

## Tax Litigation Issues

## Expert Analysis

# Below-Guidelines Sentences For Tax Defendants

In *United States v. Booker*,<sup>1</sup> the U.S. Supreme Court held that the mandatory application of the U.S. Sentencing Guidelines was unconstitutional, and required sentencing courts to consider the guidelines range as just one of several factors identified by Congress as relevant in sentencing defendants. As a result, district judges are no longer required to slavishly follow the guidelines, but must also consider the nature and circumstances of the offense, the history and characteristics of the defendant, the need to afford adequate deterrence, and the need to avoid unwarranted sentence disparities among similarly situated defendants.<sup>2</sup>

Three years ago, this column considered the impact of *Booker* on sentencing in federal tax cases, noting that data released by the Sentencing Commission suggested that while defendants convicted of tax crimes in 2012 were more likely to be incarcerated than defendants sentenced pre-*Booker*, they fared far better than both the broader cohort of defendants convicted of all crimes and defendants convicted of other fraud offenses.<sup>3</sup> This column considers the continuing trend toward below-guidelines sentences in tax cases generally and especially in cases arising out of undisclosed offshore accounts.

As reflected in a recent decision by the U.S. Court of Appeals for the Seventh Circuit, offshore account cases are especially ripe for substantial downward variances from the guidelines based on both the unique facts and circumstances of individual defendants and the effective immunity granted to tens of thousands of similarly situated taxpayers who successfully participated in one of the four Offshore Voluntary Disclosure Programs (OVDPs) that the Internal Revenue Service has offered since 2009.

### Sentencing of Tax Defendants

Based on data released by the Sentencing Commission, defendants charged with tax offenses are still more likely to receive a downward variance than both defendants generally and defendants charged with fraud. In the fiscal year ending Sept.

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30, 2014, 445 of the 648 (68.7 percent) defendants sentenced in tax cases received below-guideline sentences, with 247 (38.1 percent) being sentenced below the applicable guideline range pursuant to *Booker*.<sup>4</sup> For defendants sentenced below the guideline range under *Booker*, the median sentence was zero months in prison, the median variance was 12 months, and the median percent decrease from the guideline minimum was 100 percent.<sup>5</sup> In other words, in at least half of the tax cases in which the sentencing judge concluded that a variance was warranted, the defendant (a) received a variance of 12 months or more and (b) was not incarcerated.

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By contrast, of the 74,126 defendants sentenced in all cases in the 2014 fiscal year, 38,364 (51.8 percent) received below-guideline sentences, with 12,894 (17.4 percent) being sentenced below the applicable guideline range pursuant to *Booker*, and the median percent decrease from the guideline minimum for these defendants was 35.7 percent.<sup>6</sup> Of the 7,391 defendants sentenced in fraud cases in the 2014 fiscal year, 4,058 (54.9 percent) received below-guideline sentences, with 1,777 (24 percent) being sentenced below the applicable guideline range pursuant to *Booker*, and the median percent decrease from the guideline minimum for these defendants was 51.4 percent.<sup>7</sup>

### Offshore Accounts

Over the past six years, the IRS and Department of Justice have devoted substantial resources to investigating the use of undisclosed offshore accounts by U.S. taxpayers. In addition to the four

OVDPs and the Swiss Bank Program that have been described in previous columns,<sup>8</sup> the government has prosecuted approximately 90 taxpayers for having previously undisclosed accounts. However, of the 60 taxpayers who pleaded guilty to offenses relating solely to undisclosed offshore accounts and were assigned a guidelines range that provided for a period of incarceration, 58 (96.7 percent) received sentences below the applicable range and 37 (61.7 percent) received non-custodial sentences. Moreover, in these cases, the median variance from the bottom of the guidelines range was 12 months, and the average variance was 85.4 percent of the guidelines minimum.

Prosecutors in tax cases commonly argue that custodial sentences are necessary to encourage compliance and deter others from cheating on their taxes. In offshore account cases, prosecutors often further argue that the particular defendant should be incarcerated in order to encourage other account holders to come clean and participate in the OVDPs. However, the distinction between the tens of thousands of similarly situated offshore account holders who participated in one of the OVDPs<sup>9</sup> and criminal defendants could not be more stark: While the latter group face the stigma of a criminal conviction, substantial financial penalties and potential incarceration, the former resolve issues relating to their non-compliance by paying reduced financial penalties and without public disclosure of their past misconduct.

Thus, defense counsel representing defendants in offshore account cases have, with some success, argued that the unfairness of distinguishing between persons who engaged in virtually identical conduct based on whether (and when) they came forward to participate in one of the OVDPs, warrants substantial variances for the applicable guidelines ranges. This argument is especially compelling with respect to the subset of defendants who tried to participate in one of the OVDPs, but were deemed ineligible because the government had received their names before they came forward. An opinion recently issued by the Seventh Circuit in *United States v. Warner*<sup>10</sup> is illustrative of this point.

