



TAX LITIGATION

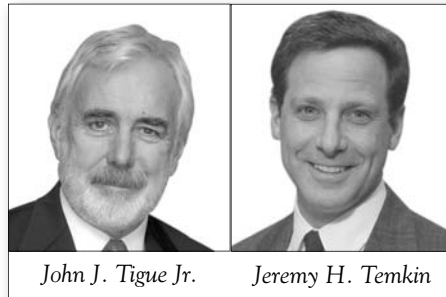
BY JOHN J. TIGUE JR. AND JEREMY H. TEMKIN

Indictment of Tax Crimes Under Fraud Statutes

In recent years, the Internal Revenue Service and the U.S. Department of Justice have announced increased and vigorous criminal tax enforcement efforts. Press releases issued every April proclaim continued success in this area with the prosecution of hundreds of “tax cheats,” promoters of tax fraud schemes, and those using abusive tax shelters.¹ In addition, the IRS is pursuing a new policy of simultaneous civil and criminal investigations in the area of tax shelters.² Eileen J. O'Connor, assistant attorney general for the Tax Division has stated that the Justice Department “is committed to using all available law enforcement tools to recover tax revenue, punish tax offenders, and to prevent future misconduct.” One way in which the government has enhanced its prosecution of alleged tax offenders is by expanding the number of statutes used to charge conduct that involves violations of the Internal Revenue Code.

All criminal cases involving tax-related offenses must be approved by the Department of Justice's Tax Division, regardless of the criminal statute used to charge the defendant.³ Thus, the Tax Division must approve any criminal indictment or complaint charging mail, wire or bank fraud either alone or as the predicate to a RICO or money laundering charge. While the Tax Division has traditionally steered clear of using general fraud statutes to charge alleged tax offenders, in October 2004, the division shifted its policy towards promoting the use of fraud statutes in tax cases when the government perceives there to be an advantage in doing so.

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Directive No. 99

The Tax Division defines criminal violations “arising under the internal revenue laws” as those involving: (1) an attempt to evade a responsibility imposed by the Code; (2) an obstruction or impairment of the IRS; or (3) an attempt to defraud the government or others through the use of mechanisms established by the IRS for filing internal revenue documents or the payment, collection, or refund of taxes.⁴ Tax Division Directive No. 99, which was in effect from March 1993 until October 2004, provided that violations “arising under the internal revenue laws” should generally be charged only as tax crimes under the Code, even though other criminal statutes may have been violated. The directive further stated that the Tax Division would exercise prosecutorial discretion to authorize mail, wire or bank fraud charges in connection with such tax crimes “only in exceptional circumstances.”⁵

Elaborating on the requirement that such cases be “exceptional,” Directive No. 99 set forth circumstances when the use of fraud charges would not be approved. For instance, when the only mailing or wire transmission to be charged involved the submission of a tax return or other internal revenue form or document, or the receipt of a tax refund, the case would not qualify as “exceptional.” Moreover, fraud charges were not to be brought when the predicate mailing, wiring or representation was only incidental to a violation. In further explanation of this latter scenario, Directive No. 99 observed that although a defendant may have mailed instructions to a cohort in

a tax shelter scheme, and that such a mailing may support a mail fraud charge, the mailing would be considered incidental to the scheme's primary purpose of defrauding the United States of income taxes.

Significantly, Directive No. 99 provided that where a tax-related crime may appropriately be charged under general fraud statutes, such as when the government loses money in a non-revenue raising capacity or individuals or other entities have been the financial victim of the crime, “[t]he bringing of such charges will seldom, if ever, be justified by the mere desire to see a more severe term of imprisonment or fine imposed. Rather, they must serve some federal interest not adequately served by the bringing of traditional tax charges.” Finally, with respect to RICO and money laundering prosecutions, Directive No. 99 noted that Congress had deliberately decided not to include tax offenses as predicate acts for RICO or specified unlawful activities for money laundering offenses. Thus, it concluded that converting a tax offense into a RICO or money laundering case by charging of mail, wire or bank fraud “could be viewed as circumventing Congressional intent unless circumstances justifying the use [of those fraud statutes] are present.”

