ** 2-3 (W.D.N.Y. June 8, 2009), 103 A.F.T.R.2d 2009-2807.

Unlike the crime of evasion, a defendant can be convicted of filing false returns even if no tax is due. This charge is often used where the government is uncertain whether the defendant can challenge the deficiency or where a taxpayer fails to report their interest in a foreign bank account.

In the context of IRC § 7206, a material false statement has been defined as a statement that "could hinder or affect the IRS in carrying out functions such as the verification of the accuracy of a tax return." *United States v. Sun Myung Moon,* 532 F. Supp. 1360, 1366 (D.C.N.Y. 1992) (citations omitted). In *United States v. Gassaway,* 966 F. Supp. 1054 (W.D. Okla. 1997), the court referenced instructions given in *United States v. Klausner*, 80 F.3d 55 (2d Cir. 1996) and *United States v. Strand*, 617 F.2d 571, 574 (10th Cir. 1980), which defined material matters in income tax returns as those essential to the accurate computation of income tax. *Gassaway, supra* at 1058. The Supreme Court defined a material statement as one having "a natural tendency to influence, or [is] capable of influencing, the decision of the decisionmaking body to which it was addressed." *Neder v. United States*, 527 U.S. 1, 16 (1999) (alteration in original) (*quoting United States v. Gaudin*, 515 U.S. 506, 509 (1995)).

In *United States v. McBane*, 433 F.3d 344 (3d Cir. 2005), the Third Circuit interpreted the term "material" broadly, finding that while "a false statement that actually affects or is capable of affecting a *specific* decision by an agency makes for an easier materiality determination, ... both the language of the materiality standard and the decisions applying that standard require only that the false statement at issue be of a type capable of influencing a *reasonable* decisionmaker." *Id.* at 351. The court further noted that whether or not the decisionmaker or government agency was actually influenced by the statement is immaterial. *Id.*; *see also United States v. Puente*, 982 F.2d 156, 159 (5th Cir. 1993). Rather, the Court identified the relevant inquiry as "whether the falsehood was of a type that one would normally predict would influence the given decisionmaking body." *McBane*, 433 F.3d at 351.

Whether a false statement is material is a mixed question of fact and law to be determined by the jury. *United States v. Uchimura*, 125 F.3d 1282, 1285-86 (9th Cir. 1997); *United States v. DiRico*, 78 F.3d 732, 736 (1st Cir. 1996); *In re Metropolitan Securities Litigation*, 532 F. Supp. 2d 1260, 1290 (E.D. Wash. 2007). In making this determination, the jury must apply the legal definition of "materiality" to the facts of the case. *DiRico, supra.* 78 F.3d 732, 736 (1st Cir. 1996). Some examples of material false statements are: the omission of gross receipts, overstating cost of goods sold, falsely claiming deductions, and falsely denying ownership of foreign bank accounts. As noted, the government need not prove a tax deficiency to establish that a false statement is material. *United States v. Tarwater*, 308 F.3d 494, 505 (6th Cir. 2002); *United States v. Young*, 804 F.2d 116, 119 (8th Cir. 1986).

The element of willfulness under IRC § 7206(1) mirrors the corresponding requirement under IRC § 7201. In *United States v. George*, 420 F.3d 991 (9th Cir. 2005), the defendant was convicted for willful filing of false tax returns by not reporting receiver fees in violation of IRC § 7206(1) and failing to file a return in violation of IRC § 7203. He appealed, arguing that the receiver fees were not taxable in the year received because they were subject to court review and possible disgorgement, and that even if the fees are taxable in the years at issue, he lacked willfulness to commit the offense since the law was sufficiently vague and ambiguous. The Ninth Circuit recognized that the government can not establish willfulness "in a criminal tax evasion case unless 'the law clearly prohibited the conduct in the alleged indictment.'" *George*, 420 F.3d at 995 (*quoting United States v. Schulman*, 817 F.2d 1355, 1359 (9th Cir. 1987), and *citing James v. United States*, 366 U.S. 213, 221-22 (1961)). Nonetheless, it found that because George was a cash-basis taxpayer, the law was clear that receiver fees are income in the year of receipt under the claim of right doctrine. *Id.* at 997-98 (citing *United States v. Merrill*, 211 F.2d 297, 299 (9th Cir. 1954), and *Jacobs v. Hoey*, 136 F.2d 954, 956-57 (2d Cir. 1943)).

