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Tax Litigation Issues

Expert Analysis

The Ever-Expanding Scope of the IRS Obstruction Statute

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One of the weapons in the arsenal of prosecutors pursuing tax offenders is 26 U.S.C. §7212(a), which criminalizes "[a]ttempts to interfere with [the] administration of the internal revenue laws." Section 7212(a) consists of two clauses: The first addresses conduct directed against IRS agents and employees enforcing the Internal Revenue Code, while the second, known as the Omnibus Clause, makes it a crime to "in any other way corruptly or by force or threats of force (including any threatening letter or communication) obstruct[] or impede[], or endeavor[] to obstruct or impede, the due administration of this title."

In recent years the government has used the Omnibus Clause to reach acts beyond those that obstruct IRS audits or investigations. Last month, the U.S. Court of Appeals for the Second Circuit joined other courts of appeals in reading the Omnibus Clause expansively, holding in *United States v. Marinello*, 2016 WL 5956687 (2d Cir. Oct. 14, 2016), that Section 7212(a) can be violated without proof that there was a pending IRS investigation or proceeding, let alone that the defendant was aware of the IRS's activity.

Background

First adopted in 1954, Section 7212(a) appears on its face to be focused on conduct aimed at obstructing investigations being conducted by IRS agents. This is supported by the legislative history, which describes the proposed statute as covering "all cases where the [IRS] officer is intimidated or injured; that is, where corruptly, by force or threat of force, directly or by communication, an attempt is made to impede the administration of the internal-revenue laws." H.R. Rep. No. 83-1622, pt. O, at 4781 (1954).

Notwithstanding this apparent focus, prosecutors have long recognized the potential application of the Omnibus Clause to conduct occurring outside of any audit or investigation being conducted by the IRS. See, e.g., *United States v. Williams*, 644 F.2d 696 (8th Cir. 1981) (affirming Section 7212(a) conviction of defendant who assisted in preparing and filing false W-4 forms as endeavoring to impede or obstruct due administration of the Internal Revenue Code). In 1989, the Tax Division of the Department of Justice issued a policy directive aimed at limiting the expansive application of the Omnibus Clause. This policy directive, which is cited in the U.S. Attorney's Manual, provides that "[i]n general, the use of the 'omnibus' provision of Section 7212(a) should be reserved for conduct occurring after a tax return has been filed—typically conduct destined to impede or obstruct an audit or criminal tax investigation, when 18 U.S.C. 371 charges are unavailable due to insufficient evidence of conspiracy." The policy directive, however, goes on to note that the Omnibus Clause is not limited to activity after filing tax returns, suggesting that the Omnibus Clause could be used to prosecute continual assistance in filing false tax returns, activity designed to obstruct audits, and other "large scale" violations.

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Thus, even after the policy directive, prosecutors continued using the Omnibus Clause to attack conduct unrelated to any IRS investigation or audit. For example, in *United States v. Popkin*, 943 F.2d 1535 (11th Cir. 1991), the U.S. Court of Appeals for the Eleventh Circuit affirmed a conviction under the Omnibus Clause based on evidence that the defendant, an attorney, created a shell corporation to assist a client avoid his tax obligations.

The government's expansive use of Section 7212(a) has not been entirely unimpeded. In 1998, the U.S. Court of Appeals for the Sixth Circuit reversed a conviction and held that a defendant must be aware of an ongoing IRS investigation in order to be charged with having violated the Omnibus Clause. *United States v. Kassouf,* 144 F.3d 952 (6th Cir. 1998). However, in *United States v. Bowman*, 173 F.3d 595 (6th Cir. 1999), the Sixth Circuit limited *Kassouf* to its particular facts, and other circuit courts of appeals have declined to follow Kassouf's narrow application of Section 7212(a). See, e.g., *United States v. Massey*, 419 F.3d 1008, 1010 (9th Cir. 2005), cert. denied, 547 U.S. 1132 (2006)). Until recently, the Second Circuit had not explicitly addressed this issue.

'United States v. Marinello'

In *Marinello*, the defendant, Carlo Marinello, owned a freight service that couriered documents and packages between the United

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States and Canada. Between 1992 and 2010, Marinello did not keep records reflecting his business income or expenses, often destroying or shredding documents. In addition, he often paid his employees in cash and failed to issue either W-2 or 1099 forms reporting their income to the IRS. Similarly, he also paid personal expenses, such as his mortgage and payments to his mother's senior living home, out of the business. Finally, and perhaps most significantly, Marinello did not file personal or corporate tax returns, and therefore he did not report any income or deductions.

