

## TAX LITIGATION ISSUES

## Expert Analysis

## Enhancing Sentences in Tax Cases: Whose Trust Is Abused?

The U.S. Supreme Court's 2005 decision in *United States v. Booker* and its progeny rendered the United States Sentencing Commission Guidelines advisory and returned greater discretion to district judges. Nonetheless, the guidelines still play a role in federal criminal sentencing as judges are required to consider them before imposing sentence.<sup>1</sup>

With respect to tax offenders, the primary factor in determining the applicable guidelines range is the tax loss caused by the offense, which determines the defendant's base offense level. The defendant is then subject to enhancements for offense characteristics, such as whether the offense involved "sophisticated means" or whether the unreported income was derived from criminal activity, in addition to other general enhancements.<sup>2</sup>

One such general enhancement is set forth in §3B1.3, which provides for a two-level enhancement where the defendant abused a position of trust or used a special skill in a manner that "significantly facilitated the commission or concealment of the offense." This enhancement is commonly applied to accountants and lawyers who are deemed to have used "special skills" "not possessed by members of the general public and usually requiring substantial education, training or licensing"<sup>3</sup> in committing tax offenses.

Application of the "abuse of trust" prong of this enhancement is less common in tax cases. The Commentary to the Guidelines notes that persons holding a position of trust "are subject to significantly less supervision than employees whose responsibilities are primarily non-discretionary in nature."<sup>4</sup> The U.S. Court of Appeals for the Second Circuit has held that whether a defendant holds a position of trust is a determination to be made from the perspective of the victim of the offense and that application of the enhancement turns on "the extent to which the position provides the freedom to commit a difficult-to-detect wrong."<sup>5</sup> While taxpayers generally do not hold a position of trust with respect to the government, two recent Second

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Circuit cases have affirmed the application of the "abuse of trust" enhancement to defendants sentenced for tax offenses based on their position with respect to third parties.

### Application in Non-Tax Cases

In *United States v. Broderson*,<sup>6</sup> the defendant was responsible for preparing and submitting a proposal made by his employer to NASA for the provision of supercomputer needs. Howard Broderson violated federal regulations requiring disclosure and updating of all cost and pricing data by failing to incorporate a decreased interest rate from a third-party financing company in the final proposal. He was convicted of major fraud against the United States, wire fraud, and two counts of making false statements to the government. In appealing his sentence, Mr. Broderson argued, in

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part, that the district court improperly imposed an abuse of trust enhancement.

The Second Circuit found that while Mr. Broderson was obligated to make accurate reports by statute, he did not occupy a position of trust with the government. Rejecting application of the enhancement under such circumstances, the court broadly noted that: "[t]he government's theory seems so far reaching that it might cause virtually anyone who is commanded by statute to make an accurate report to the government to be subject to a Section 3B1.3 enhancement. All taxpayers who file false tax returns, for example, might be included. We believe that it is fairly obvious that the Sentencing Commission harbored no intent that the enhancement be so sweeping."

The Court of Appeals also rejected application of the "abuse of trust" enhancement in *United States v. Jolly*.<sup>7</sup> There, the defendant pled guilty to mail fraud in connection with his having fraudulently borrowed funds on behalf of a corporation of which he was the president and principal. In sentencing K. Douglas Jolly, the district court applied the abuse of trust enhancement. On appeal, the Second Circuit cited *Broderson* for the proposition that "the abuse of trust enhancement applies only where the defendant has abused discretionary authority entrusted to the defendant by the victim."

After analyzing the relationship between lenders and management of a corporate borrower, the court concluded that the enhancement was improper because the transactions were made at arm's length and Mr. Jolly held no position of trust vis-à-vis the lenders. Thus, although the defendants in *Broderson* and *Jolly* were guilty of wrongdoing, the Second Circuit determined that their sentences could not be enhanced because neither defendant stood in a position of trust vis-à-vis the victim of his offense.