The court also rejected George's willfulness argument, finding that while the government bore the burden of negating the defendant's claim that he was ignorant of or misunderstood the law, or that he had a good-faith belief that his conduct did not violate the law, 420 F.3d at 999 (*citing Cheek v. United States*, 498 U.S. 192, 201 (1991)), it presented overwhelming evidence that the vast majority of fees received by George were *never reported* – even after the receiverships closed, thereby eviscerating his defense that he thought the fees were includable in later years. *Id.*

It is not uncommon for the government to charge both tax evasion under IRC § 7201 and false statement under IRC § 7206(1) with respect to the same tax return or other document. If there are no factual elements distinguishing the counts, then the false statement count may not be submitted to the jury because of the chance that the jury may convict on one count and convict on the other without any rationale basis for its decision. *See United States v. Citron*, 783 F.2d 307, 312-14 (2d Cir. 1986).

Aiding and Abetting the Preparation or Filing of False or Fraudulent Returns – 26 U.S.C. § 7206(2)

Where a person aids or assists in the preparation or filing of false or fraudulent returns or other documents of another taxpayer, the government will charge under IRC § 7206(2). Those convicted of aiding and abetting the preparation or filing of false returns are subject to fines of not more than $100,000 ($500,000 in the case of a corporation) and/or incarceration for up to 3 years, and costs of prosecution. The elements of this offense are:

(1) The defendant aided and assisted in, or procured, counseled or advised the preparation or presentation of a return or document in connection with a matter arising under the internal revenue laws;
(2) The return, statement or other document was false respect to a material matter.
(3) The defendant acted willfully.

See United States v. Clark, 577 F.3d 273, 285 (5th Cir. 2009). As the elements indicate, the scope of IRC § 7206(2) is much broader than its counterpart IRC § 7206(1), because there is no requirement that the document at issue be signed under penalties of perjury and the taxpayer whose return or statement is being filed can be completely innocent of any wrongdoing.

Several courts have held that IRC § 7206(2) does not require the actual filing of the return or other document with the Service. In *United States v. Black*, 469 F. Supp. 2d 513, 546 (N.D. Ill. 2006), defendants moved to dismiss charges for willfully procuring and assisting in the preparation of false corporate tax returns on the grounds that the indictment failed to allege an essential element – that the fraudulent or false return was filed. Citing the elements of § 7206(2) as set forth by the Seventh Circuit in *United States v. Hooks*, 848 F.2d 785, 788-89 (7th Cir. 1988), the district court denied the motion, holding that the statute does not require that the return at issue actually be filed. *See also United States v. Maius,* 378 F.2d 716, 718 (6th Cir. 1967); *United States v. Borden*, 2007 WL 1128969, at ** 2-3 (M.D. Fla. 2007). Other courts have side-stepped the filing requirement and noted, instead, that the elements of IRC § 7206(2) are satisfied if the defendant provided the false information to an intermediary that was required by law to transmit the information to the IRS. *See United States v. Cutler,* 948 F.2d 691, 694 (10th Cir. 1991); *United States v. Monteiro,* 871 F.2d 204, 210 (1st Cir. 1989).

The Seventh Circuit appeared to take a contrary view in *United States v. Palivos*, 486 F.3d 250 (7th Cir. 2007), where Marin, a loan broker in a complex, fraudulent real estate deal, was convicted of violating IRC § 7206(2) of assisting in the preparation and presentation of a false tax return of a purported buyer of problem-plagued restaurant. The buyer, a coconspirator, applied to a lender for an SBA loan. Because the buyer did not have sufficient income to qualify for the loan, Marin instructed his accountant to prepare false tax returns, which were then presented to the lender but not filed with the Service. After the purchase was complete, the buyer defaulted on the loan and the criminal investigation ensued. On appeal, the Seventh Circuit vacated Marin's conviction, stating that, "[t]here seems to be no dispute that to be a violation of this section the return must have been filed with the Internal Revenue Service." 486 F.3d at 258; *see also United States v. Dahlstrom*, 713 F.2d 1423, 1429 (9th Cir. 1983) (IRC § 7206(2) contains a filing requirement). Notwithstanding the split among the courts on the filing requirements, they appear to be in agreement that the statute of limitations begins to run under IRC § 7206(2) at the time of filing. *United States v. Kelly,* 864 F.2d 569, 74-75 (7th Cir. 1989); *United States v. Nuth*, 605 F.2d 229, 235 (6th Cir. 1979); *United States v. Kassouf*, 959 F. Supp. 450, 452 (N.D. Ohio 1997).

