New York Law Journal

SERVING THE BENCH AND BAR SINCE 1888

WWW.NYLJ.COM

An ALM Publication

VOLUME 259—NO. 50

THURSDAY, MARCH 15, 2018

Tax Litigation Issues

Expert Analysis

# Deterrence in an Age Of Dwindling Enforcement

The Tax Division of the Department of Justice has long sought to maximize the impact of criminal prosecutions by focusing its limited resources on a small number of high-profile offenders in the hopes that publicity regarding such prosecutions will lead others to comply with their tax obligations. In *United States v. Rice*, 659 F.2d 524, 527 (1981), the U.S. Court of Appeals for the Fifth Circuit recognized the validity of this approach, noting that "[t]he selection for prosecution based in part upon the potential deterrent effect on others serves a legitimate interest in promoting more general compliance with the tax laws. Since the government lacks the means to investigate every suspected violation of the tax laws, it makes good sense to prosecute those who will receive, or are likely to receive, the attention of the media."

JEREMY H. TEMKIN *is a principal in Morvillo Abramowitz Grand Iason & Anello P.C.* MIRIAM GLASER, *an associate at the firm, assisted in the preparation of this article.*

By
Jeremy H. Temkin

As a logical extension of this principle, it is commonly accepted that general deterrence is a significant consideration in sentencing convicted tax offenders. In recent years, however, the Internal Revenue Service's dwindling budget has decreased the number of tax investigations and prosecutions, heightening questions regarding the effectiveness and fairness of predicating deterrence on ratcheting sentences even higher as opposed to increasing the likelihood of detection.

## Statistical Data

The number of civil examinations and criminal prosecutions has always been a low percentage of the number of returns that are filed. According to the IRS's Data Book, which chronicles statistics regarding tax compliance and enforcement activities, during the fiscal year ending Sept. 30, 2012, the IRS audited only 1,657,698, or 0.9 percent, of the 186.7 million individual and corporate returns that were filed in calendar 2011. See 2012 IRS Data Book (2012 Data Book) at 21-25. Also in fiscal year 2012, the IRS's Criminal Investigation Division

The Internal Revenue Service's dwindling budget has decreased the number of tax investigations and prosecutions, heightening questions regarding the effectiveness and fairness of predicating deterrence on ratcheting sentences even higher as opposed to the increasing the likelihood of detection.

initiated a total of 5,125 investigations, with 3,390 indictments being returned in cases investigated by CI, 2,634 defendants convicted, and 2,466 sentenced. Id. at 44; 2012 IRS-CI Annual Report (2012 Report) at 4.[1] By comparison, during fiscal 2016, only 1,166,379 (0.6 percent) of the

approximately 193 million returns that were filed during calendar 2015 were subject to examination, and CI opened 3,395 investigations, 2,761 indictments were returned, 2,672 defendants were convicted, and 2,699 were sentenced for offenses investigated by the IRS. See 2016 IRS Data Book (2016 Data Book) at 44; 2016 IRS-CI Annual Report (2016 Report) at 5. In other words, both audits and criminal investigations initiated decreased by nearly 35 percent over the course of five years, and the number of indictments dropped nearly 20 percent. Significantly, the criminal enforcement statistics encompass non-tax-related cases investigated by IRS-CI agents, including money laundering, corporate fraud, public corruption, cybercrimes, and narcotics offenses. In fiscal year 2016, only 72.5 percent of all CI investigative time was devoted to "tax-related" crimes such as tax evasion, fraudulent returns, failure to pay employment tax, and identity theft. See Report of the Treasury Inspector General for Tax Administration, *Declining Resources Have Contributed to Unfavorable Trends in Several Key Criminal Investigation Business Results*, Sept. 13, 2017 (IG Report), at 13. The proportion of tax-related to non-tax-related investigations was similar in 2012. Id.

The decrease in tax prosecutions has occurred, in large part, as the result of drastic cuts to the IRS's budget. The IRS expended a total of $11.7 billion in fiscal 2016, compared to $12 billion for fiscal 2012. The portion of the overall budget dedicated to enforcement-related activities was $4.7 billion in 2016 (with $615.5 million being dedicated to CI), which was down from $5.3 billion in 2012 (with $645.7 million going to CI). 2012 Data Book at 65; 2016 Data Book at 65. The Inspector General of the Treasury Department recently issued an audit report chronicling the effect of lack of funding on the IRS's operations, and raising concerns that the dearth of investigative resources is hampering CI's ability to achieve "efficient and effective operations and enforcement results." Id. at 9. Several of CI's recent annual reports likewise comment on the effect of the decreased funding. For example, in its 2016 Report, CI noted that "[t]here is a clear trend of IRS-CI staffing decline affecting our core mission tax work" (2016 Annual Report at 8)[2] and that between fiscal 2012 and fiscal 2016 CI had lost 447 agents (from 2,664 agents to 2,217), which resulted in its processing 485 fewer tax prosecution authorizations (889 down from 1,374). 2016 Annual Report at 8.