Directive No. 128

The Tax Division superseded Directive No. 99 in October 2004, when it adopted Directive No. 128.⁶ The new policy reflects a more permissive (and aggressive) approach to the use of fraud statutes in prosecuting violations arising under the internal revenue laws. Directive No. 128 sets forth examples of tax-related offenses that are appropriately charged under the fraud statutes. Mail fraud or wire fraud charges may be brought where an individual used the mails or wires either to file multiple fraudulent tax returns seeking tax refunds or to promote fraudulent tax schemes. Bank fraud charges are now perceived as being appropriate when a financial institution is the victim of a tax fraud scheme, such as when the defendant uses a false claim for a tax refund to obtain a refund anticipation loan.

Directive No. 128 notes, however, that absent “unusual circumstances” the approval of fraud charges will not be given “in cases involving only one person’s tax liability, or when all submissions to the IRS were truthful.” Likewise, the directive states that the Tax Division “will not authorize the use of mail, wire or bank fraud charges to convert routine tax prosecutions into RICO or money laundering cases.” Rather, the prosecution of tax-related RICO and money laundering cases will only be authorized when “unusual circumstances” so warrant. Although the phrase “unusual circumstances” appears throughout the directive, the Tax Division does not describe when circumstances will be considered sufficiently “unusual” to justify using tax offenses as a predicate for RICO or money laundering charges.⁷

Despite the inclusion of some limiting language, the position set forth in Directive No. 128 is significantly more aggressive than the government’s prior position on the issue. Directive No. 99 set forth a clear policy that, absent “exceptional circumstances,” violations arising under the internal revenue laws should only be charged as tax crimes under the Code.

Directive No. 128 shifts the focus, permitting the use of fraud charges “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” violations of the Code. In addition, while Directive No. 99 cautioned against the use of fraud charges to seek a harsher sentence, Directive No. 128 allows the use of fraud charges where there will be a benefit to the government at the sentencing phase of a prosecution. Finally, all cautionary language contained in Directive No. 99 regarding Congress’ intended application of the RICO and money laundering statutes was eliminated from Directive No. 128, which ambiguously requires only that circumstances be “unusual” to justify the use of tax-related offenses as predicates under the RICO and money laundering statutes.

Benefit to Government

While some courts have permitted the application of the mail, wire and bank fraud statutes to cases otherwise arising under the internal revenue laws, a 1974 opinion authored by Judge Edward Weinfeld in the Southern District of New York disapproved of this practice. Anticipating concerns expressed in Directive No. 99, Judge Weinfeld concluded that Congress did not intend the mail fraud statute to apply to schemes to defraud the United States through the evasion of taxes, stating that “[t]here is in such a case no need to use the mail fraud statute as a ‘stopgap device’ until ‘particularized legislation’ is enacted ‘to deal directly with the evil,’ for Congress has enacted legislation that affords adequate protection of the public interest in the collection of income taxes.”⁸

Questioning whether the government was motivated to charge criminal conduct under the mail fraud statute rather than the internal revenue laws because the former carried a longer term of imprisonment if the defendant was convicted, the court dismissed the mail fraud counts against the defendant.

Although other courts have declined to follow Judge Weinfeld’s holding, his opinion demonstrates the curious nature of tax-related cases charged under more general criminal laws, despite the fact that the Code adequately criminalizes the alleged conduct. Obviously, the government will only include such charges when it perceives that it will obtain some strategic advantage. Indeed, Directive No. 128 hinges the Tax Division’s approval of the use of mail, wire and bank fraud charges to prosecute tax-related offenses on the government receiving “a significant benefit to bringing [such] charges instead of or in addition to Title 26 violations.”

Some have argued that the charging of tax-related offenses under more general fraud statutes imposes a less onerous burden of proof on the government.⁹ Criminal tax offenses, as set forth in the Code, include a heightened scienter requirement, requiring the government to prove that the defendant acted “willfully” in voluntarily and intentionally violating a known duty imposed by the law.¹⁰ On the other hand, the mail, wire and bank fraud statutes require only that the defendant acted “knowingly” in executing a fraudulent scheme.¹¹

Directive No. 128 describes additional benefits the government hopes to obtain in charging tax crimes under the fraud-related statutes. First, the directive states that significant benefits may arise at the charging stage of a criminal case. For instance, the inclusion of fraud charges may allow the government to describe the alleged scheme in more detail than it could for charges under the Code alone. In addition, the directive states that the inclusion of fraud charges also supports a claim for forfeiture of the proceeds of the fraud scheme, allowing the government to collect more than just taxes due.