Frequent targets under this statute include accountants, attorneys, tax return preparers and promoters of abusive tax schemes. *See United States v. Ambort*, 405 F.3d 1109 (10th Cir. 2005) (defendant convicted of conspiracy to defraud the United States by assisting in the preparation of false tax returns in violation of 18 U.S.C. § 371 and 69 counts of aiding and abetting in the preparation of false tax returns in violation of IRC § 7206(2) based on operation of *Association de Libertas*, a tax protestor organization).

False documents – 26 U.S.C. § 7207

Another misdemeanor available in the Internal Revenue Code is found in IRC § 7207, which proscribes the willful making of a false statement:

> Any person who willfully delivers or discloses to the Secretary any list, return, account, statement, or other document, known by him to be fraudulent or to be false as to any material matter, shall be fined not more than $10,000 ($50,000 in the case of a corporation), or imprisoned not more than 1 year, or both. Any person required pursuant to section

> 6047(b), section 6104(d), or subsection (i) or (j) of section 527 to furnish any information to the Secretary or any other person who willfully furnishes to the Secretary or such other person any information known by him to be fraudulent or to be false as to any material matter shall be fined not more than $10,000 ($50,000 in the case of a corporation), or imprisoned not more than 1 year, or both.

IRC § 7207. The elements of this offense are:

> (1) The defendant delivered or disclosed a list, return, account, statement or other document to the Internal Revenue Service.
> (2) The defendant knows that information contained therein is false or fraudulent.
> (3) The false or fraudulent information is material.
> (4) The defendant acted willfully.

This offense differs from the felony under IRC § 7206(1) in that IRC § 7207 does not require that the statement or document contain a declaration under penalties of perjury. *United States v. Bishop*, 412 U.S. 346 (1973). Nor does it require an amount of tax due. *Sansone v. United States*, 380 U.S. 343 (1965). Finally, it does not require that the defendant directly or indirectly participate in the preparation of the document at issue, only that the defendant willfully delivered or disclosed the document to the Internal Revenue Service with knowledge of its falsity. *Bishop, supra.*

While the government rarely charges under this statute, it has done so in cases where taxpayers provide false or fictitious documents during a civil examination. *United States v. Galaniuk*, 738 F. Supp. 225 (E.D. Mich. 1990).

Conspiracy to commit offense or defraud United States – 18 U.S.C. § 371

Under 18 U.S.C. § 371, a defendant can be charged with conspiring to commit a substantive offense (the "offense" clause) or conspiring to defraud the United States (the "defraud" clause). *See United States v. Ervasti,* 201, F.3d 1029, 1039-40 (8th Cir. 2000) (finding that § 371 clearly establishes two offenses); *United States. v. Thompson*, 814 F.2d 1472, 1476-77 (10th Cir. 1987) (applying *Blockburger v. United States,* 284 U.S. 299 (1932) to § 371 to determine that double jeopardy does not bar prosecutions for conspiracy to commit mail fraud and conspiracy to defraud the United States); *United States v. Manfredi*, 628 F. Supp. 2d 608, 620 n. 8 (W.D. Pa. 2009); *United States v. Gambone*, 125 F. Supp. 2d 128, 131 (E.D. Pa. 2000); *but see, United States v. Rigas*, 584 F.3d 594 (3d Cir. 2009), *petition for rehearing granted,* 592 F.3d 460 (3d Cir. 2010). This statute provides:

> If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any

> act to effect the object of the conspiracy, each shall be fined under this title or imprisoned not more than five years, or both.
>
> If, however, the offense, the commission of which is the object of the conspiracy, is a misdemeanor only, the punishment for such conspiracy shall not exceed the maximum punishment provided for such misdemeanor.

18 U.S.C. § 371. The elements of a § 371 conspiracy are:

(1) The existence of an agreement to accomplish an illegal or unlawful objective or to defraud the United States.

(2) The defendants knew of the agreement and with such knowledge, voluntarily participated in the conspiracy.

(3) The commission of an overt act by conspirators in furtherance of the objective of conspiracy.