In *United States v. Cusack*,<sup>8</sup> however, the court distinguished between the "primary" and "secondary" victims of the defendant's conduct. In *Cusack*, the defendant was convicted of mail and wire fraud for selling forged documents. To "authenticate" the documents, Lawrence X. Cusack offered other documents, stolen from the vaults of the Archdiocese of the Catholic Church, to which he had unsupervised access because the Archdiocese was a client of the law firm at which he was a paralegal. Although Mr. Cusack held no position of trust vis-à-vis the purchasers of the forged documents (i.e., the primary victims of his offense), the Second Circuit affirmed application of the abuse of trust enhancement where the defendant abused the trust of some other party. Thus, acknowledging that it had previously required that managerial discretion had been entrusted in the defendant by the victim of his offense, the court held that "the victim whose trust the defendant abused need not have been the primary victim of the fraud"<sup>9</sup> and that the Archdiocese's role as a "secondary" victim was sufficient to justify the imposition of an abuse of trust enhancement.

### Enhancement in Tax Cases

While *Broderson* appeared to preclude application of the abuse of trust enhancement

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to taxpayers who file false returns, *Cusack's* distinction between primary and secondary victims has expanded the reach of the abuse of trust enhancement in tax cases. In *United States v. Friedberg*,<sup>10</sup> the defendant pled guilty to five counts of tax evasion for failing to report as income funds that he embezzled from an organization of which he was the Grand Secretary. On appeal, Daniel Friedberg argued that the district court had erred in applying the abuse of trust enhancement because he did not occupy a position of trust with respect to the victim of his crime—the government. Rather than looking solely at Mr. Friedberg's relationship to the government, however, the Second Circuit focused on “whether the district court properly considered the circumstances of Friedberg's embezzlement...when imposing the abuse of trust enhancement.”

The sentencing guidelines provide that in determining whether to apply the sentencing enhancements set forth in Part B of Chapter 3 of the guidelines, a court must consider “a defendant's role in the offense” based on the “relevant conduct.” This is not limited to the elements and acts cited in the offense of conviction,<sup>11</sup> and the Second Circuit noted that four of the six courts of appeals to address the issue had affirmed abuse of trust enhancements predicated on the taxpayer's uncharged embezzlement or other fraudulent conduct toward a victim other than the government.

The Second Circuit acknowledged that, in *United States v. Guidry*,<sup>12</sup> the Tenth Circuit had held that although a defendant's uncharged embezzlement might be considered relevant conduct in a tax evasion case, an abuse of trust enhancement was improper where the defendant did not occupy a position of trust with respect to the victim of the tax evasion. The Second Circuit, however, took issue with the Tenth Circuit's “assumption that the government is always the sole victim of a tax evasion offense.”<sup>13</sup> Rather, the court noted that in *United States v. Bhagavan*,<sup>14</sup> the U.S. Court of Appeals for the Seventh Circuit had “reasoned that [where] the defendant abused his corporate position as part of an overall scheme to enrich himself at the company's expense and avoid taxes...the corporation, its shareholders and the government were all victims [of] the offense.”

Noting that *Bhagavan* was consistent with its decision in *Cusack*, the Second Circuit held that “Friedberg's tax evasion was part of a larger scheme to embezzle funds and hide the income. He effectuated this scheme by abusing his position [with the organization] and shielding the illicit income from the government.” The court went on to reject Mr. Friedberg's reliance on *Broderson* and *Jolly*, noting that Mr. Broderson had acted out of a misguided attempt to benefit his employer and that Mr. Jolly had not held a position of trust with respect to the victims of his offense. By contrast, Mr. Friedberg “both occupied a position of trust at [the organization] and used it to effectuate a scheme harmful to that organization.”<sup>15</sup>

In response to Mr. Friedberg's argument that its decision could “open the floodgates to similar enhancements for anyone convicted of tax evasion,” the Second Circuit noted the narrowness of its holding: “We hold only that where, as here, a defendant's tax evasion was part of a larger scheme constituting relevant conduct, an integral

part of which involved abusing a position of trust, the sentencing court may apply an enhancement under U.S.S.G. §3B1.3.”<sup>16</sup>

Shortly after its decision in *Friedberg*, the Second Circuit had another opportunity to consider the validity of an abuse of trust enhancement in a tax case, albeit in a sparse summary order. In *United States v. Uzoefune*,<sup>17</sup> the defendant pled guilty to making false claims to the IRS based on his submission of fraudulent corporate tax returns on behalf of himself and companies he controlled. In addition, the defendant, who operated a tax preparation business, was alleged to have claimed improper exemptions and deductions on his customers' returns and to have kept that portion of the refund attributable to the fraudulent claims.