The decline in the number of cases brought by prosecutors raises questions regarding whether increasing the severity of already harsh sentences is an appropriate substitute for providing sufficient resources to law enforcement.

### Deterrence Through Sentencing

General deterrence is undoubtedly a necessary and appropriate consideration in sentencing individuals whose criminal conduct is detected by law enforcement. Indeed, judges are required to consider both general and specific deterrence in determining an appropriate sentence for each offender, and the U.S. Sentencing Commission has opined 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." U.S. Sentencing Commission, *Guidelines Manual 2016*, at 333 (introductory comment to Tax Guidelines).

However, because the government's tax enforcement activity has been restricted as a result of Congress's fiscal decisions—a factor entirely unrelated to the number of people who violate the Internal Revenue Code or the culpability of their conduct—it may be time to revisit the wisdom of imposing harsher sentences on individual defendants to send a message to others. Unlike tax protestors, who deliberately put themselves in the IRS's "line of

fire" and arguably bring the status of "example" upon themselves (see, e.g., *Rice*, 659 F.3d at 527), the run-of-the-mill offenders did nothing other than commit the same crimes that, in innumerable other cases, go undetected. While the government does not explicitly highlight the decline in prosecutions as a reason to sentence defendants more harshly, its overall argument regarding the scarcity of sentences inevitably requires that, as prosecutions decrease, leaving fewer cases to send a message that there are serious consequences to cheating on one's taxes, the few sentences that are imposed should be harsher.[3] But the very randomness of selecting certain offenders to serve as "examples" raises the risk that a single-minded focus on deterrence will be allowed to override arguably far more important sentencing factors, such as the defendant's personal circumstances and culpability for the offense, and even of individualized retribution. See *United States v. Adelson*, 441 F. Supp. 2d 506, 513-15 (S.D.N.Y. 2006).

Nor is this scattershot approach necessarily effective in decreasing tax fraud. As the Federal Defender's Sentencing Guidelines Committee observed in a recent letter to the Sentencing Commission, tax fraud offenses account for only 1.1 percent of the federal criminal caseload and "[t]he rate of federal prosecutions for tax fraud … shows that DOJ *does not* adhere to the science of deterrence" since "certainty of punishment is far more likely to deter crime than the length of a sentence." Letter from Federal Defender to Hon. William H. Pryor, Nov. 6, 2017, at 7 n.40 (emphasis added). Moreover, as the Inspector General's report suggests, the reduction in prosecutions cannot be attributed to a decrease in crime—rather, it stems from CI's inability to investigate and recommend for prosecution a sufficient number of cases that would reflect the much larger number of tax frauds committed each year. Therefore, the potential injustice of deterrence-driven sentencing is compounded by its ineffectiveness.

## Conclusion

Fortunately, defense counsel representing tax offenders unlucky enough to be investigated and prosecuted can take solace in statistical evidence that judges are taking to heart Congress's dictate that general deterrence is but one factor to be considered in sentencing defendants. Thus, between 2012 and 2016, the percentage of sentences imposed in tax cases within the Guidelines range fell from 36.2 percent to 24.7 percent, and the average sentence imposed decreased from 18 months to 15 months. U.S. Sentencing Commission, *Quick Facts: Tax Fraud Offenses (2016)*.[4]

At bottom, the decline in the number of cases brought by prosecutors raises questions regarding whether increasing the severity of already harsh sentences is an appropriate substitute for providing sufficient resources to law enforcement. In the meantime, defense counsel need to be especially vigilant to ensure that their clients are not punished based on the tenuous theory that deterrence is being served by the length of the sentence as opposed to the certainty of prosecution.

1. Because investigations may cross fiscal years, some of the criminal dispositions discussed herein may relate to indictments and investigations initiated in prior years. Therefore, there is imperfect overlap among the categories listed in the text. See 2012 Data Book at 44 NOTE.

2. Another factor that may be contributing to the decrease in prosecution of core domestic tax offenses is the IRS's increased focus on international investigations. See IG Report at 14-15.

3. For example, in *United States v. Ciccharella*, 16-cr-738(AKH) (Feb. 27, 2017), the government argued that "[a]s a result of the significant resources required to mount a criminal tax prosecution, criminal tax prosecutions are relatively rare." Mem. at 10. It then went on to explain, citing the Federal Sentencing Guidelines' introductory comment, see supra, that "[w]here the incidence of prosecution is lower, the level of punishment must be higher to obtain the same level of deterrence." Id.

4. This decrease cannot be accounted for by an increase in government-sponsored Guidelines reductions, whether for substantial assistance or other reasons. Although government-sponsored reductions have increased slightly over the last five years, reductions initiated by the sentencing judge have accounted for a significantly greater percentage of the reduction. Id.

Reprinted with permission from the March 15, 2018 edition of the NEW YORK LAW JOURNAL © 2018 ALM Media Properties, LLC. All rights reserved. Further duplication without permission is prohibited. For information, contact 877-257-3382 or reprints@alm.com. # 070-03-18-34