See United States v. McKee, 506 F.3d 225, 238 (3d Cir. 2007); *United States v. Adkinson,* 158 F.3d 1147, 1153 (11th Cir. 1998); *United States v. Tedder*, 801 F.2d 1437, 1446 (4th Cir. 1986). "It is elementary that a conspiracy may exist and be punished whether or not the substantive crime ensues, for the conspiracy is a distinct evil, dangerous to the public, and so punishable in itself." *United States v. Fiander*, 547 F.3d 1036, 1042 (9th Cir. 2008) (*quoting Salinas v. United States,* 522 U.S. 52, 65 (1997)); *see also United States v. Feola,* 420 U.S. 671 (1975); *United States v. Pursley*, 474 F.3d 757 (10th Cir. 2007).

A defendant can be charged with conspiring to impair, obstruct, or frustrate any lawful function of the federal government. *United States v. Jenkins,* 871 F.2d 598, 602 (6th Cir. 1989). A conspiracy to defraud must have the United States or a federal agency or department as a target, but the object or purpose of the conspiracy is not narrowly construed. *United States v. Collins,* 78 F.3d 1021, 1037 (6th Cir. 1996) (*citing United States v. Licciardi,* 30 F.3d 1127, 1131 (9th Cir. 1994)). "Moreover, the conspiracy to defraud the United States need not be the main objective of the conspirators," as long as it is one of the objectives of the conspiracy. *Collins*, *supra*. at 1037. There are, however, limits to how far the government can stretch; impairment or obstruction of a federal agency's lawful function must be the *object* of the conspiracy and not simply a secondary consequence of a defendant's conduct. *Licciardi*, *supra* at 1131. There is no requirement that the government sustain a loss as a result of the illegal conduct. *United States v. Shellef,* 507 F.3d 82, 105 (2d Cir. 2007); *Tanner v. United States,* 483 U.S. 197, 128 (1987) (*citing United States v. Jackson,* 33 F.3d 866, 872-73 (7th Cir. 1994)); *see also Hammerschmidt v. United States*, 265 U.S. 182, 188 (1924).

Under the offense clause, the government does not need to prove that the United States or any federal agency or department thereof is the target of the conspiracy. *United States v. Trent*, 2009 WL 22510 (C.A.11 (Fla.)), 306 Fed. Appx. 482 (*quoting United*

States v. Harmas, 974 F.2d 1262, 1268 (11th Cir. 1992)); *see also* Sand, *et al.,* Modern Federal Jury Instructions-Criminal § 19.02 (2006) ("The principal difference between the statutory purpose instructions concerning conspiracy 'to defraud the United States' and 'to violate federal law' arises from the omission in [the defraud] provision of section 371 of the requirement that the conspiracy have the object to violate a federal law."); *United States v. Loney*, 959 F.2d 1332, 1339-340 (5th Cir. 1992).

The Agreement

The government must prove the existence of an agreement or that the defendant intended to agree with at least one co-conspirator. *United States v. Pappathanasi*, 383 F. Supp. 2d 289, 295 (D. Mass. 2005). While the evidence of a conspiracy may be circumstantial, there must be substantial proof of a meeting of the minds. *Adkinson*, 158 F.3d at 1154; *see also United States v. Durrive*, 902 F.2d 1221, 1228 (7th Cir. 1990). In *Adkinson*, there was no evidence that the defendants discussed taxes much less conspired to evade them and therefore, the evidence was insufficient to establish a conspiracy. *Id.*

A defendant can not be charged with a conspiracy if his only co-conspirator is a government agent or an informer acting in an undercover capacity, since there must be a genuine agreement between two willing parties, not one party playing a role. *United States v. Barger*, 931 F.2d 359, 369 (6th Cir. 1991).

An agreement can be established between a corporation and its officers or employees. *United States v. Ames Sintering Co.,* 927 F.2d 232, 236 (6th Cir. 1990). The courts have rejected the notion that all agents of a corporation act as a single unit and therefore, can not conspire among themselves. *United States v. Stevens,* 909 F.2d 431, 432 (11th Cir. 1990). An exception exists where the corporation is owned and operated by a single individual. A conspiracy will not lie where there is only one individual at issue. *Id.* at 431, 433-34.