### 'United States v. Warner'

In 1996, Ty Warner, the toy manufacturer and creator of Beanie Babies, opened an account at UBS AG in Zurich, Switzerland. Several years later,

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upon the advice of his banker, Warner closed his UBS account and transferred the funds to a smaller Swiss bank. Between 1996 and 2007, the account generated more than \$24.4 million in income, which Warner neglected to report and upon which he did not pay taxes. As a result, Warner deprived the government of more than \$5.5 million in tax revenue.<sup>11</sup> In 2009, Warner applied to enter the first OVDP, but his application was rejected because, unbeknownst to him, the government had already obtained his account information.

In October 2013, Warner pleaded guilty to one count of tax evasion. At sentencing, the parties agreed that a guidelines range of 46-57 months was applicable, but Warner requested a sentence of probation with special conditions of community service. In support of his proposal, Warner relied on: (i) his extraordinary acceptance of responsibility, including his attempt to join the OVDP; (ii) his payment of more than \$65 million in restitution and civil penalties; (iii) his record of charitable activity; and (iv) the sentences imposed on similarly situated defendants.<sup>12</sup> With respect to this last point, Warner stressed that the most common sentence imposed in cases involving taxpayers with undisclosed offshore accounts was probation.<sup>13</sup>

The government, by contrast, requested a sentence of incarceration for “in excess of a year and a day.”<sup>14</sup> While not disputing that Warner attempted to join the OVDP before he was aware that he was under investigation, the government discounted the significance of Warner’s conduct by arguing that he must have been aware that disclosure of his account was probable, in light of the much-publicized investigation of UBS and the indictment of his banker and other taxpayers with undisclosed accounts at UBS.<sup>15</sup>

At sentencing, Warner emphasized that, of the tens of thousands of taxpayers who had participated in the OVDPs—including many thousands who came forward long after he had—more than 99 percent never faced criminal prosecution of any kind. Warner further argued that, having endorsed a policy that effectively immunized so many people who engaged in the same conduct that he had and were distinguishable by the happenstance that the government got his name before he came forward, the government should not be permitted to argue that incarceration was the only fitting sentence.<sup>16</sup>

In addition, Warner made an impressive presentation regarding his compelling rise from poverty and his substantial charitable endeavors. After reviewing Warner’s extraordinary personal background and efforts on behalf of others, the sentencing court concluded that “Mr. Warner’s private acts of kindness, generosity, and benevolence [were] overwhelming” and evidenced an unprecedented “level of humanity and concern for the welfare of others,”<sup>17</sup> and sentenced Warner to a two-year period of probation coupled with at least 500 hours of community service.

On appeal, the Seventh Circuit rejected the government’s argument that Warner’s probationary sentence was substantively unreasonable. Instead, the court held that the district judge’s assessment of Warner’s character had ample support in the record, and it was not unreasonable for the court to give great weight to his exceptional charitable

work. Considering the seriousness of the offense, the appeals court noted that the government itself “took a fairly lenient approach to Warner’s punishment,” charging him with a single count of tax evasion and requesting a sentence well below the guidelines range.<sup>18</sup>

The circuit court further held that it was appropriate for the district court to take into account Warner’s attempt to enter the OVDP, noting that the fact that he was on notice that there was some probability his account would be discovered did not eliminate the mitigating force of his attempt—particularly since “[m]any other offshore-account holders were similarly on notice, given the IRS’s widely publicized prosecutions and enforcement efforts,” but were ultimately admitted into the OVDP anyway.<sup>19</sup> Acknowledging that general deterrence is an important goal of sentencing and that white-collar criminals are “prime candidates” for deterrence, the Seventh Circuit held that Warner’s sentence, coupled with the nearly \$54 million civil penalty Warner paid, sent a sufficiently strong message.<sup>20</sup>

Finally, the appeals court also dismissed the government’s argument that Warner’s sentence created unwarranted sentencing disparities when compared with other violators who were sentenced to some period of incarceration. The court noted that probation is a common sentence in offshore tax evasion cases, and that the defendants cited by the government were not situated similarly to Warner in that none had paid a civil penalty comparable to Warner’s, only one had tried to enter the OVDP, and in every case the government itself sought a sentence within the guidelines range.