In December 2004, the IRS initiated an investigation into Marinello's tax compliance. However, the agency eventually closed this inquiry because it could not determine whether the unreported income was significant. While Marinello was apparently unaware of the investigation, in 2005, he sought advice regarding his non-compliance from both an attorney and a certified public accountant.

While the CPA asked Marinello for documentation of his business receipts and expenses in order to prepare corporate tax returns, because he had not maintained the necessary records, Marinello was unable to provide them as requested. Moreover, despite having received advice regarding the importance of good documentation, Marinello continued his practice of not keeping necessary books and records.

In 2009, the IRS re-opened its investigation, and an IRS agent interviewed Marinello who eventually admitted that he had earned income and should have paid taxes but that he "never got around to" filing returns. Marinello also admitted paying personal expenses out of his business and confirmed that he had not kept (or had shredded) records of the business' income and expenses. Following the second investigation, the government charged Marinello with one felony count of interference with the administration of the Internal Revenue Code in violation of Section 7212(a) and six misdemeanor counts of failure to file returns in violation of 26 U.S.C. §7203.

The 7212(a) charge was predicated on Marinello's (1) failure to maintain proper books and records; (2) failure to provide information to his accountant; (3) destruction of records; (4) cashing of checks issued to the business; (5) concealment of business income in non-business accounts; (6) transferring assets to another person to conceal their improper use; (7) paying employees with cash; and (8) paying personal expenses out of the business. At trial, Marinello conceded that he had failed to file the returns, but argued that an affirmative act, such as filing false returns, was required to support a conviction under Section 7212(a).

After the jury convicted him on all counts and the district court denied his post-trial motions, Marinello argued on appeal that a conviction under the Omnibus Clause requires that the government establish both (a) the existence of a pending IRS investigation and the defendant's knowledge of that investigation, and (b) an affirmative act as opposed to the failure to keep books and records. The Second Circuit rejected both arguments.

Given its conclusion that the IRS's administration of the tax code is not limited to investigations or proceedings, but rather extends to conduct pre-dating the filing of any return, the court rejected Marinello's argument that a conviction under section 7212(a) requires a showing that the defendant was aware of a pending IRS action.

The court first declined to follow the Sixth Circuit's narrow reading of Section 7212(a) set forth in *Kassouf* and found that the Omnibus Clause could be violated even in the absence of an IRS investigation or proceeding. In this regard, the court noted that, unlike the first clause of Section 7212(a), which refers broadly to the activities of an IRS official or employees, the Omnibus Clause "is a catch-all provision that criminalizes 'any other way' of corruptly obstructing or impeding the due administration of the Internal Revenue Code."

The court, citing to prior Second Circuit decisions, noted that the word "corruptly" encompasses any conduct that is intended to "secure an unlawful advantage or benefit either for one's self or for another." Given its conclusion that the IRS's administration of the tax code is not limited to investigations or proceedings, but rather extends to conduct pre-dating the filing of any return, the court rejected Marinello's argument that a conviction under section 7212(a) requires a showing that the defendant was aware of a pending IRS action.

The Second Circuit also rejected Marinello's claim that a violation of the Omnibus Clause required proof that the defendant engaged in an affirmative act, as opposed to omissions such as the failure to maintain books and records. Rather, the court concluded that a defendant could not escape liability merely because he delayed the IRS in the administration of its duties through a corrupt omission, as opposed to an affirmative act. Significantly, however, the Second Circuit acknowledged in a footnote that the Omnibus Clause was not without limit and suggested that a mere failure to file tax returns would not give rise to liability under Section 7212(a).

Conclusion

Marinello is a recent example of the continued expansion of Section 7212(a), and lawyers representing individuals in criminal tax investigations need to be conscious of its potential for blurring the line between careless business practices and criminal obstruction of the IRS. Defense counsel should be especially attentive to any evidence that their clients acted with the requisite "intent to secure an unlawful advantage or benefit" and be prepared to argue that the client did not act "corruptly," but rather that the conduct or omissions at issue were due to negligence or bad business practices.