In *United States v. Mubayyid*, 567 F. Supp. 2d 223 (D. Mass. 2008), the defendants were charged and convicted of conspiring to defraud the United States by impairing and impeding the lawful functions of the IRS in violation of 18 U.S.C. § 371. The defendants moved for judgment acquittal on the grounds that only one of them was involved in obtaining tax exempt status for Care International and, on the application for recognition of exemption under IRC § 501(c)(3), concealing the material fact that the organization solicited funds for and issued publications supporting and promoting Islamic holy war and holy warriors. The court found no evidence that the other defendants knew anything about the submissions to the IRS or that Care International would have to hide its non-charitable purposes to obtain exempt status. The court noted that the fact that an organization is small is not sufficient to establish that the members of the organization are involved in a conspiracy.

Intent

The government must establish that a defendant has the specific intent to participate in the conspiracy and to defraud the United States or to violate the substantive statutes that are the object of the conspiracy. Knowledge of the unlawful conduct of others, without more, will not suffice. *United States v. Falcone*, 109 F.2d 579, 581 (2d Cir. 1940). Nor will mere association with the conspirators. *Id.; see also United States v. Pupo,* 841 F.2d 1235, 1238 (4th Cir. 1988); *United States v. Cole,* 704 F.2d 554, 557 (11th Cir. 1983). The government must show "a 'unity of purpose,' the intent to achieve a common goal and an agreement to work together toward the goal." *United States v. Wexler*, 838 F.2d 88, 90-91 (3d Cir. 1988); *see also United States v. Thompson*, 518 F.3d 832, 853 (10th Cir. 2008): *United States v. American Investors of Pittsburgh, Inc.*, 879 F.2d 1087, 1100 (3d Cir. 1989); *United States v. Rankin,* 870 F.2d 109, 113 (3d Cir. 1989).

In *Pappathanasi*, *supra,* the defendants, executives of West Lynn Creamery (WLC) were charged with conspiring with Dunkin' Donut franchisees to help them evade taxes in violation of 18 U.S.C. § 371, by inflating invoices and then rebating back the difference in checks and cash. The franchisees failed to report the rebate payments on their respective income tax returns.

The district court denied motions to dismiss the indictment and superseding indictment. After a 4-week jury trial, the court granted motions for acquittal on the ground that the government failed to prove that defendants had both the intent to agree with franchisees and the intent to assist franchisees' efforts to defraud the IRS. The court held that, even if the government submitted sufficient evidence of a conspiracy between Pappathanasi and one of the franchises, based on a brief exchange on a golf course, this was insufficient to establish the conspiracy charged in the indictment. At most, the government established that the franchisees independently evaded taxes by omitting the rebate funds on their respective returns.

To establish willfulness, the government must prove that the defendant knowingly and intentionally associated with co-conspirators and participated in the conspiracy. *United States v. Mankani*, 738 F.2d 538, 547, n.1 (2d Cir. 1984). If the government presents sufficient evidence, the jury may be instructed that deliberate ignorance or willful blindness may establish the defendant's knowledge of the objectives of the conspiracy. *United States v. Fletcher,* 928 F.2d 495, 502 (2d Cir. 1991).

The Overt Act

"An overt act is any act performed by any conspirator for the purpose of accomplishing the objectives of the conspiracy." *United States v. McKee,* 506 F.3d 225, 243 (3d Cir. 2007) (*citing United States v. Falcone,* 311 U.S. 205, 207 (1940) ("[T]he gist of the offense of conspiracy ... is agreement among the conspirators to commit an offense attended by an act of one or more of the conspirators to effect the object of the conspiracy")). An overt act by one conspirator is considered an overt act by all co-conspirators, regardless of whether there was a specific agreement to commit that particular act. *United States v. Moran,* 493 F.3d 1002, 1009 (9th Cir. 2007) (*citing Pickerton v. United States*, 328 U.S. 640, 646-47 (1946)); *United States v. Walls,* 225 F.3d 858, 864 (7th Cir. 2000).

The overt act in furtherance of a conspiracy need not be illegal conduct in and of itself. *United States v. Campa,* 529 F.3d 980, 1002 (11th Cir. 2008); *United States v. Acevido Vila,* 588 F. Supp. 2d 194, 207 (D. Puerto Rico 2008). Overt acts can include conversations with co-conspirators, opening bank accounts, transferring funds from one account to another, opening a post office box, or forming a corporation. The overt act could also be the substantive offense that is the object of the conspiracy – filing a false return, making a false statement to a government agency, etc. The government will frequently list multiple overt acts in the indictment and does not need to prove that each overt act occurred, or that the particular defendant committed the act, to sustain a conspiracy conviction. *Braverman v. United States,* 317 U.S. 49, 53 (1942); *United States v. Thompson,* 518 F.3d 832, 854 (10th Cir. 2008) (*citing United States v. Weidner*, 437 F.3d 1023, 1033 (10th Cir. 2006); *United States v. Walls*, 225 F.2d 858,864 (7th Cir. 2000).