The defendant appealed the sentencing enhancement for abuse of trust arguing that because he was a paid tax preparer, and not a tax accountant or advisor, he did not hold a position of trust that was characterized by “substantial discretionary judgment uncontrolled by the ultimate supervision” of the IRS (i.e., the victim of his conduct). The Second Circuit rejected Patrick Uzoefune's argument in one sentence, simply stating that the district court did not err in finding that in his position as a tax preparer, the defendant abused a position of trust pursuant to §3B1.3.

In so holding, the court cited its opinions in *Friedberg* and *United States v. Hirsch*, another summary order.<sup>18</sup> In *Hirsch*, the owner of a payroll service firm was charged with embezzling client funds for his own purposes, filing false payroll taxes, and failing to declare the embezzled income on his personal returns. After Menachem Hirsch was convicted of wire fraud and tax evasion, the Second Circuit affirmed the district court's enhancement of Mr. Hirsch's sentence for abuse of trust, stating that “[i]n this case it is clear that the defendant-appellant was entrusted with discretion over the victim's money and, further, that it was this discretion that provided the defendant with the opportunity to commit the crime.” In the alternative, the court noted that the sentencing enhancement properly could have been imposed under the “special skills” prong of §3B1.3 since Mr. Hirsch employed his “special skill” in preparing the tax forms.

Like the defendant in *Hirsch*, Mr. Uzoefune could have been subject to the two-level enhancement under the “special skills” prong of §3B1.3 because of his role as “tax preparer.” But nothing in the court's brief decision in *Uzoefune* suggests that this was the case. Rather, the citation to *Friedberg* and, to a lesser extent, *Hirsch*, suggests that *Uzoefune* reflects an expansion of the abuse of trust enhancement in tax cases based on the existence of “secondary” victims with whom the defendant holds a position of trust.

## Conclusion

Defendants convicted of tax crimes—like all defendants—can take solace in the greater freedom accorded district judges to fashion sentences that are reasonable given all of the facts and circumstances of a particular case. However, the recent case law suggests that the abuse of trust enhancement may present one more hurdle for defense counsel seeking to avoid prison sentences for their taxpayer-clients.

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1. See, e.g., *United States v. Jones*, 531 F.3d 163, 170 (2d Cir. 2008).
  2. See John J. Tigue, Jr. and Jeremy H. Temkin, “Sentencing in Criminal Tax Cases Post-Booker,” NYLJ (May 18, 2006).
  3. U.S.S.G. §3B1.3, cmt note 4.
  4. U.S.S.G. §3B1.3, cmt note 1 (distinguishing between embezzlement by an attorney serving as a guardian and that “by an ordinary bank teller or hotel clerk”).
  5. *United States v. Allen*, 201 F.3d 163, 166 (2d Cir. 2000) (internal citation omitted).
  6. 67 F.3d 452 (2d Cir. 1995).
  7. 102 F.3d 46 (2d Cir. 1996).
  8. 229 F.3d 344 (2d Cir. 2000).
  9. 229 F.3d at 349 (citing *United States v. Barrett*, 178 F.3d 643, 645-47 (2d Cir. 1999)) (affirming abuse of trust enhancement based on defendant's relationship to his employer, the secondary victim of his offense, even though his primary victim, a bank, had not entrusted him with any special authority, noting that “Barrett's relationship with [his employer] enabled him to commit and conceal his crime, and [his employer's] relationship with [the bank] enabled Barrett to realize cash from his fraudulent checks”).
  10. 558 F.3d 131 (2d Cir. 2009).
  11. U.S.S.G. Ch. 3, Pt. B, introductory cmt.
  12. 199 F.3d 1150 (10th Cir. 1999).
  13. The court noted an Eleventh Circuit case which held that the sentencing court can only consider conduct relating to the offense of conviction when determining whether an enhancement under §3B1.3 is appropriate. The Second Circuit dismissed this holding, however, noting that the Eleventh Circuit's opinion had been criticized as contrary to the plain language of the sentencing guidelines. 558 F.3d at 134.
  14. 116 F.3d 189 (7th Cir. 1997).
  15. 558 F.3d at 136 (emphasis added).
  16. *Id.*
  17. 334 Fed. Appx. 360 (2d Cir. 2009). Due to the brevity of the court's decision, the facts are drawn from the government's appellate brief. See *United States v. Uzoefune*, No. 08-4347-cr, 2009 WL 2389893 (2d Cir.).
  18. 249 Fed. Appx. 863 (2d Cir. 2007).