### Implications for Enforcement

Whether the frequency with which sentencing courts impose below-guideline sentences for cases involving offshore accounts—a trend exemplified by *Warner*—will negatively impact the government’s enforcement efforts remains to be seen. As the government emphasized at Warner’s sentencing and again on appeal, general deterrence is an important consideration when imposing sentences for tax-related offenses. Indeed, in developing the tax guidelines, the Sentencing Commission noted that “[b]ecause of the limited number of criminal tax prosecutions relative to the estimated incidence of such violations, deterring others from violating the tax laws is a primary consideration underlying these guidelines.”<sup>21</sup>

However, the government’s concern that the imposition of below-guidelines sentences in tax cases will have a negative impact on overall enforcement is predicated on the assumption that any would-be offender, when weighing the risks and rewards associated with evading his taxes, would be willing to accept a criminal prosecution and conviction if the chances of a long period of incarceration following conviction were low. As the Seventh Circuit recognized in *Warner*, deterrence can be achieved through other penalties. Thus, the threat of prosecution and conviction—and attendant social and professional consequences and feelings of shame and humiliation, not to mention often severe financial penalties—must

surely weigh more heavily in the calculations of any would-be offender than the promise of a below-guidelines sentence after conviction.<sup>22</sup>

Moreover, where (as in *Warner*) the defendant attempted to participate in one of the OVDPs, but was rejected because his application was deemed untimely, the disparity between account holders who are able to resolve their non-compliance quietly and those who must bear the stigma of a criminal conviction is significant.

Finally, in identifying the criteria to be considered in sentencing defendants, Congress expressly authorized judges to evaluate the defendant’s “history and characteristics,” and in many tax cases, the defendant’s history and characteristics include an extensive record of good works. While crediting a defendant’s charitable endeavors may cynically be viewed as allowing him to “buy his way out of jail,” a defendant cannot manufacture an extensive record of giving to others on the eve of sentencing. Rather, as Judge Jed Rakoff noted in *United States v. Adelson*,<sup>23</sup> “if ever a man is to receive credit for the good he has done, and his immediate misconduct assessed in the context of his overall life hitherto, it should be at the moment of his sentencing, when his very future hangs in the balance.”

1. 543 U.S. 220, 245 (2005).

2. 18 U.S.C. §3553(a).

3. See Jeremy H. Temkin, “The Promise of ‘Booker’ Revisited,” *New York Law Journal* (Sept. 17, 2013).

4. U.S. Sent’g Comm’n, Final Quarterly Data Report, Table 3, at 9 (Fiscal Year 2014). The Sentencing Commission classifies Booker variances as “non-government sponsored below range” sentences that include “[a]ll cases sentenced outside of the guideline range in which no departure was indicated and in which the court cited *United States v. Booker*, 18 U.S.C. §3553, or related factors as one of the reasons for sentencing out of the guideline system.”

5. *Id.* at 24 (Table 12).

6. *Id.* at 1 (Table 1) and 24 (Table 12).

7. *Id.* at 8 (Table 3) and 24 (Table 12).

8. See Jeremy H. Temkin, “Offshore Accounts: The Beat Goes On,” *New York Law Journal* (July 16, 2015); Jeremy H. Temkin, “New Justice Department-Swiss Bank Program Announced,” *New York Law Journal* (Oct. 28, 2013).

9. Internal Revenue Service, Press Release FS-2014-6, “IRS Offshore Voluntary Disclosure Efforts Produce \$6.5 Billion; 45,000 Taxpayers Participate” (May 13, 2015) (available at [http://www.irs.gov/uac/Newsroom/IRS-Offshore-Voluntary-Disclosure-Efforts-Produce-\\$6.5-Billion;45,000-Taxpayers-Participate](http://www.irs.gov/uac/Newsroom/IRS-Offshore-Voluntary-Disclosure-Efforts-Produce-$6.5-Billion;45,000-Taxpayers-Participate)).

10. 792 F.3d 847 (7th Cir. 2015).

11. *Id.* at 851.

12. Defendant’s Sentencing Memorandum at 1, *United States v. Warner*, No. 13-731 (N.D. Ill. Dec. 31, 2013) (ECF No. 24).

13. *Id.* at 29, Ex. 1.

14. *Warner*, 792 F.3d at 852. Note that a sentence of imprisonment of more than one year would have made Warner eligible for good-time credit, thus likely reducing his actual time served by 15 percent. See 18 U.S.C. §3624(b)(1).

15. Government’s Sentencing Memorandum at 24-25, *United States v. Warner*, No. 13-731 (N.D. Ill. Jan. 7, 2014) (ECF No. 26).

16. Transcript of Sentencing Proceedings at 29-33, *United States v. Warner*, No. 13-731 (N.D. Ill. Jan. 14, 2014) (ECF No. 33).

17. *Id.* at 50-51.

18. *Warner*, 792 F.3d at 859.

19. *Id.* at 859-60.

20. *Id.* at 860-61.

21. U.S. Sentencing Guidelines Manual §2T1, introductory cmt. (U.S. SENTENCING COMM’N 2014).

22. Raymond Paternoster, “How Much Do We Really Know About Criminal Deterrence?” 100 *J. Crim. L. & Criminology* 765, 817 (2010) (summarizing empirical studies of deterrence and concluding there is no apparent deterrent effect from more severe punishments, a modest deterrent effect for the perceived certainty of legal punishment, and “an even stronger effect for the certainty of non-legal or informal sanctions”).

23. 441 F.Supp.2d 506, 513-14 (S.D.N.Y. 2006).