A *Klein* conspiracy

A conspiracy to defraud the IRS is commonly referred to as a *Klein* conspiracy, after *United States v. Klein*, 247 F.2d 908 (2d Cir. 1957). The elements of a *Klein* conspiracy are:

(1) The existence of an agreement to defraud or impede the Internal Revenue Service in the assessment and/or collection of taxes.

(2) The defendant knew of the agreement and with such knowledge, voluntarily participated in the conspiracy.

(3) The commission of an overt act by conspirators in furtherance of the objective of conspiracy.

See McKee, 506 F.3d at 238; *United States v. Adkinson*, 158 F.3d 1147, 1153 (11th Cir. 1998); *United States v. Tedder,* 801 F.2d 1437, 1446 (4th Cir. 1986).

A *Klein* conspiracy requires that an objective of the conspiracy be to undermine the efforts of the IRS to determine and collect tax. *United States v. Acevido Vila*, 588 F. Supp. 2d 194, 207 (D. Puerto Rico 2008); *United States v. Vogt*, 910 F.2d 1184, 1203 (4th Cir. 1990). The intent to defraud the Service need not be the only object of the conspiracy; instead, "if one of the objectives, even a minor one, is the evasion of federal taxes, the offense is made out, even though the primary objective may be concealment of another crime." *United States v. Collins,* 78 F.3d at 1021, 1037-38 (6th Cir. 1996) (*citing Ingram v. United States,* 360 U.S. 672, 679-80 (1959)); *see also United States v. Gricco,* 277 F.3d 339, 348 (3d Cir. 2002); *United States v. Ervasti*, 201 F.3d 1029, 1037-38 (8th

Cir. 2000) (intent to defraud clients of payroll company by stealing funds designated for employment tax deposits sufficient to establish intent to undermine efforts of IRS to collect tax). "If a tax evasion motive plays any part in a scheme, the offense can be made out even though the scheme may have other purposes such as the concealment of other crimes." *United States v. Shermetaro,* 625 F.2d 104, 109 (6th Cir. 1980) (citations omitted); *see also Untied States v. Presbitero,* 569 F.3d 691 (7th Cir. 2009).

As noted above, mere knowledge of tax evasion or false statements by others is not sufficient to establish that a defendant participated in a conspiracy to defraud the Service. This limitation was addressed in *United States v. Goldberg,* 105 F.3d 770, 773-74 (1st Cir. 1997), where the First Circuit stated that proof that a defendant agreed to pay someone under the table knowing that the recipient would not report the income is not sufficient to establish a *Klein* conspiracy. Instead, the government must prove that the defendant entered into an agreement with the recipient and that the objective of that agreement was to defraud the Service.

Klein conspiracies are frequently charged against tax protestors, fraudulent tax return preparers and promoters of tax shelters and other abusive transactions. *See United States v. Cohen,* 510 F.3d 1114 (9th Cir. 2007) (tax protestor); *United States v. Fletcher,* 322 F.3d 508 (8th Cir. 2003) (tax return preparers); *United States v. Bryan,* 868 F.2d 1032 (9th Cir. 1989) (tax shelters); *United States v. Morse,* 785 F.2d 771 (9th Cir. 1986) (tax shelters).

Withdrawal from Conspiracy

A defendant's membership in a conspiracy is deemed to continue until there is an affirmative withdrawal or the conspiracy ends. *United States v. Richardson,* 596 F.2d 157, 163 n.10 (6th Cir. 1979); *United States v. Kerik,* 615 F. Supp. 2d 256, 267 (S.D.N.Y. 2009). A defendant's withdrawal from a conspiracy acts as a defense to substantive offenses committed by co-conspirators after the withdrawal and prevents the admission against the defendant of co-conspirators acts and statements made after the withdrawal. *United States v. United States Gypsum Co.,* 438 U.S. 422, 464-65 (1978); *Pickerton v. United States,* 328 U.S. 640, 646 (1946).