Second, the directive also notes that the inclusion of fraud charges may benefit the government at the trial stage. Specifically, it states that by charging fraud offenses, the government can “ensur[e] that the court will admit all relevant evidence of the scheme” and will permit it greater flexibility in choosing witnesses. Finally, the directive comments that the government can benefit from the inclusion of mail, wire or bank fraud charges during the sentencing phase as well, noting that the addition of fraud charges authorizes courts to order full restitution. Quoting the U.S. Attorneys’ Manual, the directive observes that “[i]f the evidence is available, it is proper to consider the tactical advantages of bringing certain charges.”

On Nov. 3, 2005, the Department of Justice issued a press release announcing the

indictment of six individuals for a \$20 million conspiracy to defraud the U.S. government.¹² In indicting these defendants for promoting a tax fraud scheme, the government charged not only numerous counts under the Code and a conspiracy to defraud the United States in connection with the tax scheme, but also charged the defendants with conspiracy to commit mail and wire fraud. Announcing that they were relying on “all available tools to investigate and prosecute tax fraud,” the Justice Department and the IRS noted that they have initiated a “new approach to dealing with these types of schemes.” Specifically, the press release details how the indictment includes a notice to seek forfeiture of the proceeds of the crimes alleged in the indictment against certain defendants.

Directive No. 128 and the government’s increased reliance on fraud statutes in charging tax crimes is another example of the increased and more aggressive efforts of the IRS and Justice Department. Although charges are available under the Code to prosecute the same misconduct, it is clear that the government will seek additional or alternative charges under the criminal code where it provides a tactical benefit, or a harsher penalty.

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1. See, e.g., Press Release, Department of Justice, Justice Department and IRS Highlight Tax Enforcement Efforts (April 11, 2006) (available at <http://www.usdoj.gov/tax/txdv06212.htm>); Press Release, Department of Justice, Justice Department Notes Increase in Tax Enforcement (April 6, 2005) (available at <http://www.usdoj.gov/tax/txdv05167.htm>); Press Release, Department of Justice, Justice Department Notes Increase in Tax Enforcement (April 6, 2004) (available at 2004 WL 741260 (D.O.J.)).

2. John J. Tigue, Jr. and Jeremy H. Temkin, “IRS: Quick, Simultaneous Enforcement Over Long-Time Practices,” *New York Law Journal* (May 19, 2005).

3. 28 C.F.R. §0.70(b).

4. Department of Justice, Tax Division, Directive No. 128 (Oct. 29, 2004).

5. Department of Justice, Tax Resource Manual, 18 Tax Division Directive No. 99 (March 30, 1993) (available at http://www.usdoj.gov/usao/eousa/foia_reading_room/usam/title6/tax00018.htm).

6. Department of Justice, Tax Division, Directive No. 128 (Oct. 29, 2004).

7. As Directive No. 128 notes, cases brought under the RICO statute also must be approved by the Organized Crime and Racketeering Section of the Department of Justice’s Criminal Division, and money laundering cases may require the authorization of the Criminal Division’s Asset Forfeiture and Money Laundering Section. *Id.*; see also United States Attorneys Manual §§9-110.101, 9-105.300.

8. *United States v. Henderson*, 386 F. Supp. 1048, 1052-53 (S.D.N.Y. 1974).

9. See e.g., Kathryn Keneally and Kenneth M. Breen, “Tax Crimes: More Aggressive Government Policies and Practices,” *The NACDL Champion Magazine* (April 2006).

10. See 26 U.S.C. §§7201, 7203, 7206(a) and (b).

11. *United States v. Precision Medical Laboratories, Inc.*, 593 F.2d 434, 443 (2d Cir. 1978).

12. Press Release, Department of Justice, Six Indicted for \$20 Million Conspiracy to Defraud the U.S. Government (Nov. 3, 2005) (available at http://www.usdoj.gov/opa/pr/2005/November/05_tax_589.html).