Courts have found evidence of withdrawals where the defendant has been arrested and incarcerated. *United States v. Panebianco*, 543 F.2d 447, 453-54 n.5 (2d Cir. 1976). A *prima facie* case of withdrawal has also been established where a defendant/employee has terminated an employment relationship. *United States v. Steele,* 685 F.2d 793, 804 (3d Cir. 1982). On the other hand, a letter written by a defendant to co-conspirators asking them to stop the illegal conduct has been rejected as evidence of sufficient withdrawal. *United States v. Balistrieri,* 778 F.2d 1226 (7th Cir. 1985).

Statute of Limitations – 26 U.S.C. § 6531

The statute of limitations for criminal tax offenses under Title 26 of the U.S. Code is 6 years pursuant to IRC § 6531. For tax evasion under IRC § 7201, the period of limitations runs from the latest act of evasion. *See United States v. Kelley*, 2009 WL 5062018 (D.S.D. Oct. 23, 2009), 104 A.F.T.R.2d 2009-7587 ("An act constituting evasion which occurs during the limitations period brings the prosecution within the statute of limitations even if the taxes being evaded were due and payable prior thereto.") (*quoting United States v. Shorter*, 608 F. Supp. 871, 874 (D.D.C. 1985)); *United States v. Mui*, 214 Fed.Appx. 40 (Table), 2007 WL 177839 (2d Cir. (NY)); *United States v. Daniels*, 387 F.3d 636, 641 (7th Cir. 2004); *United States v. Anderson*, 319 F.2d 1218, 1219 (10th Cir. 2003).

The 6-year statute of limitations also applies to conspiracy charges brought under 18 U.S.C. § 371 pursuant to IRC § 6531(1) and (8). The statute begins to run from the last overt act in furtherance of the conspiracy by any member of the conspiracy. *United States v. Kerik*, 615 F. Supp. 2d 256, 266 (S.D.N.Y. 2009); *United States v. Bellomo*, 176 F.3d 580, 598 (2d Cir. 1999); *United States v. Lash*, 937 F.2d 1077, 1083-84 (6th Cir. 1991); *United States v. Christensen*, 344 F.Supp.2d 1294, 1297-298 (D. Utah 2004).

With regarding to filing false returns in violation of IRC § 7206(1), the statute of limitations runs from the date the return was filed, not the due date of the return. *Id.* at 1298 (*citing United States v. Habig*, 390 U.S. 222 (1968)). For failure to file returns, the operative date is the due date *including* extensions. 344 F. Supp. 2d at 1298.

In *United States v. Blanchard*, 2007 WL 1976359 (E.D. Mich. July 3, 2007), the Blanchards, who owned an underground excavating business, were charged with various tax offenses including 15 counts of willfully failing to truthfully account for and pay over withholdings of employment taxes in violation of IRC § 7202 for periods from 1999 through 2002. The Blanchards moved to dismiss the majority of the IRC § 7202 counts as time-barred, arguing that the general 3-year statute of limitations under IRC § 6531 applied to the offenses of willfully failing to *pay over* a tax, not the extended 6-year period which applied to offenses of willfully failing to *pay* any tax.

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

The statute of limitations under IRC § 6531 is suspended if a person whose liability is the subject of a third-party summons moves to quash the summons. IRC § 7609(e)(1); *see also United States v. Thomas*, 2006 WL 2225302 (D. Me. Aug. 2, 2006);

United States v. Meyer, 808 F.2d 1304, 1306 (8th Cir.1987). Under such circumstances, the period of limitations will be tolled for the pendency of the proceedings regarding the summons. The statute is also suspended if the Service has issued a third party summons with respect to the matter at issue and the response is delayed. IRC § 7609(e)(2). Suspension under this statute begins six months after the summons is served and the statute remains tolled until final resolution of summoned party's response.

With the exception of conspiracies charged under 18 U.S.C. § 371, violations under Title 18 of the U.S. Code are generally subject to a five-year period of limitations under 18 U.S.C. § 3282. For example, "[t]o satisfy the statute of limitations for mail fraud, the government must prove that the predicate mailing occurred in the five years before the indictment." *United States v. Manges,* 110 F.3d 1162, 1169 (5th Cir. 1997).

Under either IRC § 6531 or 18 U.S.C. § 3282, the period of limitations is met when an indictment is filed. *United States v. Zvi,* 168 F.3d 49, 54 (2d Cir. 1999) (*citing United States v. Grady,* 544 F.2d 598, 601 (2d Cir. 1976)).